Annual Report 2010

PÉTROLIA

Quebec's Leader in Oil Exploration

RAPPORT ANNUEL 2010 ANNUAL REPORT

Promising Future

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2010 Building the foundation for lasting success

For Pétrolia, controlling its development, building alliances with the community, and entering into partnerships that protect the environment where its activities take place promote acceptance and maximize the long-term benefits of developing this resource. Since its beginnings, the Company has devoted itself to extending its expertise, maintaining relations with the community and seeking out partners who share its vision for developing the Company and its resources. This is why Pétrolia believes it can contribute to building an industry that will benefit us all.

Pétrolia has been guided by its desire to build the foundations for lasting success in its decisions and actions this year.

I think it's better to use local resources than to import them. Knowing there's a possibility of producing such an important resource in Quebec and that we could bring work to people by producing something we import is very exciting. I would love to be able to run an oil company to develop our potential and contribute to improving society.

A word from the President

Oil and gas exploration activities have received a great deal of media attention, both internationally and nationally.

First, on the international scene, the accident at the Deepwater Horizon platform and the resulting environmental disaster in the Gulf of Mexico attracted the world's attention. People everywhere are questioning industry practices, looking at the legal framework governing these activities, and questioning our dependence on oil.

Closer to home, in the wake of questions raised by the disaster, the potential development of shale gas grabbed the Quebec media's attention and emerged as a major news story. Enthusiasm gave way to fear. Opposition to its development became so vocal that the Government of Quebec delayed tabling a law on hydrocarbons, set in motion public BAPE hearings, and reviewed requirements for issuing authorizations for certain work, in particular for fracturing operations.

Alongside these questions, the World Energy Congress held in Montréal in September provided the opportunity to take stock of the magnitude of the energy challenges facing the world. The rapid development of emerging countries, particularly of the two most populous countries in the world, China and India, creates significant demand for energy, while alternative solutions to fossil fuels are not enough to meet this increased demand. Decried as a polluting form of energy, coal is on its way to becoming the leading source of energy worldwide. Although oil's relative weight is diminishing worldwide, oil will continue to meet a major share of energy needs, with its production increasing from around 84 million barrels a day in 2009 to more than 99 million barrels a day in 2035 according to the New Policies Scenario of the International Energy Agency.

While Pétrolia remained on the sidelines of these debates, the Company has nonetheless drawn lessons from them. The first lesson relates to the safety of work and the protection of the environment. The second relates to the importance of maintaining relations with the community where its activities take place. While the Company has always been concerned about safety, protecting the environment, and relations with the receiving environment, the events of recent months have prompted us to redouble our determination. As a result, we intend to devote even more energy to protecting the environment and communicating with the communities in which we operate. The territory belongs first and foremost to the community that lives in it, and it is our priority to protect its environment and lifestyle, as well as to respect its right to understand the nature of our work and to influence our activities. We recognize that our success is intimately linked to the community's acceptance of our activities, and we are determined to respectfully take its reality into consideration.

André Proulx, president of the Company

New perspectives opened up for Pétrolia during the year just ended. First of all, with regard to rights, the Company has consolidated its position by renewing all of its oil leases; it has also increased its interest in Haldimand and entered into an agreement with Investcan Energy (Québénergie Inc.). Furthermore, drilling work conducted during the year ending September 30 confirmed the presence of oil in the Haldimand structure, measured the importance of this discovery, demonstrated the exceptional characteristics of reservoirs on Anticosti Island, and opened new exploration programs both in the Gaspé region and on Anticosti.

Through the position it occupies in Eastern Quebec and the province's oil potential, Pétrolia is becoming a key player in the development of this potential in Quebec. This is why the Company decided to sell its interest in shale gas.

However, the Company does face major challenges. Developing oil potential under license on a largely underexplored territory requires major capital. To remain in charge of our development and our expertise, we need access to this capital without losing control of our leases or the resource. However, this challenge is not insurmountable, and we fully intend to find the means to tackle it.

We are confident that the objective of transforming Pétrolia into a fully-fledged oil company is not only a challenge that we can be passionate about, but also the path to maximizing shareholders' equity in the medium term while taking an active part in the economic development of Eastern Quebec. In its pursuit of this objective, Pétrolia will rely on its dedicated personnel, who are fully committed to the Company's vision. On behalf of the shareholders, I would like to sincerely thank all of our employees for the work they have already accomplished and for the commitment they exhibit every day.

The year 2011 will be an exciting one. The development of the Haldimand project and drilling for the Bourque project are likely to change perceptions about Pétrolia and Eastern Quebec. Pétrolia is heading into a year that could well be decisive, with the passion that has driven it since its foundation.

Objective:

5% Pétrolia has set itself the mission of meeting 5% of the demand in Quebec. This demand is currently met in its entirety through imports, more than 90% of which coming from overseas. The goal is not to promote the increased use of this non-renewable resource, but rather to take advantage of domestic demand for oil to help create wealth through the development of a natural resource. While the quest for greater energy efficiency and the better use of energy (oil in particular) is a noble one and should be encouraged, the fact remains that Quebec will continue to consume oil for a few decades yet. This is why Pétrolia believes it is preferable to produce the resource locally rather than to count exclusively on imports to meet the needs of Quebecers.

I like to work with my hands and make things you can touch. I also like team sports where everyone has a part to play in winning the game. When I'm an adult, I would like to be an oil driller and drill wells that will produce a resource that we all need. Doing that in Quebec would be great.

2010: Building the foundation for lasting success

The first oil drilling in Canada occurred on the Gaspé Peninsula during the second half of the nineteenth century. Attracted by the natural oil seepage that had always been apparent, the first explorers came up against a geology not terribly inclined to yield oil. The technologies of the day did not allow for the extraction of the resource from the substratum or for the location of reservoirs that would have allowed oil exploration to continue.

The evolution of technology has made it possible to envisage tapping into reservoirs with a porosity and permeability that led the first explorers to abandon the territory. Additionally, technological advances in geophysics now make it possible to identify potential pitfalls that could not be identified at the time.

Objectives and strategy

Pétrolia's mission is to discover oil accumulations in Quebec and bring them into production as soon as possible, in order to increase its autonomy and allow it to control its development in the long term. As a result, the Company's strategy is a long-term one, and its objective is to position itself as a fully-fledged oil company with the technical and financial resources to successfully accomplish every aspect of its projects.

By relying on advanced technologies for the detection of potential pitfalls and the development of unconventional reservoirs, Pétrolia has set itself the mission of meeting 5% of the demand in Quebec. This demand is currently met in its entirety through imports, more than 90% of which coming from overseas. The goal is not to promote the increased use of this non-renewable resource, but rather to take advantage of domestic demand for oil to help create wealth through the development of a natural resource. While the quest for greater energy efficiency and the better use of energy (oil in particular) is a noble one and should be encouraged, the fact remains that Quebec will continue to consume oil for a few decades yet. This is why Pétrolia believes it is preferable to produce the resource locally rather than to count exclusively on imports to meet the needs of Quebecers.

For Pétrolia, controlling its development, building alliances with the community, and entering into partnerships that protect the environment where its activities take place promote acceptance and maximize the long-term benefits of developing this resource. Since its beginnings, the Company has devoted itself to extending its expertise, maintaining relations with the community and seeking out partners who share its vision for developing the Company and its resources. This is why Pétrolia believes it can contribute to building an industry that will benefit us all.

Pétrolia has been guided by its desire to build the foundations for lasting success in its decisions and actions this year.

Oil is everywhere in our world. It's not used only to power vehicles. There's petroleum in our clothes, in computers, even in chewing gum. We're obviously going to be using it for a long time to come but we have to do it in a responsible way, because it's a scarce resource and it has an impact on the environment. Eventually, I'd like to become an engineer to work on better ways of using this resource.

Highlights for the year ended September 30, 2010

The Haldimand project

Since the Haldimand discovery, Pétrolia has believed that the development of the project and the potential of the York River Formation require strong, determined leadership. The Company saw its efforts pay off during the 2010 fiscal year, while acquiring the assurance to stay in control of its leases and the resource.

A strategic choice

The partnership with Québénergie is in keeping with Pétrolia's desire to ensure its lasting development. Pétrolia chose Québénergie's partnership proposal over all the proposals received, its enterprise culture being in accordance with that of the Company. Both partners share a common vision for the project, which must proceed with significant consideration given to the local environmental and social context. Québénergie's decision to establish in Quebec demonstrates its long-term commitment and will contribute to improving synergies with Pétrolia. In addition to contributing the resources necessary to advance the project, the proposal was in line with Pétrolia's desire to play a major role in the operations and decision making for developing the oilfield and the territory. This agreement makes Pétrolia the oilfield operator with regard to exploration, grants it resources to pursue its activities, and gives it a key role in decision making, because the agreement establishes interest parity between the partners.

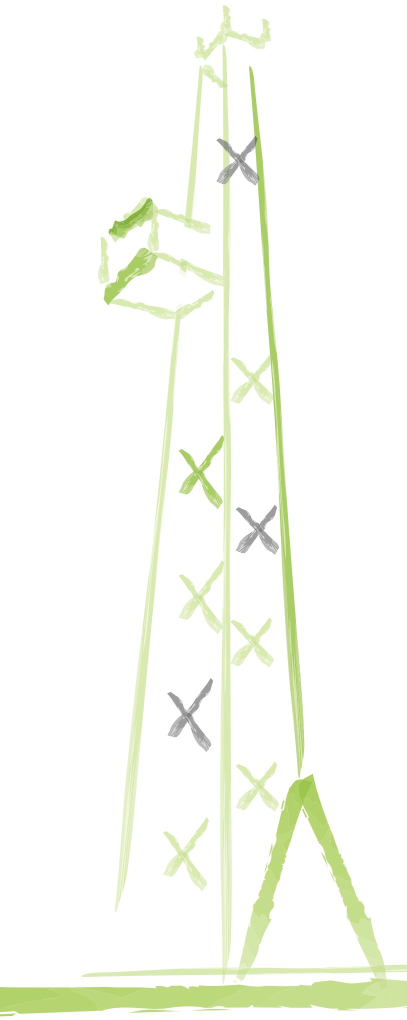
Informed and vigorous direction

Before entering into this agreement, the purpose of which being to speed up the development of the Haldimand project and part of the territory under lease, Pétrolia undertook a number of important and necessary efforts over the past year:

- Pétrolia became the oilfield operator for the Haldimand project during the second round of drilling on the discovery structure. Through agreements entered into with Junex (July 30, 2009) and Gastem (October 19, 2009), Pétrolia increased its interest from 45% to 64% in the 9-km^2 discovery territory.
- Pétrolia has acquired all of the interests in the 150-km^2 territory surrounding the discovery through an agreement with Junex (June 9, 2010). This agreement allowed Pétrolia to extend its control over a territory covered by the Haldimand structure.
- The mandate assigned to the independent firm of experts Sproule Associates Limited confirmed estimates of 7.7 million barrels of oil as the recoverable portion of the Haldimand oil in place.

New horizons

- The drilling at Haldimand No. 2 and Tar Point not only confirms the presence of oil in the York River Formation, but also makes it possible to envisage commercial development of the Indian Cove Formation.
- This work was also decisive in understanding the unconventional nature of the reservoir discovered in the York River Formation. It helps orient the search for a technical approach to production suited to the nature of the reservoir.



Moving toward production
On June 30, 2010, Pétrolia launched new production tests on the Haldimand No. 1 well. The well naturally and consistently delivers around ten barrels of oil per day.

This production is modest compared with Pétrolia's objective of producing 20,000 barrels per day by 2014. The expanse of the York River Formation (over 1,500 km^2), the prospect of the Indian Cove Formation, and the potential of the Bourque and Anticosti projects suggest that the objective is realistic and worth pursuing. The reefal structures of the West Point (Bourque) and those found on Anticosti Island could well lead to world-class discoveries.

The Anticosti project

Unlike in 2009, when unfavourable economic conditions forced Pétrolia and its partner to delay their planned drilling program, the context of 2010 was favourable for both partners. Since Pétrolia had suspended some activities on the Haldimand project while seeking and negotiating the terms of an agreement with a partner, 2010 provided an opportunity to carry out the work planned and to see progress on the Anticosti project.

A strategic advance
The presence of recognized oil potential, well defined and documented targets, and an experienced partner to share the risk provided Pétrolia with the opportunity to implement the planned drilling program.

While the program did not lead to a discovery, it demonstrated the existence of a reservoir with remarkable characteristics, once again showing that Anticosti Island has all the attributes of a petroleum system.

The 2010 program gave the partners the opportunity to remove a core from the McCasty Formation, which could be a new and potentially very promising exploration environment. The McCasty Formation, made up of oil-saturated shale, covers almost the entire Anticosti territory, and its expanse is already generating a great deal of interest in the industry. Studies currently under way will allow Pétrolia and its partner to determine the potential of these shales. This type of analysis requires several months of analysis, the results should be known within a few months.

A partnership with the community

Since it began operations, Pétrolia has known that its success is intimately tied to the community's acceptance of its activities. Regardless of the rights and privileges conferred upon Pétrolia by the Mining Act, the fact remains that the Company's operations occur in an environment where many activities are already taking place. Pétrolia's operations have to blend harmoniously into the environment so that they can contribute to the region's economic and social progress. Respect, receptiveness, information and transparency are all fundamental factors that guide the Company's activities. The past year has been no exception to this.

The Company's activities have included:

- an open house day during the Tar Point drilling, which gave over 300 Gaspesians the opportunity to witness and understand different aspects of this type of operation;
- a number of press conferences in Gaspé and press releases to update the public about the progress of the Company's work;
- regular field visits by Company executives and meetings with local authorities, which were an opportunity to share information about Pétrolia's activities and better identify community concerns;
- the publication of a series of columns in local weeklies to provide information about the territory's geology, the stages of exploration, the nature of the work, the techniques used, etc.;
- the production of a number of videos to illustrate the stages of drilling, from transport to the operations themselves, to foster a better understanding of the oil industry. These videos are available in the production section of the website (www.petroliagaz.com/en/production).

Over the course of the coming year, Pétrolia intends to pursue and step up similar initiatives.

Taking advantage of market conditions to finance exploration activities

At the end of 2009, prevailing stock market conditions were favourable to Pétrolia. On December 4, 2009, the Company issued close to eight million shares in exchange for $7.13 million. In addition to contributing to its working capital, these funds have largely been allocated to executing the year's work.

The agreement with Québénergie, signed on December 20, 2010, provides Pétrolia payment in the amount of $6.7 million. Québénergie is also committed to handling expenditures for the work in the amount of $8.5 million for a maximum of two years. The financial contribution resulting from the signature of this agreement as well as commitments from its partner provides Pétrolia with the security necessary to be able to meet its commitments and obligations and to pursue the development of its projects.

Management discussion and analysis for the year ended September 30, 2010

This annual management report is an addition and supplement to the audited financial statements for the fiscal years ended September 30, 2010 and 2009, and should be read in conjunction with those statements, which were prepared in accordance with Canada's generally accepted accounting principles (GAAP). This management report presents the views of management on current Company activities and on the annual financial results, as well as a preview of activities during the coming fiscal year.

Date

This annual management report for the fiscal year ended September 30, 2010 is dated December 20, 2010.

Nature of activities

The Company is incorporated under Part 1A of the Quebec Companies Act. The Company has been listed on the TSX Venture Stock Exchange since February 16, 2005. The Company's primary activities are the exploration and development of its oil and gas properties. In addition, to achieve its objectives, the Company has entered into various partnership agreements characteristic of the oil and gas industry.

Forward-looking statements

This report contains statements which should be considered forward-looking statements. The said statements relate to future events or to Pétrolia's future economic results and involve risks, uncertainties, and other factors, both known and unknown, that could significantly affect the results, performance, and achievements indicated or implied by Pétrolia's statements. Actual events and results could be very different. Accordingly, a decision to invest in Pétrolia's securities should in no circumstance be based on these forward-looking statements. Pétrolia has neither the intention nor the obligation to update these forward-looking statements.

Nature and activity

Pétrolia is a junior exploration company that is concentrating its efforts on the search for oil. It focuses on territories where the chances for success are higher in order to provide short-term returns, and innovates by working with new exploration programs that offer very high potential for discovery. Its activities take place primarily in the Gaspé region and on Anticosti Island, where the main oil potential in Quebec is located.

Strategy and outlook

To accomplish its mission, Pétrolia holds promising leases in territories where oil is likely to be discovered. It uses advanced technologies and associates with partners with the technical and financial resources to support the development of the oil potential of Eastern Quebec. Pétrolia is actively searching for partners, with the aim of entering into agreements that allow it to control its development and progress toward becoming a fully-fledged oil company.

Pétrolia knows that its success is closely linked to the community's acceptance of its activities. It is therefore careful to maintain ongoing relations with local stakeholders. Its relations with the community are based on full, accessible and transparent information. Pétrolia is aware that the territory in which it operates is first and foremost a living environment, so it seeks to ensure that its operations blend harmoniously into this environment and that it be perceived as a source of economic and social progress.

The Company's development and the context of its operations require that Management pay particular attention to recruiting. Management is guided in its choice of employees by a quest for balance between technical expertise, sensitivity to the physical and human environment, as well as experience and the need to plan for the future.

For more isolated needs, the Company calls on outside expertise. A firm's proven experience and reputation are among the criteria the Company uses to choose the services that will fill out the expertise necessary for developing its projects.

In a resource-rich region, commercializing the natural heritage is the main tool for developing the community that wants to earn lasting benefits. If these activities are to be accepted, citizens must be informed, consulted, and involved so people can fully master the stakes.

Exploration work for 2010

A dominant position

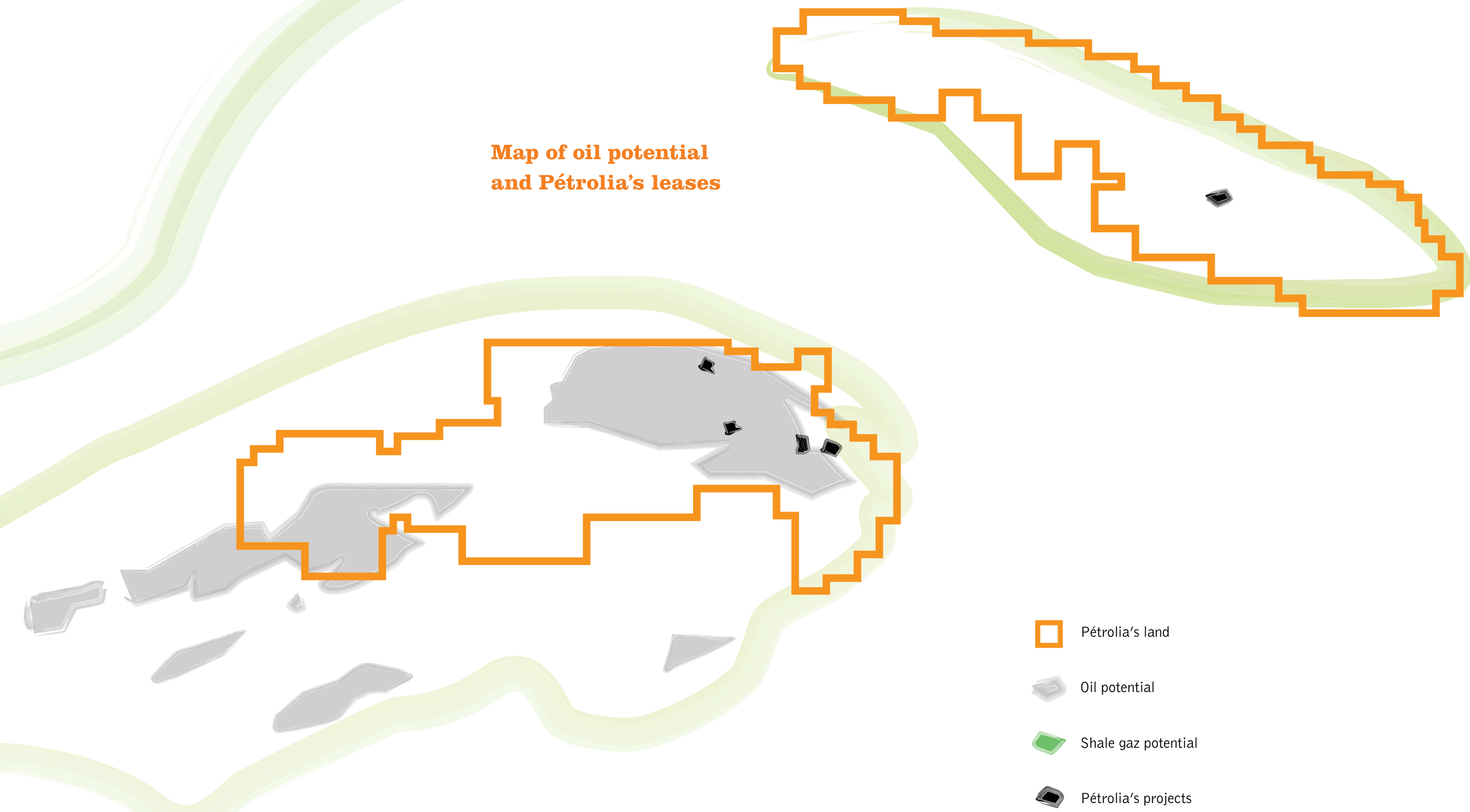
In Quebec, oil resources are found in the east of the province, in the Gaspé region, on Anticosti Island, and perhaps in the Gulf of St. Lawrence. Since it was founded in 2005, the Company has acquired leases that cover more than 15,000 km^2, mainly in the Gaspé region and on Anticosti Island. These leases, essentially located in the Gaspé region and on Anticosti Island, cover more than 70% of Quebec's land petroleum potential.

In concentrating its efforts on searching for oil just as the industry was displaying its enthusiasm for shale gas, the Company may have appeared rash. The recent and foreseeable rise in the price of oil and natural gas has made the decision appear judicious in hindsight. The portion of the territory that has potential for oil controlled by Pétrolia makes it a dominant player in Quebec.

During the fiscal year ended September 30, 2010, certain changes occurred with respect to the leases the Company holds. Two of these are more significant:

- the first resulted in an agreement between Pétrolia and Junex pursuant to which Pétrolia acquired 100% of the interest in the territory surrounding the discovery;
- the second resulted from the partnership agreement with Québénergie pursuant to which Pétrolia transferred 50% of its interests in the Haldimand discovery and on 13 leases for a total around 2,500 km^2.

Map of oil potential and Pétrolia's leases



Since the beginning of its operations, Pétrolia has been interested in the potential of the York River Formation in the Gaspé region, where we found many signs of oil and the burial depth is not significant. The discovery of the Haldimand deposit and the Tar Point project have confirmed the potential of the formation.

Exploration and production cycle

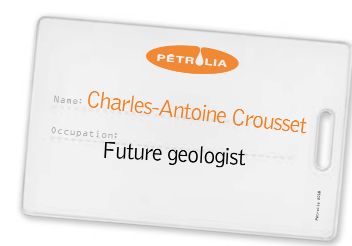
Stage (progress of work)

Exploration work	Exploration expenditures as at Sept. 30, 2010	Forecast exploration expenditures for 2011	Exploration expenditures as at Sept. 30, 2010: Geology	Geophysics	Exploration drilling	Completion and production tests	Forecast exploration expenditures for 2011: Confirmation drilling	Production infrastructure
HALDIMAND	$9,383,853	$7,918,664	Accomplished before 2010	Accomplished before 2010	Accomplished before 2010	Accomplished in 2010	Projected for 2011	Projected for 2011
TAR POINT	$4,699,028	$1,555,594	Accomplished before 2010	Accomplished before 2010	Accomplished in 2010	Projected for 2011		
BOURQUE	$3,580,147	$42,224	Accomplished before 2010	Accomplished in 2010	Projected for 2011 (contingent to the participation of a partner)			
GASPÉSIA	$3,531,433	$93,000	Accomplished before 2010	Projected for 2011				
GASTONGUAY	$73,473	$15,000	Accomplished before 2010	Projected for 2011				
ANTICOSTI	$5,305,277	$380,000	Accomplished before 2010	Accomplished before 2010	Accomplished in 2010			
DALHOUSIE	$1,111,708	$450,000	Accomplished before 2010	Accomplished before 2010				

Legend:

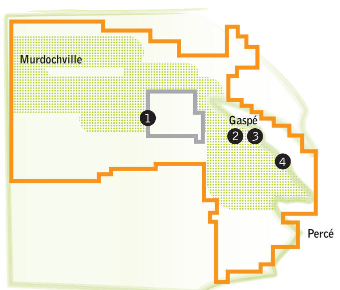
Orange	Accomplished before 2010
Grey	Accomplished in 2010
Black	Projected for 2011
Light orange	Projected for 2011 (contingent to the participation of a partner)

I was fascinated when I heard that the Gaspé area, where I live, used to be an ancient tropical sea hundreds of millions of years ago. When I go to college, I'm going to study earth science to learn how our environment developed ever since the origin of the Earth. As a geologist, I could work for the oil and gas industry, which offers a good outlook for jobs. Working near home—that would really be nice.



Unconventional reservoir exploration projects

Since the beginning of its operations, Pétrolia has been interested in the potential of the York River Formation in the Gaspé region, where many signs of oil were found and the burial depth is not significant. The discovery of the Haldimand deposit and the Tar Point project have confirmed the potential of the formation.



1_ Le Ber No. 1
2_ Haldimand No. 2
3_ Haldimand No. 1
4_ Tar Point No. 1

Pétrolia's leases

York River Formation

Haldimand project

Since the discovery in 2006, Pétrolia has been taking control of and increasing its interest in the project to accelerate development.

To this end, on May 6, 2008 Pétrolia signed an agreement with Junex pursuant to which it became the oilfield operator for the project, and it has been developing the deposit since it began drilling the Haldimand No. 2 well in September 2009. In addition to guaranteeing that it be the main contractor for the project, this agreement gives Pétrolia a larger interest in the 9-km² territory where the discovery occurred.

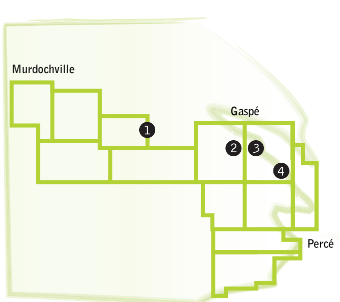
Pétrolia also signed another agreement with Gastem to acquire its interest in the discovery. These two agreements increased Pétrolia's participation in the 9-km² discovery territory from 45% to 64%.

The results of tests conducted on the two wells provided a better understanding of the Haldimand deposit. It is made up of a reservoir with low matrix porosity, cut by a network of open fractures whose role in the production mechanism remains to be clarified. The porosity and permeability encountered in the Haldimand reservoir make it somewhat similar to the Bakken program in the central northern United States, which produces large quantities of oil.

Previously impossible to exploit, this type of deposit has been generating a great deal of industry interest since the refinement of horizontal drilling and stimulation techniques. Some of these deposits need to be stimulated and then turn out to be very productive, quickly amortizing the cost of exploration and development.

Pétrolia also consolidated its position in the 150-km² territory surrounding the discovery by signing another agreement with Junex which increased its interest to 100%. According to the terms of this agreement, the two companies exchanged territories of equal size. Pétrolia thereby acquired a 100% interest in the lease surrounding the Haldimand discovery.

Finally, a report by Sproule Associates Limited, a firm that specializes in the valuation of recoverable resources, confirms Pétrolia's valuation. Based on information available on December 31, 2009, Sproule confirms Pétrolia's best estimate, which puts the level of original oil in place at 69.7 million barrels and the recoverable portion thereof, using existing or developing technologies, at 7.7 million barrels of oil. Sproule also notes that according to seismic data, the Haldimand structure extends beyond the 9-km² territory the estimate was performed on, so the recoverable oil could be higher (see press release dated July 6, 2010).



1_ Le Ber No. 1
2_ Haldimand No. 2
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Partnership with Québénergie

Agreement with Québénergie

The $15.2-million agreement signed with Québénergie is the end result of Pétrolia's efforts to find a partner for developing the deposit. Québénergie meets Pétrolia's criteria: it is a partner that wants to exploit the deposit in a manner that respects both the surrounding environment and principles of sustainable development, while ensuring that Pétrolia will continue to play a major role in the development of the project and leases covered by the agreement.

The agreement makes Pétrolia the oilfield operator during the exploration activities. Québénergie will be the oilfield operator during the development phase, in which it has recognized expertise. The parity of interests (50/50) between the two partners ensures that Pétrolia will play a key role in the decisions to be made about the development of the project and the 13 leases covered by the agreement.

Since June 30, 2010, as part of a restricted rate production test, the Haldimand No. 1 well has naturally produced (without the assistance of a pump) around 10 barrels of oil per day. Production is transported by truck to the Ultramar refinery in Saint-Romuald. The Haldimand No. 2 well was suspended to determine the nature of the stimulation work needed.

Pétrolia and its partner are currently evaluating the best options for developing the deposit. The use of horizontal drilling and hydraulic stimulation are among the options being studied. Likewise, the results of geophysical work conducted at the end of summer 2010 (magnetotelluric survey) were sufficiently conclusive for the technique to be used to locate the most promising areas for a third round of drilling on the structure.

Tar Point project

The Tar Point No. 1 well is located near a well drilled in the 1950s where signs of oil were found. Tar Point is also located in the unconventional reservoir petroleum system and is part of the Company's strategy of concentrating its efforts on the projects with the highest probability of success. The Tar Point project is also covered by the Québénergie agreement.

Located approximately 15 km southwest of the Haldimand wells, this well has reached a total depth of 2,434 m. It crosses the entire York River Formation over a thickness of 1,536 m, as well as part of the Indian Cove Formation over 619 m; after crossing a fault, it once again enters the Gaspé Sandstones over 150 m.

This well revealed the following:

- the upper portion of the York River Formation contains no oil, because burial is too limited;
- the lower portion contains limited signs of oil with porosity and permeability characteristics similar to those of Haldimand;
- in the Indian Cove Formation, two sections of open fractures, each around 100 m thick, revealed many signs of gas and oil. During a production test on one of these two zones, and in spite of the low permeability detected, the Formation delivered light crude.

In its annual report last year, Pétrolia announced its intention to determine the scope of the discovery at Indian Cove through a production test, and to assess the possibility of stimulating this reservoir. This is still its intention, although it has been delayed by efforts to find a partner. With the signing of the agreement between Pétrolia and Québénergie, this project will be assessed by the partners and could be included in the program of work under development.

Conventional reservoir exploration projects

Pétrolia is pursuing two projects in this category. The Bourque project, in the Gaspé region, explores the system of reefs in the West Point Formation. The other project is on Anticosti Island and mainly targets the hydrothermal dolomites of Trenton/Black River.

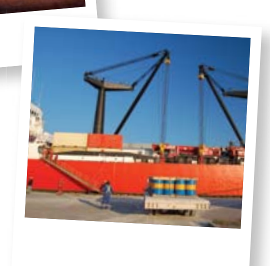
The Bourque project

A 3-D seismic survey conducted by Pétrolia in 2008 clearly demonstrated the possibility of the presence of a reef complex in the West Point Formation, which is older than the York River Formation. Located approximately 70 km west of the town of Gaspé, this reef complex is reminiscent of the Leduc reefs in Alberta in which giant fields have been discovered—a turning point in that province's oil exploration.

The Company had an agreement with Pilatus Energy to drill the structure in 2009. However, the stock market crisis of 2008 and the ensuing recession in 2009 deprived the partner of the liquidity necessary to move ahead. Pilatus and Pétrolia agreed to terminate the partners' obligations. Pilatus retains a 5% interest in the project and remains a shareholder of the Company.

In 2010, the conditions were not right to drill the Bourque project. Working with CIBC World Markets, Pétrolia is pursuing its efforts to find a partner that meets its criteria. This project remains a priority for 2011, the year in which Pétrolia would like to perform two drills on this structure.

This project is very important for Pétrolia due to the discovery potential of this type of large oil trap. The presence of other similar structures, e.g. Corte Real, is also likely to stimulate the interest of potential investors and partners. However, in the Gaspé region, this type of structure carries a relatively high risk because of the cost of drilling; this is why Pétrolia would like to take on partners who have both the financial capacity and the technical expertise to invest and complete this project.



The Anticosti project

Anticosti Island is a vast territory that is very promising but not well explored. The bedrock of the island is formed by rocks whose composition and age are similar to those of productive land in the northeastern United States. The rocks on the island are also similar to those of the Lower St. Lawrence. The analyses of the organic matter in the parent rock show that it produces large quantities of oil. Shell has already valuated the quantity of oil produced by this parent rock in the history of this sedimentary basin at 30 billion barrels. Additionally, porous zones and signs of oil were found in the wells drilled to date. A number of structures have been identified by the seismic survey. These are favourable to hydrothermal dolomitization and are likely to have trapped a portion of the oil produced by this parent rock. This system was the main objective of the drilling program conducted during summer 2010.

This program of three drilling efforts was conducted on as many targets. Initially, the program was for four drilling efforts, but because of expenses largely attributable to the transport of equipment, the partners decided to limit the program to three.

Jupiter well

This well, which is a re-entry to the Corridor/Hydro-Québec Jupiter No. 1 wells, was intended to find dolomitized and fractured carbonates in the Mingan and Romaine formations likely to be a reservoir. In spite of a few indications of oil in the Mingan Formation, no major reservoir was found, so the well drilled in 2010 was abandoned.

The data gathered during the drilling of this well provided a great deal of information about this play which is being studied by the partners. The Anticosti Island territory, particularly the western portion of the island, has many structures that are not part of this play and that continue to offer solid potential for discovery.

Chaloupe well

The objective for this well was to discover a hydrothermal dolomite reservoir in the Trenton/Black River Formation. The well revealed only lightly dolomitized carbonates. There was no reservoir of any importance noted.

The partners also agreed to remove a 27-m core from the McCasty Formation shales. This core is currently being analyzed to confirm a new exploration play on Anticosti Island.

Saumon well

The objective for this well was the same as for the Chaloupe well. While few dolomitized carbonates were found, the well revealed the presence of a very large reservoir in the fractured carbonates of Trenton/Black River. The volume of salt water produced, (27 m^3 or 170 barrels in 45 minutes) corresponds to a daily flow of 15,000 barrels/day. The absence of oil in this reservoir is undoubtedly disappointing. However, the existence of a reservoir of this quality confirms that Anticosti Island has all the elements of a petroleum system, specifically a productive parent rock, excellent reservoirs, and cover rock that could contain oil.

As for the Chaloupe well, the presence of salt water in the reservoir led the partners to abandon the lower portion of the well and to suspend exploration of the upper portion, where the presence of McCasty Formation shales was noted.

Unconventional reservoir
According to the partners' information, the shales of the McCasty Formation, present everywhere on the island, could be saturated in oil over the entire northern portion of the territory.

As mentioned earlier, Corridor and Pétrolia recovered a core from the McCasty Formation in the Chaloupe well. If the tests on this core are positive, the partners will have defined a new exploration play for the Anticosti Island territory.

The objective of the studies under way is to determine the production potential of this formation. A number of major companies have already indicated their interest in this area, given the size of the territory covered by this shale.

Define an exploration program
The drilling campaign for the year 2010 ended in the demonstration of the existence of an excellent reservoir on Anticosti Island and the launch of a new exploration play. For the latter, the presence of a partner experienced in the development of shale oil play is indispensable to the two partners. Pétrolia and Corridor had already started to promote this play, so far very well received by the industry.

In the coming months, Pétrolia and its partner will devote their energies to analyzing the data gathered in the drilling done in 2010. From these analyses, an exploration program will be established, which will include shale oil targets.

Other exploration projects

Dalhousie

The seismic survey conducted in 2008 and 2009 on the Dalhousie property in New Brunswick was sufficiently promising for Pétrolia to want to drill. As mentioned in last year's annual report, the project was put on hold, because the political and economic situation made the natural gas market less attractive in this province. The conditions have not changed during the year just ended, so the status of the project remains unchanged.

Pétrolia intends to closely follow the evolution of conditions in New Brunswick and to pursue its efforts to find a partner.

Gaspésia, Gastonguay and Edgar

More information is needed from the Gaspésia, Gastonguay and Edgar properties to better evaluate the potential. The lack of complete information is why these territories have not been included in the Company's priorities to date. To better document the potential of these properties, Pétrolia has planned knowledge acquisition projects:

- thermal maturation and petroleum potential studies have begun in order to determine the most favourable areas for the conservation of hydrocarbons;
- a surface geochemical survey will also be performed. This survey will be conducted on the Gaspésia and Edgar properties. The goal of this project is to locate and characterize the hydrocarbon anomalies.

The results of these studies will be known in spring 2011.

Management analysis of financial information

Operating results and cash position

For the fiscal year 2010, the Company's income is made up of interest income on short-term investments of $24,321 compared with $175,238 for fiscal year 2009, project management income of $1,781 compared with $11,706.

The loss for the fiscal year of $1,358,529 is comparable with the loss for 2009 of $854,911.

The decrease in interest income is explained by the decrease in cash flows.

As of September 30, 2010, the Company had cash and cash equivalents of $1,949,055, and its working capital was positive at $2,629,009.

During the fiscal year, the Company issued 7,960,568 shares in exchange for $7,129,910 in cash. On December 20, 2010, the Company received $6,690,000 from the sale of an interest in certain exploration leases. Management feels that the current cash situation is satisfactory to meet its current commitments. For its financial needs, the Company could rely on its capacity to mobilize shareholders' equity through public offerings and negotiated private placements.

Analysis of general and administrative expenses

General and administrative expenses increased by $380,951, mainly because of the increase in the Company's exploration activities.

The main differences in the general and administrative expenses are:

- Professional services: Non-recurring fees related to recruiting administrative personnel were incurred in 2010 ($31,510), as well as fees related to financing ($109,500).
- Salaries and benefits: The Company's payroll increased because of the increase in the Company's exploration activities. Administrative employees were hired.

Selected annual information

	2010	2009	2008
	$	$	$
Revenue	26,102	204,644	255,174
Net loss	(1,358,529)	(854,911)	(774,527)
Basic and diluted net loss per share	(0.028)	(0.021)	(0.022)
Total assets	30,994,857	24,024,439	26,831,615
Dividend per share	N/A	N/A	N/A

Summary of quarterly results

	2010						2009	2008
	September	June	March	December	September	June	March	December
	$	$	$	$	$	$	$	$
Revenue	(46,658)	47,342	6,646	18,772	46,759	66,186	27,921	63,778
Net earnings (net loss)	(330,057)	(244,544)	(402,692)	(381,236)	386,447	(135,103)	(456,584)	(649,671)
Net earnings (net loss)								
Basic	(0.0068)	(0.0053)	(0.0092)	(0.0092)	0.0095	(0.0033)	(0.0112)	(0.0159)
Diluted per share	(0.0068)	(0.0053)	(0.0092)	(0.0092)	0.0073	(0.0033)	(0.0112)	(0.0159)

Revenue consists mainly of interest earned for each of the quarters. The benefit for fourth quarter was negative mainly because of the reclassification of petroleum reservoir evaluation income of the first three quarters which has been set against the deferred exploration expenses. General and administrative expenses are relatively stable from one quarter to another. The main changes in quarterly losses or profits are explained as follows:

2008 – December	Unrealized loss of $540,000 on an investment recorded;
2009 – March	Capital tax of $164,124 for fiscal years 2006, 2007, and 2008, which the Company disputed through a notice of objection to Revenu Québec, and an unrealized loss of $180,000 on an investment recorded;
2009 – September	Unrealized gain of $200,000 on an investment and future income taxes of $542,000 recorded;
2009 – December	Unrealized loss of $458,500 on an investment and a gain on disposal of shares of $395,163 recorded;
2010 – March	Stock-based compensation costs of $183,600 recorded.

Related-party transactions

Transactions were made with two companies (Géominex Inc. and Gestion Lestrois Inc.) whose main officer, holding a minority interest, is also a director of Pétrolia Inc.:

	2010	2009
	$	$
Balance sheet:		
Deferred exploration expenses	51,532	76,068
Income statement:		
Salaries and benefits	938	–
Write-off of a receivable	–	62,205
Other expenses	11,847	8,668

As at September 30, 2010, $35,915 is due from these companies (2009 – $57,852).

Transactions were carried out with a director who acts as a consultant for the Company under the corporate name SEISServ:

	2010	2009
	$	$
Balance sheet:		
Deferred exploration expenses	22,905	47,421

The balance due to this director as at September 30, 2010 is $0 (2009 – $1,195).

The Company made the following transactions with Ressources Appalaches Inc., a company with the same chief executive officer:

	2010	2009
	$	$
Balance sheet:		
Deferred exploration expenses	–	64,000
Income statement:		
Salary and benefits	101,724	276,724
Office supplies	2,600	3,632
Telecommunications	5,322	6,086

The balance due to this company as at September 30, 2010 is $161 (2009 – $16,179).

These transactions occurred in the normal course of business and were recorded at the fair exchange value, which is the amount of the established consideration accepted by the related parties.

Commitments

Under the terms of exploration leases granted by the Quebec ministère des Ressources naturelles et de la Faune and the New Brunswick Department of Natural Resources, the Company has agreed to pay fees to them in the amount of $622,266 between now and 2013.

In addition, the Company must perform work on its properties on a yearly basis, for which the minimum costs vary according to the age of the leases; therefore, they correspond to $0.50 per hectare for the first year of the lease and increase annually by $0.50, ultimately reaching $2.50 per hectare beginning with the fifth year. The minimum work to be initiated is $135,398 in 2011, $968,687 in 2012, $665,747 in 2013, and $840,943 in 2014.

The Company has entered into a lease until 2012 for the rental of offices and a house with four companies. The balance of the commitments under these leases, excluding escalation clauses, is $84,686, $11,900 of which is payable to a company in which a director holds a minority interest.

Fourth quarter

The fourth quarter closed with a loss of $330,057 ($0.0068 per share). Income for the quarter is $(46,658) due to the reclassification of petroleum reservoir evaluation income during the first three quarters.

New accounting standards

Financial Instruments – Disclosures

In June 2009, the CICA amended Section 3862, "Financial Instruments – Disclosures", of the Handbook in order to adopt changes recently made by the IASB to International Financial Reporting Standard 7, "Financial Instruments: Disclosures" (IFRS 7) in March 2009. These changes apply to companies that have a public accountability obligation as well as to closely held companies, cooperative enterprises, rate-regulated enterprises, and non-profit organizations that have decided to adopt Section 3862. The changes were made in order to include additional disclosure obligations involving valuations of financial instrument fair value and to expand the disclosure obligations regarding liquidity risk.

The changes took effect for the annual financial statements for fiscal years ended after September 30, 2009. In order to ease the burden on preparers and for the sake of consistency with IFRS 7, the CICA decided that, in the first year of application, the entities would not have to disclose comparative information for the information required under the changes. The adoption of Section 3862 had no impact on the amounts recorded in the Company's financial statements as at September 30, 2010.

Financial instruments – Recognition and Measurement

In August 2009, the CICA amended Section 3855, "Financial Instruments – Recognition and Measurement", by adding and modifying paragraphs pertaining to the categorization of financial assets and to financial assets having lost value and by providing particular transitional guidelines. On October 1, 2009, the Company adopted the changes to Section 3855. Their application had no significant impact on the Company's operating results, its financial position, or its disclosures.

Accounting changes

In June 2009, the CICA amended Section 1506, "Accounting Changes," in order to exclude from the scope of application changes in accounting methods resulting from the full replacement of an entity's accounting basis. This change applies to fiscal years opened after July 1, 2009. It was adopted for the fiscal year ended September 30, 2010, and had no impact on the financial statements.

Future accounting standards

IFRS Convergence

In February 2008, the Accounting Standards Board confirmed that Canadian generally accepted accounting principles (GAAP) for publicly accountable enterprises will be replaced by the international financial reporting standards (IFRS). The IFRS rely on a conceptual framework similar to that of Canadian GAAP, but with significant differences in terms of recognition, evaluation, and disclosures.

The transition will take place at the latest for fiscal years begun on or after January 1, 2011. Consequently, the Company expects that the interim financial statements for the three-month period ended on December 31, 2011 and the annual financial statements for the fiscal year ended on September 30, 2012 will be the first that it presents in accordance with the IFRS.

Training
The personnel assigned to convergence with the IFRS have undergone and continue to receive training by the Ordre des comptables agréés du Québec. Given that the IFRS will change by 2011, all changes that could affect the Company must be monitored.

Affected accounting standards
The detailed analysis of accounting standards affected by the IFRS convergence should be completed throughout the fiscal year 2010-2011. In general, much effort must be put into the presentation of financial statements, since the IFRS require more disclosures.

The following list contains the main areas in which the accounting standard modifications are expected to have an impact on the Company's financial statements. This list should not be considered an exhaustive list of the modifications that will result from conversion to the IFRS. It aims to highlight the areas that the Company considers most important; however, the analysis of the modifications is not complete, and the choice of accounting standards under IFRS, if any, has not been determined. The regulatory bodies that promulgate Canadian GAAP and the IFRS carry out significant projects on a continuous basis, which could have an impact on the final differences between Canadian GAAP and the IFRS, and their repercussions on the Company's financial statements over the coming years. The following list covers the standards that exist based on the current Canadian GAAP and IFRS. For now, however, the Company is unable to reliably quantify the expected impact of these differences on its financial statements. The standards are as follows:

Initial adoption (IFRS 1)
IFRS 1 gives directives on the general approach to be taken when the IFRS are adopted for the first time. The fundamental principle of IFRS 1 is the retrospective application of the valid IFRS as of the date of initial adoption. IFRS 1 realizes that full retrospective application may not be possible or appropriate in all situations and stipulates:

- exemptions for certain specific aspects of certain IFRS in the preparation of the opening balance sheet;
- mandatory exemptions in the retrospective application of certain IFRS.

In addition, to ensure the financial statements contain high-quality information that is transparent to users, IFRS 1 contains disclosure obligations to highlight the changes made to the financial statements following the IFRS convergence.

The following table presents some of the main modifications of accounting methods which we believe should have an impact on the recording and evaluation of certain elements of the balance sheet and the income statement. Unless otherwise indicated, all accounting method modifications will be applied retrospectively.

Accounting method	Main differences in accounting treatment	Potential impacts
Provisions and contingent liabilities	IFRS require the recording of a provision if it is more likely than not that an outflow of resources will be necessary to settle the obligation, while Canadian GAAP use a higher threshold. IFRS also require that a provision be recorded in the case of onerous contracts, while according to GAAP, the recording of such a liability is only required in certain situations.	Opening balance sheet and after the transition: We have not finished our evaluation. It is possible that additional provisions will be recorded according to IFRS.
Income tax	The various accounting method modifications according to IFRS will also have an impact on the corresponding deferred tax asset or liability, unless a reduction of value is required.	Opening balance sheet: No significant impact is expected. No short-term deferred taxes. After the transition: The impact will depend on the net effect of all of the differences between the accounting methods.
	The tax consequences of a transaction recorded in other comprehensive income or directly in shareholders' equity during previous periods must be recorded directly in other comprehensive income or directly in shareholders' equity ("retrospective research"). According to Canadian GAAP, any subsequent variation of deferred taxes is charged against earnings.	Opening balance sheet: No significant impact is expected on shareholders' equity. After the transition: The impact on earnings will depend on the extent of the variations in deferred taxes that will be recorded in other comprehensive income or directly in shareholders' equity.
Stock-based compensation	IFRS requires that expected extinctions be taken into account in the recording of stock-based compensation cost at the time of the granting rather than recognize the extinctions when they occur. When the acquisition is gradual, IFRS requires that each segment of the granting be evaluated and recorded separately, as each segment has a different acquisition period, and the fair value of each will therefore be different.	Opening balance sheet: No significant impact. After the transition: The impact will depend on the method of granting stock options.

Information systems
The Company's accounting process is simple, since it is a company in the exploration stage. The Company should be able to operate its accounting systems under IFRS, since no significant challenge is foreseen. However, certain Excel spreadsheets will need to be adapted in order to support the necessary changes due to the convergence.

Internal controls
The Company's signing officers have the responsibility of ensuring that there are processes allowing them to have the necessary knowledge in support of the declarations made in the certifications, more specifically that the documents in SEDAR are reliable. The officers will ensure that once the convergence process is completed, they will still be able to sign their certification.

Impact on commercial activities

The Company's business processes are simple, and no significant challenge is expected in order to operate according to IFRS. The Company has few transactions in foreign currencies, and has no long-term debt or capital obligations. The Company does not expect that the IFRS will change these processes when it completes flow-through private placements. The Company has no compensation plan that will be affected by the IFRS. The stock option plan is not affected by financial ratios or objectives.

Business processes will be monitored during fiscal year 2010-2011 in order to detect impacts not identified during our initial analysis.

Financial instruments

Risk management policy

The Company's financial assets and liabilities expose it to various risks. The following analysis provides an assessment of the risks as at September 30, 2010, the date of the balance sheet:

Credit risk

Financial instruments that potentially subject the Company to credit risk consist primarily of cash and cash equivalents and accounts receivable. The Company's cash and cash equivalents are held with or issued by first-class financial institutions. Receivables mostly represent sums due from governments and from partners. Therefore, Management considers the risk of non-performance on these instruments to be very minimal.

Maximum exposure to credit risk:	2010	2009
	$	$
Cash	448,055	115,270
Money market fund	1,000	4,717,814
Guaranteed investment certificates	2,254,331	–
Receivables	2,920,900	2,029,860
	5,624,286	6,862,944

Liquidity risk

Liquidity risks are the risks that the Company would be unable to cope with its financial obligations at the required times or could only do so at excessive cost. The Company finances its growth through the issuance of shares and the sale of participation in some of its petroleum assets. One of Management's main financial objectives is to maintain an optimal level of liquidities by actively managing the exploration work to be performed. Considering the liquid resources at the Company's disposal, Management feels that the Company is exposed to high liquidity risks.

All of the Company's financial liabilities have a maturity of less than one year.

Market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate due to market factors. Market risk includes three types of risk: interest rate risk, currency risk, and other price risks. The Company is exposed to two of these risk: interest rate risk and other price risks.

A) Interest rate risk

Interest rate risk refers to the impact of fluctuation in interest rates on the value of long-term investments and debt.

Investments bear interest at a fixed rate and thus expose the Company to the risk of variations in the fair value caused by interest rate fluctuations. As at September 30, 2010, if the interest rates in force on that date had increased or decreased by 1%, all other variables remaining constant, the net loss would have varied by $1,590.

The Company has a variable-rate bank loan. Consequently, it incurs interest rate risk based on the fluctuation of the prime rate. As at September 30, 2010, if the interest rates in force on that date had increased or decreased by 1%, all other variables remaining constant, the net loss would have varied by $600.

B) Other price risks

The Company is exposed to fluctuations in petroleum and gas prices, as they influence the potential profitability of the oil and gas properties held by the Company and therefore have an impact on its exploration plan and any decision whether to proceed with production.

Categorization of financial instruments

Financial instruments fall into one of the following five categories: held for trading, investments held to maturity, loans and receivables, financial assets available for sale, or other financial liabilities. The category determines the instrument's accounting treatment. The Company establishes the category during the initial recording of the financial instrument based on its underlying goal.

The Company's financial assets and liabilities are categorized and valued as follows:

Financial assets/liabilities	Category	Valuation
Cash and cash equivalents	Held for trading	Fair value
Receivables	Loans and receivables	Amortized cost
Investments	Held for trading	Fair value
Payable and accrued expenses	Other financial liabilities	Amortized cost
Loans	Other financial liabilities	Amortized cost

Financial instruments valued at the amortized cost are initially recognized at fair value then at the amortized cost, with gains and losses recognized in net earnings for the period during which the gain or loss occurs. Changes in the fair value of financial instruments categorized as held for trading are recorded in net earnings for the period during which the change takes place.

Fair value

The fair value of investments is assessed in the following manner:

Guaranteed investment certificates: the cost corresponds to the fair value considering their recent issuance or their short-term maturity.

Money market fund: the cost corresponds to the fair value considering its short-term maturity.

For long-term debt, the book value is fairly close to the fair value because of the variable interest rate on the debt.

Management analysis of financial information

Hierarchy of fair value valuations

Financial instruments recorded at fair value on the balance sheets are categorized according to a hierarchy that reflects the significance of the data used to carry out the valuations.

The hierarchy of fair value valuations is broken down into the following levels:

Level 1 – valuation based on the prices (non-adjusted) listed on the asset markets for identical assets or liabilities: cash is found on this level;

Level 2 – valuation techniques based on data other than the listed prices referred to in level 1, observable for assets or liabilities directly (prices) or indirectly (price derivatives): cash equivalents and investments are included in this level;

Level 3 – valuation techniques based on a significant share of data related to the asset or liability not based on observable market data (non-observable data).

The hierarchy that applies as part of the determination of the fair value requires the use of data observable on the market each time such data exist. A financial instrument is placed at the lowest level of the hierarchy for which a piece of significant data has been taken into account in the valuation of the fair value.

For the fiscal year, there have been no transfers in financial assets valuation between levels 1 and 2.

The fair value of financial instruments is summarized as follows:

	2010		2009	
	Book value	Fair value	Book value	Fair value
	$	$	$	$
Financial assets held for trading:				
Cash and cash equivalents	1,949,055	1,949,055	4,833,084	4,833,084
Investments	754,331	754,331	975,200	975,200
Loans and receivables:				
Receivables	2,920,900	2,920,900	2,029,860	2,029,860
Other financial liabilities:				
Payables and accrued expenses	822,339	822,339	1,661,967	1,661,967
Loan	2,243,310	2,243,310	–	–

Risks and uncertainties

The mining properties held by the Company are at the exploration stage. The Company's long-term profitability is related in part to the costs and success of the exploration and subsequent development programs, which could also be influenced by different factors. The factors that have to be taken into consideration include environmental regulation, the possible attributes of the mining deposits, i.e. the quality and quantity of resources, as well as the development costs of a production infrastructure, the cost of financing, the price of metals, the market value of mine products, and the competitive nature of the industry. Major investments are needed to carry out the exploration and reserves development programs. In the absence of cash flows generated by mining operations, the Company depends on capital markets to finance these exploration and development activities. The market conditions and other unforeseeable events could have an impact on the Company's ability to raise the funds required for its development.

Additional information

a) Supplemental documents

Certain supplemental documents, including prior management reports and press releases, are available online at **www.sedar.com** in the documents section or on Pétrolia's website at **www.petroliagaz.com**.

b) Rule 51-102 Section 5.2

The deferred exploration expenses for the fiscal year ended September 30, 2010 are detailed as follows:

	Geology	Geophysical surveys	Drilling	Options	Completion	Analysis	Capacity tests	General expenses	Total
	$	$	$	$	$	$	$	$	$
Anticosti	104,541	22,977	3,832,065	507	–	–	–	1,163	3,961,253
Gastonguay	26,610	–	329	–	–	32	–	–	26,971
Gaspésia–Edgar–Marcel-Tremblay	54,472	1,347	–	–	–	–	–	80	55,899
Gaspé	56,286	27,926	2,645	5,432	694	520	–	24,775	118,278
Bourque project	16,563	69,033	129,578	–	–	–	–	742	215,916
Haldimand project	112,827	109,965	1,404,465	–	1,281,681	5,347	123,531	14,836	3,052,652
Tar Point project	64,389	1,654	3,106,864	–	1,347,279	1,123	–	579	4,521,888
Dalhousie	21,106	3,676	260	1,186	–	–	–	177	26,405
	456,794	236,578	8,476,206	7,125	2,629,654	7,022	123,531	42,352	11,979,262

The deferred exploration expenses for the fiscal year ended September 30, 2009 are detailed as follows:

	Geology	Geophysical surveys	Drilling	Options	Total
	$	$	$	$	$
Anticosti	211,066	30,619	5,536	507	247,728
Gastonguay	13,962	168	303	–	14,433
Gaspésia–Edgar–Marcel-Tremblay	59,403	40,492	2,498	–	102,393
Gaspé	89,912	808	6,812	5,432	102,964
Bourque project	102,069	561,230	27,349	–	690,648
Haldimand project	320,359	1,551,682	1,669,712	–	3,541,753
Tar Point project	12,371	2,508	162,261	–	177,140
Dalhousie	82,821	871,007	16,171	1,186	971,185
	891,963	3,058,514	1,890,642	7,125	5,848,244

c) **Rule 51-102 section 5.3**

Information on shares issued, warrants, and stock options as at December 20, 2010:

Common shares: 50,067,287 common shares have been issued and are outstanding.

Warrants: warrants can be exercised as follows:

- 2,163,161 shares at a price of $1.30 per share until December 4, 2011.
- 1,750,000 shares at a price of $1.00 per share until October 10, 2012;
- 3,000,000 shares at a price of $1.00 per share until January 10, 2013;

Stock options outstanding: The stock options granted to the directors, members of senior management, employees, and service providers are as follows:

- 675,000 options exercisable at a price of $0.40 per share until February 3, 2011;
- 150,000 options exercisable at a price of $0.58 per share until May 10, 2011;
- 50,000 options exercisable at a price of $0.74 per share until May 21, 2012;
- 662,500 options exercisable at a price of $0.40 per share until June 21, 2012;
- 400,000 options exercisable at a price of $0.60 per share until February 12, 2013;
- 150,000 options exercisable at a price of $0.60 per share until March 3, 2013;
- 427,500 options exercisable at a price of $1.25 per share until July 7, 2013;
- 180,000 options exercisable at a price of $0.74 per share until May 21, 2014;
- 270,000 options exercisable at a price of $0.89 per share until February 25, 2015.
- 920,000 options exercisable at a price of $0.50 per share until December 8, 2015.

Management's responsibility for financial information

Pétrolia's financial statements are the responsibility of Management and were approved by the board of directors under the recommendation of the audit committee. The financial statements were prepared by Management in accordance with Canadian generally accepted accounting principles. These financial statements were audited by the Company's auditors. The financial statements include certain amounts that are based on the use of estimates and judgments. Management has reasonably determined these amounts to ensure that the financial statements are presented faithfully in all material respects.

Rimouski, December 20, 2010
On behalf of the Board

André Proulx, president of the Company

Auditors' report to the shareholders of Pétrolia Inc.

We have audited the balance sheets of Pétrolia Inc. as at September 30, 2010 and 2009, and the statements of income and comprehensive income, shareholders' equity, deferred exploration expenses and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing of the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at September 30, 2010 and 2009, and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Mallette

Mallette[1]
LLP
Chartered Accountants
Rimouski, Canada
October 28, 2010 (December 20, 2010 for Note 18)

[1]CA auditor permit No. 8832

Balance sheet Pétrolia

As at September 30	2010	2009
	$	$
Assets		
Current assets		
Cash and cash equivalents	1,949,055	4,833,084
Receivables (Note 6)	2,920,900	2,029,860
Prepaid expenses	70,372	356,068
Investments cashable during the next fiscal year (Note 7)	754,331	380,000
	5,694,658	7,599,012
Investments (Note 7)	–	595,200
Tangible fixed assets (Note 8)	213,159	150,530
Oil and gas properties (Note 9)	3,852,629	2,333,394
Deferred exploration expenses (Note 10)	21,234,411	13,346,303
	30,994,857	24,024,439
Liabilities		
Current liabilities		
Payables and accrued expenses	822,339	1,661,967
Loan (Note 11)	2,243,310	–
	3,065,649	1,661,967
Future taxes (note 13)	1,323,583	913,549
	4,389,232	2,575,516
Shareholders' equity		
Capital stock (Note 12)	28,288,874	21,674,783
Contributed surplus – Stock options	1,300,615	1,957,120
Contributed surplus – Expired stock options	783,366	225,721
Deficit	(3,767,230)	(2,408,701)
	26,605,625	21,448,923
	30,994,857	24,024,439

Agreements, commitments and contingencies (Notes 9, 14 and 15)

On behalf of the Board

André Proulx, Director

Vincent Causse, Director

Statement of income and comprehensive income

Fiscal year ended September 30	2010	2009
	$	$
Revenue		
Project management	1,781	11,706
Interest income	24,321	175,238
	26,102	186,944
Operating costs		
Administrative expenses (Appendix A)	1,759,903	1,378,952
General expenses (Appendix B)	–	–
	1,759,903	1,378,952
Loss before other item and income taxes	(1,733,801)	(1,192,008)
Other item		
Change in the fair value of financial assets designated as held for trading	(59,603)	(423,100)
Loss before income taxes	(1,793,404)	(1,615,108)
Future income taxes (Note 13)	(434,875)	(760,197)
Net loss and comprehensive income	(1,358,529)	(854,911)
Basic and diluted net loss per share	(0.028)	(0.021)

Statement of shareholders' equity

	Capital stock		Contributed surplus			
			Stock options	Expired stock options	Deficit	Total
	Number	$	$	$	$	$
Balance as at September 30, 2008	40,914,219	21,674,783	1,877,170	195,946	(1,553,790)	22,194,109
Other activities	–	–	–	–	–	–
Stock-based compensation	–	–	109,725	–	–	109,725
Expired stock options	–	–	(29,775)	29,775	–	–
Net loss	–	–	–	–	(854,911)	(854,911)
Balance as at September 30, 2009	40,914,219	21,674,783	1,957,120	225,721	(2,408,701)	21,448,923
Issued during the fiscal year						
Cash	7,960,568	7,129,910	–	–	–	7,129,910
Stock options exercised	1,192,500	806,585	(289,585)	–	–	517,000
Share issuance costs						
Future taxes	–	(844,909)	–	–	–	(844,909)
Others	–	(477,495)	–	–	–	(477,495)
Other activities						
Stock-based compensation	–	–	190,725	–	–	190,725
Expired stock options	–	–	(162,675)	162,675	–	–
Expired broker warrants	–	–	(394,970)	394,970	–	–
Net loss	–	–	–	–	(1,358,529)	(1,358,529)
Balance as at September 30, 2010	50,067,287	28,288,874	1,300,615	783,366	(3,767,230)	26,605,625

Statement of deferred exploration expenses

Fiscal year ended September 30	2010	2009
	$	$
Exploration expenses		
Analysis	7,022	–
Drilling	8,476,206	1,890,642
Geology	456,794	891,963
Geophysical surveys	236,578	3,058,514
Completion work	2,629,654	–
Petroleum reservoir evaluation	123,531	–
General exploration expenses	42,352	–
Stock-based compensation	7,125	7,125
	11,979,262	5,848,244
Deductions		
Petroleum reservoir evaluation income	109,738	–
Expenses carried over to properties following the swap	826,321	–
Exploration subsidies	2,816,828	1,743,180
Partner contributions	338,267	(109,352)
	4,091,154	1,633,828
Net increase in exploration expenses for the fiscal year	7,888,108	4,214,416
Balance, beginning of year	13,346,303	9,131,887
Balance, end of year	21,234,411	13,346,303

Statement of cash flows

Fiscal year ended September 30	2010	2009
	$	$
Operating activities		
Net loss	(1,358,529)	(854,911)
Items not affecting cash		
Stock-based compensation	183,600	102,600
Depreciation of tangible fixed assets	73,247	60,910
Future income taxes	(434,875)	(760,197)
Change in the fair value of financial assets designated as held for trading	59,603	423,100
	(1,476,954)	(1,028,498)
Net change in non-cash items related to operations	610,557	16,266
	(866,397)	(1,012,232)
Financing activities		
Acquisition of financing	2,243,310	–
Capital stock issuance	7,646,910	–
Share issuance costs	(477,495)	–
	9,412,725	–
Investing activities		
Disposal of investments	915,597	21,700
Acquisition of investments	(754,331)	(380,000)
Acquisition of tangible fixed assets	(130,486)	(16,877)
Acquisition of oil and gas properties	(692,915)	(243,242)
Increase in deferred exploration expenses net of deductions	(10,768,222)	(4,811,322)
	(11,430,357)	(5,429,741)
Decrease in cash and cash equivalents	(2,884,029)	(6,441,973)
Cash and cash equivalents, beginning of year	4,833,084	11,275,057
Cash and cash equivalents, end of year	1,949,055	4,833,084
Cash and cash equivalents are made up of the following:		
Cash	448,055	115,270
Guaranteed investment certificate, cashable at any time, 1.6%, maturing in September 2011	1,500,000	–
Money market fund	1,000	4,717,814
	1,949,055	4,833,084

Additional cash flow information: Note 17

Notes to financial statements

September 30, 2010

1. Instrument of incorporation and nature of activities

The Company, incorporated under part IA of the Quebec Companies Act, is an oil and gas exploration company. Its stock has been listed on the TSX Venture Exchange since February 16, 2005, under the symbol PEA.

The oil and gas properties held by the Company are in the exploration stage. The Company's long-term profitability is related in part to the costs and success of the exploration and subsequent development programs. The Company has not yet determined whether its properties hold economically viable reserves.

All amounts are expressed in Canadian dollars.

2. Significant accounting policies

New accounting standards

Financial Instruments – Disclosures

In June 2009, the CICA amended Section 3862, "Financial Instruments – Disclosures", of the Handbook in order to adopt changes recently made by the IASB to International Financial Reporting Standard 7, "Financial Instruments: Disclosures" (IFRS 7) in March 2009. These changes apply to companies that have a public accountability obligation as well as to closely held companies, cooperative enterprises, rate-regulated enterprises, and non-profit organizations that have decided to adopt Section 3862. The changes were made in order to include additional disclosure obligations involving valuations of financial instrument fair value and to expand the disclosure obligations regarding liquidity risk.

The changes took effect for the annual financial statements for fiscal years ended after September 30, 2009. In order to ease the burden on preparers and for the sake of consistency with IFRS 7, the CICA decided that in the first year of application, entities would not have to disclose comparative information for the information required under the changes. The adoption of Section 3862 had no impact on the amounts recorded in the Company's financial statements as at September 30, 2010.

Financial Instruments – Recognition and Measurement

In August 2009, the CICA amended Section 3855, "Financial Instruments – Recognition and Measurement", by adding and modifying paragraphs pertaining to the categorization of financial assets and to financial assets having lost value and by providing particular transitional guidelines. On October 1, 2009, the Company adopted the changes to Section 3855. Their application had no significant impact on the Company's operating results, its financial position, or its disclosures.

Accounting changes

In June 2009, the CICA amended Section 1506, "Accounting Changes," in order to exclude from the scope of application changes in accounting methods resulting from the full replacement of an entity's accounting basis. This change applies to fiscal years opened after July 1, 2009. It was adopted for the fiscal year ended September 30, 2010, and had no impact on the financial statements.

2. Significant accounting policies (continued)

Recording of income

Income from investments is recorded when it is earned. Project management income is recorded when the exploration work is carried out.

Conversion of currencies

Monetary assets and liabilities are converted at the exchange rate in force as at the date of the balance sheet. Income and expenses denominated in foreign currencies are recorded at the exchange rate in force as at the date of the transaction. Exchange gains and losses are recorded in the earnings.

Transaction costs – financial instruments

Transaction costs are recorded as operating costs as they are incurred.

Tangible fixed assets

Tangible fixed assets are recorded at cost. Depreciation is calculated based on their useful life according to the following methods and annual rates:

	Methods	Rates
Leasehold improvements	Straight line	3 years
Office equipment	Declining balance	20%
IT equipment and rolling stock	Declining balance	30%

Use of estimates

The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires Management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the amounts of revenues and expenses recorded during the fiscal year. Actual results could differ from those estimates.

Oil and gas properties and deferred exploration expenses

The Company follows the full-cost accounting method, according to which costs related to the acquisition, exploration, and development of properties, less government subsidies and petroleum reservoir evaluation income, are recorded by property until the start of commercial production. These costs include geological and geophysical expenses, the cost of drilling productive and non-productive wells, the portion of general expenses directly attributable to these activities, and estimated expenses for abandonment of installations. If economically profitable hydrocarbon reserves are developed, the capitalized costs of the properties in question are transferred to fixed assets and amortized based on the units of production of the fiscal year based on the likely and proven crude oil and natural gas reserves. If it is established that the capitalized acquisition, exploration, and development costs are not recoverable according to the estimated lifetime of the property or if the project is abandoned, the project is written down to its net realizable value.

The recovery of amounts indicated under the properties section and related deferred exploration expenses depends on the discovery of economically recoverable reserves, the Company's ability to obtain the financing required to see development through to completion, and the established profitable production or proceeds from disposal of these assets. The amounts recorded for oil and gas properties and deferred exploration expenses do not necessarily represent the present or future value. Lastly, its activities are subject to governmental regulation.

2. Significant accounting policies (continued)

Site restoration costs

A provision for restoration costs, net of any expected recovery, is recorded if such costs are reasonably determinable. This provision is calculated on estimated costs according to the expected method and the extent of environmental remedial work, in accordance with legislative requirements, industry practices, current technology, and the potential future use of the site. A provision is established when Management approves the sale or the closing of an oil or gas property and is recorded at its fair value in consideration of the increased cost of the assets in question.

Joint activities

The Company conducts certain oil and gas resource exploration activities jointly with third parties. These financial statements only take into account the Company's proportional participation in these activities.

Government subsidies and partner contributions

Exploration tax credits, exploration expense grants, and partner contributions are recorded as a reduction in exploration expenses. Subsidies applied to operations are recorded as revenues in the statement of income.

In the event of any variances between the government subsidies claimed by the Company and the amounts granted by the tax authorities, the resulting gain or loss will be recorded in the fiscal year in which these variances are noted.

Income taxes

The Company uses the tax liability method of accounting for income taxes. Under this method, future income tax assets and liabilities are determined according to differences between the book value and tax value of assets and liabilities. They are measured by applying enacted or substantively enacted tax rates and laws as of the date of the financial statements for the fiscal years in which the temporary differences are expected to be recovered.

Under the provisions of tax legislation, deductions for resource expenses related to exploration and development activities and financed by flow-through shares are forfeited in favour of investors. According to the tax liability method related to the recording of income taxes, future income taxes related to differences occurring at the time of the forfeiture were recorded with a corresponding charge to share issuance costs.

Basic and diluted net loss per share

Net loss per share is calculated according to the weighted average of outstanding shares during the reporting period. The diluted net loss per share is similar to the net loss per share, since the exercising of warrants and stock options would have the effect of reducing the loss per share.

Stock-based compensation

The Company accounts for the allocation of stock options granted under the stock option plan and the allocation of broker warrants as part of certain funding on a fair value basis. Stock options granted to salaried and non-salaried persons and broker warrants are accounted for on the basis of their fair value according to the Black-Scholes option pricing model.

When options and broker warrants are granted, the compensation expenses are applied to the activity in question and offset in contributed surplus.

Any consideration paid by the participants when options and broker warrants are exercised, as well as the contributed surplus created when options and broker warrants are allocated, are credited to capital stock.

2. Significant accounting policies (continued)

Capital stock

Capital stock issued as non-monetary consideration is accounted for at the fair market value of shares to be issued by the Company and depends on the stock price as at the date on which the stock issuance agreement was entered into.

Cash and cash equivalents

The Company's cash and cash equivalents are made up of cash and short-term investments that can be converted into cash at any time.

3. Future accounting policies

Business combinations and non-controlling interests

In October 2008, the CICA issued Handbook Sections 1582, "Business Combinations," 1601, "Consolidated Financial Statements," and 1602, "Non-controlling Interests." Section 1582 establishes standards for the measurement of a business combination and the recognition and measurement of assets and liabilities assumed, Section 1601 provides the guidelines for the preparation of consolidated financial statements subsequent to acquisition other than by non-controlling interests, and Section 1602 establishes guidance for the acquisition of non-controlling interests subsequent to a business combination. These new standards will take effect for the Company on October 1, 2011. The application of these new sections is not expected to have an impact on the amounts recorded in the financial statements.

International financial reporting standards

The Accounting Standards Board (AcSB) of Canada has confirmed that, effective January 1, 2011, the International Financial Reporting Standards (IFRS) will replace Canadian generally accepted accounting principles (GAAP) for companies that have public accountability obligations. The IFRS will apply to fiscal years opened on or after January 1, 2011.

Consequently, the Company expects that the interim financial statements for the three-month period ended on December 31, 2011, and the annual financial statements for the fiscal year ended on September 30, 2012, will be the first that it presents in accordance with the IFRS. The IFRS use a conceptual framework similar to Canadian GAAP, but there are significant differences in recognition, measurement, presentation, and disclosure requirements.

The regulatory bodies that promulgate Canadian GAAP and the IFRS carry out significant projects on a continuous basis, which could have an impact on the final differences between Canadian GAAP and the IFRS and their repercussions on the Company's financial statements during the coming years. The future impact of the IFRS will also depend on the particular circumstances that prevail during this time period. For now, however, the Company is unable to reliably quantify the expected impact of these differences on its financial statements.

4. Financial instrument disclosures

Risk management policy

The Company's financial assets and liabilities expose it to various risks. The following analysis provides an assessment of the risks as at September 30, 2010, the date of the balance sheet:

4. Financial instrument disclosures (continued)

Credit risk

Financial instruments that potentially subject the Company to credit risk consist primarily of cash and cash equivalents and accounts receivable. The Company's cash and cash equivalents are held with or issued by first-class financial institutions. Receivables mostly represent sums due from the federal and provincial government and from partners. Therefore, Management considers the risk of non-performance on these instruments to be very minimal.

Maximum exposure to credit risk:	2010	2009
	$	$
Cash	448,055	115,270
Money market fund	1,000	4,717,814
Guaranteed investment certificate	2,254,331	–
Receivables	2,920,900	2,029,860
	5,624,286	6,862,944

Liquidity risk

Liquidity risks are the risks that the Company would be unable to cope with its financial obligations at the required times or could only do so at excessive cost. The Company finances its growth through the issuance of shares and the sale of participation in some of its petroleum assets. One of Management's main financial objectives is to maintain an optimal level of liquidities by actively managing the exploration work to be performed. Considering the liquid resources at the Company's disposal, Management feels that the Company is exposed to high liquidity risks.

All of the Company's financial liabilities have a maturity of less than one year.

Market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate due to market factors. Market risk includes three types of risk: interest rate risk, currency risk, and other price risks. The Company is exposed to two of these risks: interest rate risk and other price risks.

A) Interest rate risk

Interest rate risk refers to the impact of fluctuations in interest rates on the value of long-term investments and debt.

Investments bear interest at a fixed rate and thus expose the Company to the risk of variations in the fair value caused by interest rate fluctuations. As at September 30, 2010, if the interest rates in force on that date had increased or decreased by 1%, all other variables remaining constant, the net loss would have varied by $1,590.

The Company has a variable-rate bank loan. Consequently, it incurs interest rate risk based on the fluctuation of the prime rate. As at September 30, 2010, if the interest rates in force on that date had increased or decreased by 1%, all other variables remaining constant, the net loss would have varied by $600.

B) Other price risks

The Company is exposed to fluctuations in petroleum and gas prices, as they influence the potential profitability of the oil and gas properties held by the Company and therefore have an impact on its exploration plan and any decision whether to proceed with production.

4. Financial instrument disclosures (continued)

Categorization of financial instruments
Financial instruments fall into one of the following five categories: held for trading, investments held to maturity, loans and receivables, financial assets available for sale, or other financial liabilities. The category determines the instrument's accounting treatment. The Company establishes the category during the initial recording of the financial instrument based on its underlying goal.

The Company's financial assets and liabilities are categorized and valued as follows:

Financial assets/liabilities	Category	Valuation
Cash and cash equivalents	Held for trading	Fair value
Receivables	Loans and receivables	Amortized cost
Investments	Held for trading	Fair value
Payables and accrued expenses	Other financial liabilities	Amortized cost
Loan	Other financial liabilities	Amortized cost

Financial instruments valued at the amortized cost are initially recognized at fair value then at the amortized cost, with gains and losses recognized in net earnings for the period during which the gain or loss occurs. Changes in the fair value of financial instruments categorized as held for trading are recorded in net earnings for the period during which the change takes place.

Fair value
The fair value of investments is assessed in the following manner:

Guaranteed investment certificates: the cost corresponds to the fair value considering their recent issuance or their short-term maturity.

Money market fund: the cost corresponds to the fair value considering its short-term maturity.

For long-term debt, the book value is fairly close to the fair value because of the variable interest rate on the debt.

Hierarchy of fair value valuations
Financial instruments recorded at fair value on the balance sheet are categorized according to a hierarchy that reflects the significance of the data used to carry out the valuations.

The hierarchy of fair value valuations is broken down into the following levels:

Level 1 – valuation based on the prices (non-adjusted) listed on the asset markets for identical assets or liabilities: cash is found on this level;

Level 2 – valuation techniques based on data other than the listed prices referred to in level 1 observable for assets or liabilities directly (prices) or indirectly (price derivatives)—cash equivalents and investments are found on this level;

Level 3 – valuation techniques based on a significant share of data related to the asset or liability not based on observable market data (non-observable data).

The hierarchy that applies as part of the determination of the fair value requires the use of data observable on the market each time such data exist. A financial instrument is placed at the lowest level of the hierarchy for which a piece of significant data has been taken into account in the valuation of the fair value.

4. Financial instrument disclosures (continued)

For the fiscal year, there have been no transfers in financial assets valuation between levels 1 and 2.

The fair value of financial instruments is summarized as follows:

	2010		2009	
	Book value	Fair value	Book value	Fair value
	$	$	$	$
Financial assets held for trading:				
Cash and cash equivalents	1,949,055	1,949,055	4,833,084	4,833,084
Investments	754,331	754,331	975,200	975,200
Loans and receivables:				
Receivables	2,920,900	2,920 900	2,029,860	2,029,860
Other financial liabilities:				
Payables and accrued expenses	822,339	822,339	1,661,967	1,661,967
Loan	2,243,310	2,243,310	–	–

5. Information regarding capital

In its capital management operations, the Company's objectives are to:

- Maintain financial flexibility in order to preserve its capacity to meet its financial commitments, including its potential obligations resulting from additional acquisitions;
- Maintain a capital structure allowing the Company to encourage the financing of its growth strategy;
- Optimize the use of its capital in order to offer its shareholders a good return on their investment.

The Company defines its capital as follows:

- Shareholders' equity;
- Loan.

The Company's financial strategy is developed and adapted based on market conditions in order to maintain a flexible capital structure in compliance with the aforementioned objectives and to respond to the characteristics of the risks linked to the underlying assets. In order to maintain or adjust its capital structure, the Company, being in its early stages, is required to issue new shares.

The Company's capital management objectives, policies, and procedures have not changed since October 1, 2009.

The Company is subject to the following capital requirement imposed by third parties:

Maximum adjusted long-term debt/equity ratio of 2.5/1.

As at September 30, 2010, the Company is meeting all of its financial commitments.

6. Receivables

	2010	2009
	$	$
Partners	–	68,317
Consumer tax credits	24,210	157,005
Tax credits receivable	2,816,842	1,743,180
Interest receivable	2,512	1,226
Others	77,336	60,132
	2,920,900	2,029,860

The tax credits refer to requests that have not yet been examined by the tax authorities.

7. Investments

	2010	2009
	$	$
Guaranteed investment certificates, 0.3%, maturing in July 2010	–	380,000
Guaranteed investment certificates, 1.68%, cashable beginning in July 2011 and maturing in July 2012	530,000	–
Guaranteed investment certificate, 1.60%, cashable at any time and maturing in September 2012	224,331	–
Gastem Inc. 0 common share (2009 – 960,000)	–	595,200
	754,331	975,200
Portion cashable during the next fiscal year	754,331	380,000
	–	595,200

8. Tangible fixed assets

			2010	2009
			$	$
	Cost	Accumulated depreciation	Net value	Net value
Leasehold improvements	18,387	16,831	1,556	7,053
IT and office equipment	160,040	60,713	99,327	53,675
Rolling stock	236,187	123,911	112,276	89,802
	414,614	201,455	213,159	150,530

9. Oil and gas properties

	2010	2009
	$	$
Quebec		
Anticosti [(1)]	259,970	241,006
Gastonguay	638,497	612,595
Gaspésia–Edgar–Marcel-Tremblay	382,915	360,897
Gaspé [(1)]	2,427,941	979,120
New Brunswick		
Dalhousie	143,306	139,776
	3,852,629	2,333,394

9. Oil and gas properties (continued)

The properties indicated by the reference (1) in the previous table carry obligations related to their eventual coming onstream. To date, the Company has satisfied all of its obligations. Only its future or potential obligations and transactions specific to the fiscal year are described below:

Gaspé properties

On May 6, 2008, the Company signed a comprehensive agreement that amended a prior agreement with Junex regarding the Gaspé and Gastonguay properties. Under this agreement, Pétrolia acquired a 100% interest over 6,043 km² of these properties, subject to a fee varying from 0.5% to 2.5% of the future hydrocarbon production. In June 2010, the Company carried out an asset swap, bringing its interest to 100% over all licences, an area of 150 km², with the exception of a 9-km² zone where its interest is 64% (Haldimand project).

Haldimand project

On May 6, 2008, a second agreement set the boundaries of a development area of 9 km² around the Pétrolia Haldimand No. 1 well over which Pétrolia holds a 45% interest, Junex 45%, and Gastem 10%. Some licences of these properties are subject to fees of 5%. Under an amendment to the original agreement signed on July 22, 2009, Pétrolia became the operator over the entire development area of 9 km². On October 1, 2009, Pétrolia proceeded to acquire the entirety of Gastem's interests. Following its decision not to participate in the drilling of a second well, Junex's participation was reduced by 9%. This brings Pétrolia's interest in Haldimand to 64%, while Junex holds the remaining 36%.

Bourque project

The Company signed a $20M farmout agreement with the oil company Pilatus Energy Canada, which is affiliated with the Company. During the next five years, this company could have earned a 70% interest over the four licences of the Bourque project by investing $20M in exploration and development work.

Unfortunately, the difficult economic situation in 2009 prevented Pilatus from meeting the obligations provided in the agreement with Pétrolia. The parties mutually agreed to terminate the partners' obligations provided in the initial agreement in exchange for a 5% interest in the project being granted to Pilatus.

As a result, Pétrolia has returned to actively pursuing the steps necessary to find a new partner to develop the project.

Anticosti property

The Company has acquired all of the rights belonging to Hydro-Québec on Anticosti Island. In return, a priority fee on future oil production will be paid to Hydro-Québec. Under this agreement, Pétrolia shares with Corridor Resources Inc. an interest of 25% in 6 licenses and of 50% in 29 exploration licences on the island and acts as operator over most of them. In June 2010, the Company participated in the drilling of three exploration wells and carried out a core drilling to evaluate the McCasty formation's potential as an oil shale reservoir.

Saint-Simon project

The Company held a 10% interest in the Saint-Simon well and the geological structure. In June 2010, the Saint-Simon project was the subject of a property swap with Junex. Since that date, Pétrolia no longer holds an interest in this property.

10. Deferred exploration expenses

	September 30, 2010	Additions	Exchange (Note 9)	September 30, 2009
	$	$	$	$
Quebec				
Anticosti	5,305,277	3,961,253	–	1,344,024
Gastonguay	73,473	26,971	–	46,502
Gaspésia–Edgar–Marcel-Tremblay	3,531,433	55,899	–	3,475,534
Gaspé	2,264,806	118,278	(728,799)	2,875,327
Bourque project	3,580,147	215,916	–	3,364,231
Haldimand project	9,383,853	3,052,652	–	6,331,201
Tar Point No. 1 project	4,699,028	4,521,888	–	177,140
Others	–	–	(102,707)	102,707
New Brunswick				
Dalhousie	1,111,708	26,405	–	1,085,303
	29,949,725	11,979,262	(831,506)	18,801,969
Less				
Exploration subsidies and partner contributions				
Anticosti	1,930,632	1,488,021	–	442,611
Gastonguay	18,415	7,732	–	10,683
Gaspésia–Edgar–Marcel-Tremblay	341,818	16,624	–	325,194
Gaspé	483,228	25,589	(5,185)	462,824
Bourque project	3,027,548	183,317	–	2,844,231
Haldimand project	2,170,519	869,333	–	1,301,186
Tar Point No. 1 project	626,494	564,479	–	62,015
Dalhousie	6,922	–	–	6,922
	8,605,576	3,155,095	(5,185)	5,455,666
Petroleum reservoir evaluation income				
Anticosti	–	–	–	–
Gastonguay	–	–	–	–
Gaspésia–Edgar–Marcel-Tremblay	–	–	–	–
Gaspé	–	–	–	–
Bourque project	–	–	–	–
Haldimand project	109,738	109,738	–	–
Tar Point No. 1 project	–	–	–	–
Dalhousie	–	–	–	–
	109,738	109,738	–	–
	21,234,411	8,714,429	(826,321)	13,346,303

10. Deferred exploration expenses (continued)

	September 30, 2009	Additions	September 30, 2008
	$	$	$
Quebec			
Anticosti	1,344,024	247,728	1,096,296
Gastonguay	46,502	14,433	32,069
Gaspésia–Edgar–Marcel-Tremblay	3,475,534	102,393	3,373,141
Gaspé	2,875,327	102,964	2,772,363
Bourque project	3,364,231	690,648	2,673,583
Haldimand project	6,331,201	3,541,753	2,789,448
Tar Point No. 1 project	177,140	177,140	–
Others	102,707	–	102,707
New Brunswick			
Dalhousie	1,085,303	971,185	114,118
	18,801,969	5,848,244	12,953,725
Less			
Exploration subsidies and partner contributions			
Anticosti	442,611	86,527	356,084
Gastonguay	10,683	5,051	5,632
Gaspésia–Edgar–Marcel-Tremblay	325,194	35,838	289,356
Gaspé	462,824	34,136	428,688
Bourque project	2,844,231	170,648	2,673,583
Haldimand project	1,301,186	1,239,613	61,573
Tar Point No. 1 project	62,015	62,015	–
Dalhousie	6,922	–	6,922
	5,455,666	1,633,828	3,821,838
	13,346,303	4,214,416	9,131,887

11. Loan

The Company has access to a bank loan authorized for $2,500,000; $2,243,310 of which has been drawn upon as at September 30, 2010, bearing interest at the Caisse centrale Desjardins prime rate plus 1%. The bank loan is guaranteed by a $2,500,000 mortgage on all of the Company's present and future debts and receivables, creating a priority claim on the reimbursable tax credits and future tax credits; it is also guaranteed by an 80% surety from Investissement Québec. The repayment of the principal is due during the next fiscal year.

12. Capital stock

Authorized

Unlimited number of common, participating, voting and no par value shares.

Issued

50,067,287 common shares.

Stock-based compensation

The Company has a stock option plan that allows it to grant a maximum of 10% of the shares issued to its directors, officers, key employees, and suppliers on an ongoing basis. The exercise price of each option corresponds to the market price or discounted market price on the day before the option was granted. Granted options cannot last more than five years. Options can be exercised immediately upon allocation for directors and according to a three-year vesting schedule for other participants.

During the fiscal year, the Company granted stock options, and the fair value of each allocated option was calculated using the Black-Scholes option pricing model with the following assumptions:

	2010	2009
	February	May
Risk-free interest rate	2.25%	2.25%
Expected volatility	102%	103%
Lifetime granted (years)	5	3 and 5
Rate of return of shares	Nil	Nil

Accordingly, the stock-based compensation was distributed as follows:

	2010	2009
	$	$
Statement of income	183,600	102,600
Deferred exploration expenses	7,125	7,125
Total	190,725	109,725

The following table summarizes information about the stock options:

	2010		2009	
	Number of options outstanding	Weighted average exercise price	Number of options outstanding	Weighted average exercise price
		$		$
Outstanding and exercisable, beginning of year	4,090,000	0.58	3,907,500	0.58
Granted	270,000	0.89	230,000	0.74
Exercised	(1,192,500)	0.43	–	–
Expired	(202,500)	1.03	(47,500)	0.91
Outstanding and exercisable, end of year	2,965,000	0.64	4,090,000	0.58

The weighted average of the fair values at the date of allocation is $0.89 (2009 – $0.74).

12. Capital stock (continued)

As at September 30, 2010, the stock options granted as part of the Plan are allocated as follows:

Weighted average exercise price	Number	Weighted average remaining years	Expiration date
$			
0.40	675,000	0.3	February 3, 2011
0.58	150,000	0.6	May 10, 2011
0.74	50,000	1.7	May 21, 2012
0.40	662,500	1.8	June 21, 2012
0.60	400,000	2.3	February 12, 2013
0.60	150,000	2.4	March 3, 2013
1.25	427,500	2.8	July 7, 2013
0.74	180,000	3.7	May 21, 2014
0.89	270,000	4.4	February 25, 2015

Warrants

Outstanding warrants can be exercised as follows:

Exercise price	Number	Expiration date
$		
1.50	3,333,332	December 6, 2010
1.30	2,163,161	December 4, 2011
1.00	1,750,000	October 10, 2012
1.00	3,000,000	January 10, 2013

13. Future income taxes

The Company's effective tax rate differs from the combined statutory rate (federal and provincial).

This difference is attributable to the following items:

	2010	2009
	$	$
Loss before income taxes	(1,793,404)	(1,615,108)
Income tax at combined statutory rate of 28.4% (2009 – 30.9%)	(509,327)	(499,069)
Capital cost allowance on issuance costs	(89,696)	–
Stock-based compensation	52,142	31,703
Revaluation of future tax debits and credits	145,768	(382,050)
Non-deductible expenses and others	25,240	21,115
Non-taxable portion of capital gain	(62,423)	–
Difference due to the rate change	(67,465)	–
Unrealized capital loss	70,886	68,104
	(434,875)	(760,197)

13. Future income taxes (continued)

Future tax assets and liabilities come from differences between the tax value and the book value of the following items:

	2010	2009
	$	$
Future tax assets:		
Deferred losses	(1,396,141)	(1,114,117)
Share issuance costs	(194,865)	(162,775)
Others	(37,883)	(29,693)
	(1,628,889)	(1,306,585)
Future tax liabilities:		
Investment	–	76,508
Properties	28,373	30,871
Deferred exploration expenses	2,924,099	2,112,755
	2,952,472	2,220,134
Net future tax liabilities	1,323,583	913,549

As at September 30, 2010, the tax losses likely to reduce future taxes and having tax benefits that have been recorded are approximately $5,196,545 on the federal level and $4,526,554 on the provincial level. The Company may use the tax benefit resulting from the carry-over of these losses before:

	Federal	Provincial
	$	$
2014	8,618	6,776
2015	351,319	287,294
2026	574,450	440,410
2027	648,473	514,153
2028	660,423	524,691
2029	1,367,495	1,235,683
2030	1,585,767	1,517,547

14. Commitments

Under the terms of exploration licences granted by Quebec's Ministry of Natural Resources and Wildlife and New Brunswick's Ministry of Natural Resources, the Company has agreed to pay fees in the amount of $622,266 between now and 2013. The minimum payments due during the upcoming fiscal years are as follows:

2011	2012	2013
$209,776	$206,245	$206,245

In addition, the Company must perform work on its properties, on a yearly basis, for which the minimum costs vary according to the age of the licences; therefore, they correspond to $0.50 per hectare for the first year of the licence and increase annually by $0.50, ultimately reaching $2.50 per hectare beginning with the fifth year. The minimum work to be initiated is $135,398 in 2011, $968,687 in 2012, $665,747 in 2013, and $840,943 in 2014.

The Company has entered into a lease until 2012 for the rental of offices and a house with four companies. The balance of the commitments under these leases, excluding escalation clauses, is $84,686, $11,900 of which is payable to a company in which a director holds a minority interest.

The minimum payments required over the coming years are as follows:

2011	2012
$81,186	$3,500

15. Contingencies

Financing

The Company is partially financed through the issuance of flow-through shares and has fulfilled all of its commitments related to the exploration work to be performed. However, even though the Company took all necessary measures for this purpose, there is no guarantee that all of the funds spent by the Company with regard to these shares will be declared acceptable by the tax authorities in the event that they conduct an audit. The rejection of certain expenses by the tax authorities may then have negative tax consequences for investors.

Guarantee

The Company assumes potential liability in guaranteeing a lease with a term of five years for $258,342. The lease will expire on May 31, 2014. As at September 30, 2010, the remaining amount of the guarantee is $202,983. It is currently impossible to assess the amount that the Company may be called upon to honour if the tenant defaults.

Environment and guarantee letter

The Company's operations are subject to governmental legislation regarding environmental protection. Environmental consequences are difficult to identify, whether in terms of outcome, timetable, or impact. To the best of Management's knowledge, the Company is currently operating in accordance with existing laws and regulations. Nevertheless, as at September 30, 2010, a site restoration provision has been recorded in the amount of $50,000 and irrevocable guarantee letters in the amount of $530,000 in favour of the Ministry of Natural Resources were issued to ensure that the wells will be close properly.

A guarantee letter of $224,331 in favour of Investissement Québec was also issued.

These guarantees letters are guaranteed by the guaranteed investment certificates for an equivalent amount (Note 7).

16. Related-party transactions

Transactions were made with two companies whose main officer, holding a minority interest, is also a director of Pétrolia Inc.:

	2010	2009
	$	$
Balance sheet:		
Deferred exploration expenses	51,532	76,068
Statement of income:		
Salaries and fringe benefits	938	–
Write-off of a receivable	–	62,205
Other expenses	11,847	8,668

As at September 30, 2010, an amount of $35,915 is due from these companies (2009 – $57,852).

Transactions were carried out with a director who acts as a consultant for the Company:

	2010	2009
	$	$
Balance sheet:		
Deferred exploration expenses	22,905	47,421

The balance due to this director is $0 as at September 30, 2010 (2009 – $1,195).

16. Related-party transactions (continued)

The Company made the following transactions with a company with the same chief executive officer:

	2010	2009
	$	$
Balance sheet:		
Deferred exploration expenses	–	64,000
Statement of income:		
Salaries and fringe benefits	101,724	276,724
Office supplies	2,600	3,632
Telecommunications	5,322	6,086

The balance due to this company is $161 as at September 30, 2010 (2009 – $16,179).

These transactions occurred in the normal course of business and are valued at the exchange value, which is the amount of the established consideration accepted by the related parties.

17. Additional cash flow information

Items not affecting cash and cash equivalents related to financing and investing activities are as follows:

	2010	2009
	$	$
Receivables related to deferred exploration expenses	(1,158,284)	553,727
Stock-based compensation related to deferred exploration expenses	7,125	7,125
Payables and accrued expenses related to deferred exploration expenses	(902,635)	(1,157,758)
Payables and accrued expenses related to tangible fixed assets	5,390	–
Future taxes related to share issuance costs	844,909	–

18. Events subsequent to the balance sheet date

On December 20, 2010, the Company signed final agreements with Québénergie Inc. (a subsidiary of Investcan) for the sale of 50% of its interest in the Haldimand discovery and in 13 licences surrounding the discovery for a total of $15,190,000. A sum of $6,690,000 was paid in cash, and $8,500,000 in exploration work will be carried out by Québénergie Inc. over the next two years.

19. Comparative figures

Certain comparative figures have been reclassified to make them consistent with the presentation adopted during the 2010 fiscal year.

For the fiscal year ended September 30	2010	2009
	$	$
A- Administrative expenses		
Stock-based compensation (Note 12)	183,600	102,600
Salaries and fringe benefits	599,801	391,031
Insurance	53,146	49,946
Travel	112,407	67,722
Maintenance and office supplies	52,532	17,937
Board of directors expenses	137,869	116,687
Information for shareholders	84,231	62,923
Rent	35,457	27,998
Promotion and entertainment	126,717	99,433
Write-off of a receivable	–	62,206
Professional fees	219,497	67,332
Capital tax	60,505	220,124
Telecommunications	18,885	16,246
Depreciation of tangible fixed assets	51,929	37,714
Other expenses	23,327	39,053
	1,759,903	1,378,952
B- General expenses		
Salaries and fringe benefits	999,763	713,174
Insurance	2,203	1,905
Travel	8,148	16,784
Maintenance and office supplies	32,946	22,342
Training	4,797	9,072
Rent	72,645	74,314
Professional fees	–	4,241
Telecommunications	8,380	8,081
Depreciation of tangible fixed assets	21,318	23,196
Other expenses	2,747	11,896
Allocation to deferred exploration work	(1,152,947)	(885,005)
	–	–

Pétrolia

BOARD OF DIRECTORS

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President and Chief Executive Officer

Vincent Causse
Director

Saeed Youssef
Director

Albert Wildgen
Director

Erick Adam
Director

Myron A. Tétreault
Director

Alain Ferland
Lead director

Jacques L. Drouin
Director

AUDITORS

Mallette, LLP
Chartered Accountants
Rimouski

LEGAL COUNSEL

Miller Thomson Pouliot LLP
Benoît Gascon, Attorney
Montréal

LISTED SHARES - TRANSFERT AGENT

Computershare Trust Company of Canada
Montréal

SHARES LISTED

TSX Venture Exchange
Symbol: PEA

CAPITAL STOCK

50,067,287 common shares issued
as at September 30, 2010

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The Annual Meeting of the Shareholders of Pétrolia will be held on Friday, February 25, 2011 at 10:00 a.m. at the Auberge Saint-Antoine (Auditorium room), 8 Saint-Antoine Street, Québec, Quebec G1K 4C9.

DESIGN AND REALIZATION

Propage

When Pétrolia came to me asking to drill a well on my property, I first had my doubts. I finally agreed for two reasons: the economic development potential for the region, and the fact that Pétrolia undertook to do things according to good engineering practice, while protecting the environment and the surrounding area. So far, Pétrolia has met all its commitments.

← English