Annual Report 2010

PÉTROLIA

Financial statements

Quebec's Leader in Oil Exploration

Promising Future

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.

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

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.

Appendix

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

André Proulx
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.