Quebec's Lender in Oil Exploration

together

2011

Annual Report

Financial statements

rigor

The criteria selected by Pétrolia for its drilling programs exceed current standards.

Independent auditor's report

To the shareholders of Pétrolia Inc.

We have audited the accompanying financial statements of Pétrolia Inc., which comprise the balance sheets as at September 30, 2011 and 2010, and the statements of income and comprehensive income, shareholders' equity, deferred exploration expenses and cash flows for the years then ended and a summary of significant accounting policies and other explanatory information.

Management's responsibility for the financial statements

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

Auditor's responsibility

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

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

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

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Pétrolia Inc. as at September 30, 2011 and 2010 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Mallette[1]
LLP
Chartered Accountants
Rimouski, Canada

December 5, 2011

[1] CA auditor permit No. 8832

Balance sheet

As at September 30	2011	2010
	$	$
ASSETS		
Current assets		
Cash and cash equivalents	8,151,034	1,949,055
Receivables (Note 6)	4,617,371	2,920,900
Inventories	61,619	–
Prepaid expenses	141,158	70,372
Investments collectable during the next fiscal year (Note 7)	930,000	754,331
	13,901,182	5,694,658
Tangible fixed assets (Note 8)	931,779	213,159
Oil and gas properties (Note 9)	3,148,005	3,852,629
Deferred exploration expenses (Note 10)	22,555,784	21,234,411
	40,536,750	30,994,857
LIABILITIES		
Current liabilities		
Payables and accrued expenses	1,469,518	822,339
Loan (Note 11)	2,243,310	2,243,310
Provision for future site restoration (Note 12)	135,500	–
	3,848,328	3,065,649
Deferred lease incentives	112,273	–
Provision for future site restoration (Note 12)	233,678	–
Future income taxes (Note 14)	2,239,130	1,323,583
	2,585,081	1,323,583
	6,433,409	4,389,232
SHAREHOLDERS' EQUITY		
Capital stock (Note 13)	33,314,786	28,288,874
Contributed surplus – Stock options	1,491,320	1,300,615
Contributed surplus – Expired stock options	903,797	783,366
Deficit	(1,606,562)	(3,767,230)
	34,103,341	26,605,625
	40,536,750	30,994,857

Agreements, commitments and contingencies (Notes 9, 15 and 16)

On behalf of the Board

(signed)
André Proulx, Director

(signed)
Jacques L. Drouin, Director

Statement of income and comprehensive income

Fiscal year ended September 30	2011	2010
	$	$
REVENUE		
Project management	44,854	1,781
Interest income	133,587	24,321
	178,441	26,102
OPERATING COSTS		
Administrative expenses (Appendix A)	2,261,057	1,759,903
General expenses (Appendix B)	–	–
	2,261,057	1,759,903
LOSS BEFORE OTHER ITEMS AND INCOME TAXES	(2,082,616)	(1,733,801)
OTHER ITEMS		
Change in the fair value of financial assets designated as held for trading	–	(59,603)
Gain on disposal of interest in certain licences	5,158,607	–
GAIN (LOSS) BEFORE INCOME TAXES	3,075,991	(1,793,404)
Future income taxes (Note 14)	915,323	(434,875)
NET GAIN (NET LOSS) AND COMPREHENSIVE INCOME	2,160,668	(1,358,529)
BASIC NET GAIN (NET LOSS) PER SHARE	0.042	(0.028)
DILUTED NET GAIN (NET LOSS) PER SHARE	0.041	(0.028)

Statement of shareholders' equity

	Capital stock		Contributed surplus			
			Stock options	Expired stock options	Deficit	Total
	Number	$	$	$	$	$
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 income 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
ISSUED DURING THE FISCAL YEAR						
Debt settlement	75,000	33,750	–	–	–	33,750
Warrants exercised	3,878,440	4,505,472	–	–	–	4,505,472
Stock options exercised	558,750	487,748	(189,072)	–	–	298,676
SHARE ISSUANCE COSTS						
Future income taxes	–	(224)	–	–	–	(224)
Others	–	(834)	–	–	–	(834)
OTHER ACTIVITIES						
Stock-based compensation	–	–	500,208	–	–	500,208
Expired stock options	–	–	(120,431)	120,431	–	–
Net gain	–	–	–	–	2,160,668	2,160,668
BALANCE AS AT SEPTEMBER 30, 2011	54,579,477	33,314,786	1,491,320	903,797	(1,606,562)	34,103,341

Statement of deferred exploration expenses

Fiscal year ended September 30	2011	2010
	$	$
EXPLORATION EXPENSES		
Analysis	3,103	7,022
Drilling	1,241,470	8,476,206
Geology	1,033,892	456,794
Geophysical surveys	573,889	236,578
Completion work	60,204	2,629,654
Oil reservoir evaluation	57,337	123,531
General exploration expenses	239,717	42,352
Site maintenance	266,445	–
Evaluation of resources	97,057	–
Stock-based compensation	41,325	7,125
	3,614,439	11,979,262
DEDUCTIONS		
Oil reservoir evaluation expenses	107,021	109,738
Expenses carried over to properties following the swap	–	826,321
Exploration subsidies	502,092	2,816,828
Partner contributions	1,683,953	338,267
	2,293,066	4,091,154
NET INCREASE IN EXPLORATION EXPENSES FOR THE FISCAL YEAR	1,321,373	7,888,108
BALANCE, BEGINNING OF YEAR	21,234,411	13,346,303
BALANCE, END OF YEAR	22,555,784	21,234,411

Statement of cash flows

Fiscal year ended September 30	2011	2010
	$	$
OPERATING ACTIVITIES		
Net gain (net loss)	2,160,668	(1,358,529)
Items not affecting cash		
Stock-based compensation	458,883	183,600
Depreciation of tangible fixed assets	126,114	73,247
Depreciation of deferred lease incentives	27,273	–
Future income taxes	915,323	(434,875)
Gain on disposal of interest in certain licences	(5,158,607)	–
Change in the fair value of financial assets designated as held for trading	–	59,603
	(1,470,346)	(1,476,954)
Net change in non-cash items related to operations	192,585	610,557
	(1,277,761)	(866,397)
FINANCING ACTIVITIES		
Raising of financing	–	2,243,310
Capital stock issuance	4,804,148	7,646,910
Share issuance costs	(834)	(477,495)
Cash lease incentive	85,000	–
	4,888,314	9,412,725
INVESTING ACTIVITIES		
Disposal of investments	–	915,597
Acquisition of investments	(175,669)	(754,331)
Acquisition of tangible fixed assets	(836,703)	(130,486)
Disposal of interest in certain licences	6,690,000	–
Expenses for disposal of interest in certain licences	(725,333)	–
Acquisition of oil and gas properties	(101,436)	(692,915)
Increase in deferred exploration expenses net of deductions	(2,259,433)	(10,768,222)
	2,591,426	(11,430,357)
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	6,201,979	(2,884,029)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	1,949,055	4,833,084
CASH AND CASH EQUIVALENTS, END OF YEAR	8,151,034	1,949,055
CASH AND CASH EQUIVALENTS ARE MADE UP OF THE FOLLOWING:		
Cash	695,699	448,055
Guaranteed investment certificate, collectable at any time, 2.4%, maturing in December 2012	4,100,000	–
Guaranteed investment certificate, collectable at any time, 1.75%, maturing in May 2013	3,354,331	–
Guaranteed investment certificate, collectable at any time, 1.6%, matured in September 2011	–	1,500,000
Money market fund	1,004	1,000
	8,151,034	1,949,055

Additional cash flow information: Note 18

Notes to financial statements

September 30, 2011

1. Instrument of incorporation and nature of activities

The Company, incorporated under Part IA of the *Québec Companies Act*, and governed by the provisions of the *Quebec Business Corporations 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

Basis of presentation

The financial statements are prepared using the historical cost method, except for certain financial instruments that are recognized at fair value. No information on fair value is presented when the carrying amount corresponds to a reasonable approximation of the fair value.

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.

Revenue recognition

Revenue from investments is recognized when it is earned. Project management revenue is recognized when the exploration work is carried out.

Inventories

Inventories are measured at the lower of cost and net realizable value using the average cost method.

Foreign currency conversion

Monetary assets and liabilities are converted at the rate of exchange at the balance sheet date. Revenue and expenses denominated in a foreign currency are recorded at the exchange rate in effect as at the date of the transaction. Exchange gains and losses are recorded in earnings.

Tangible fixed assets

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

	Method	Rate
Leasehold improvements	Straight line	3 years
Office and field equipment	Declining balance	20%
IT equipment and rolling stock	Declining balance	30%
Reservoirs	Declining balance	20%
Land	N/A	N/A

Notes to financial statements

September 30, 2011

Transaction costs – financial instruments

Transaction costs are recognized as operating expenses when they are incurred.

Oil and gas properties and deferred exploration costs

The Company follows the full-cost accounting method, whereby costs related to the acquisition, exploration and development of properties, less government subsidies and revenues from oil reservoir evaluations, are recorded by property until the beginning of commercial production. These costs include geological and geophysical costs, the cost of drilling productive and non-productive wells, direct overhead related to these activities, and provisions for future site restoration. If economically profitable hydrocarbon reserves are developed, the capitalized costs of the properties in question are transferred to tangible fixed assets and amortized based on the production units for the fiscal year as a proportion of proven and probable crude oil and natural gas reserves. If it is determined that capitalized acquisition, exploration, and development costs are not recoverable over the estimated life of the property, or if the project is abandoned, the project is written down to its net realizable value.

The recovery of amounts recorded for properties and the related deferred exploration costs depends on the discovery of economically recoverable reserves, the ability of the Company to obtain the necessary financing to complete the development, and on future profitable production or alternatively, on the sufficiency of proceeds from disposal. The amounts recorded for oil and gas properties and deferred exploration expenses do not necessarily represent present-time or future value. Lastly, its activities are subject to governmental regulation.

Site restoration costs

The Company recognizes the fair value of a future obligation associated with the provision for future site restoration as a liability in the period in which it is incurred and when a reasonable estimate of the fair value can be made. The fair value is capitalized and amortized over the same period as the underlying asset. The Company estimates the liability based on the estimated cost to abandon and reclaim a site in relation to its net ownership interest in the wells and facilities, including the estimated schedule of costs that will be incurred to this end in future periods. This estimate is periodically reviewed and changes are recorded prospectively as an increase or decrease in liability. Changes in the net present value of the future liability associated with site restoration are accrued pro rata to the time elapsed. Actual site restoration costs are charged to the accumulated provision as incurred.

Joint activities

The Company conducts certain oil and gas 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, subsidies for exploration costs 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 were forfeited in favour of investors. According to the tax liability method related to the recognition of income taxes, future taxes related to differences occurring at the time of the forfeiture were recorded with a corresponding charge to share issuance expenses.

Basic and diluted net loss or gain per share

Net gain or 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 net loss per share.

The diluted net gain per common share is calculated using the treasury stock method to evaluate the dilutive effect of stock options and warrants. Under this method, instruments with a dilutive effect, i.e. when the average market price of a share for the period exceeds the exercise price, are considered to have been exercised at the beginning of the period (or at the time of issuance if later) and the proceeds received are considered to have been used to redeem common shares of the Company at the average market price for the period.

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.

Comprehensive income

Comprehensive income is the change in equity of an enterprise arising from transactions and other events and circumstances from non-owner sources. It includes items that would not normally be included in net income such as unrealized gains and losses on available-for-sale investments.

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

International Financial Reporting Standards

The Accounting Standards Board (AcSB) of Canada has confirmed that effective January 1, 2011, International Financial Reporting Standards (IFRS) will replace Canadian generally accepted accounting principles (GAAP) for publicly accountable enterprises. IFRS will apply to fiscal years beginning on or after January 1, 2011.

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

The standard-setting bodies that promulgate Canadian GAAP and the IFRS have significant ongoing projects that could affect the ultimate differences between Canadian GAAP and IFRS and their impact on the Company's financial reports in future years. The future impact of IFRS will also depend on the particular circumstances prevailing in those years.

Notes to financial statements

September 30, 2011

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, 2011, the balance sheet date:

Credit risk

Financial instruments that potentially expose 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 governments and from partners. Therefore, Management considers the risk of non-performance on these instruments as minimal.

Maximum credit risk exposure:

	2011	2010
	$	$
Cash	695,699	448,055
Money market fund	1,004	1,000
Guaranteed investment certificates	8,384,331	2,254,331
Receivables	4,617,371	2,920,900
	13,698,405	5,624,286

Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due or do so only at excessive cost. The Company finances its growth through the issuance of shares and the sale of interests in some of its oil assets. One of Management's main financial objectives is to maintain an optimal level of liquidity by actively managing the exploration work to be performed. Considering the liquid resources at the Company's disposal, Management feels that the Company's exposure to liquidity risk is low.

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 as a result of changes in market conditions. There are three types of market 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 interest rate fluctuations 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, 2011, a 1% move in interest rates, with all other variables held constant, would have affected the net gain by $39,480.

The Company has a variable-rate bank loan. Consequently, it incurs interest rate risk based on fluctuations in the prime rate. As at September 30, 2011, a 1% move in interest rates, with all other variables held constant, would have affected the net gain by $16,399.

B) Other price risks

The Company is exposed to fluctuations in the price of oil and gas, as the price influences the potential profitability of the Company's oil and gas properties and therefore affects its exploration program and any decision whether to proceed with production.

Classification of financial instruments

Financial instruments are classified into one of the following five categories: held for trading, held to maturity, loans and receivables, available for sale, or other financial liabilities. The classification determines the accounting treatment of the instruments. The classification is determined by the Company when the financial instrument is initially recorded based on its underlying purpose.

The Company's assets and liabilities are classified and measured as follows:

Financial assets / liabilities	Category	Measurement
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 measured at amortized cost are initially recognized at fair value and then subsequently at amortized cost with gains and losses recognized in the statement of income the period in which the gain or loss occurs. Changes in the fair value of financial instruments classified as held for trading are recorded in the statement of income in the period in 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.

Money market fund: The cost corresponds to the fair value because of their short-term maturity date.

For long-term debt, the book value approximates their fair value because of the variable interest rate on the debt.

Notes to financial statements

September 30, 2011

4. Financial instrument disclosures (continued)

Fair value hierarchy

Financial instruments recorded at fair value on the balance sheet are classified using a fair value hierarchy that reflects the significance of the inputs used in making the measurements.

The three levels of the fair value hierarchy are:

Level 1 – Valuation based on unadjusted quoted prices in active markets for identical assets or liabilities: Level 1 consists of cash;

Level 2 – Valuation techniques using inputs other than quoted prices that are observable for the asset or liability either directly (i.e. as prices) or indirectly (i.e. derived from prices). Cash equivalents and investments are classified in Level 2.

Level 3 – Valuation techniques using inputs that are not based on observable market data (unobservable inputs).

The fair value hierarchy requires the use of observable market inputs whenever such inputs exist. A financial instrument is classified in the lowest level of the hierarchy for which a significant input has been considered in measuring fair value.

For the fiscal year, no financial assets were transferred between levels 1 and 2.

The fair value of financial instruments is summarized as follows:

	2011		2010	
	Book value $	Fair value $	Book value $	Fair value $
Financial assets held for trading:				
Cash and cash equivalents	8,151,034	8,151,034	1,949,055	1,949,055
Investments	930,000	930,000	754,331	754,331
Loans and receivables:				
Receivables	4,617,371	4,617,371	2,920,900	2,920,900
Other financial liabilities:				
Payables and accrued expenses	1,469,518	1,469,518	822,339	822,339
Loan	2,243,310	2,243,310	2,243,310	2,243,310

5. Capital management

The Company's capital management objective is to preserve its ability to continue its exploration activities. The Company includes shareholders' equity and loans in its definition of capital. Management reviews its capital management approach on an ongoing basis and believes that this approach is reasonable considering the Company's size.

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.

There were no changes in the Company's capital management objectives, policies and procedures during the year.

The Company is subject to the following externally exposed capital requirements:

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

As at September 30, 2011, the Company is meeting all of its financial commitments.

6. Receivables

	2011	2010
	$	$
Partners	981,613	–
Consumer tax credits	41,847	24,210
Tax credits	3,318,935	2,816,842
Interest	114,763	2,512
Others	160,213	77,336
	4,617,371	2,920,900

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

7. Investments

	2011	2010
	$	$
Guaranteed investment certificates, 1.68%, collectable beginning in July 2011 and maturing in July 2012	–	530,000
Guaranteed investment certificate, 1.60%, collectable at any time and maturing in September 2012	–	224,331
Guaranteed investment certificate, 2.40%, collectable at any time and maturing in December 2012	480,000	–
Guaranteed investment certificate, 1.752%, collectable at any time and maturing in May 2013	450,000	–
	930,000	754,331
Portion collectable during the next fiscal year	930,000	754,331
	–	–

Notes to financial statements

September 30, 2011

8. Tangible fixed assets

	2011			2010		
	Cost	Accumulated depreciation	Net book value	Cost	Accumulated depreciation	Net book value
	$	$	$	$	$	$
Leasehold improvements	565,179	65,807	499,372	18,387	16,831	1,556
IT and office equipment	266,809	96,046	170,763	160,040	60,713	99,327
Rolling stock	236,187	157,594	78,593	236,187	123,911	112,276
Reservoirs	115,739	8,122	107,617	–	–	–
Land	75,434	–	75,434	–	–	–
	1,259,348	327,569	931,779	414,614	201,455	213,159

9. Oil and gas properties

	2011	2010
	$	$
Quebec		
Anticosti[1]	296,297	259,970
Gastonguay	664,398	638,497
Gaspésia – Edgar – Marcel-Tremblay	404,933	382,915
Gaspé[1]	1,635,540	2,427,941
New Brunswick		
Dalhousie	146,837	143,306
	3,148,005	3,852,629

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

Gaspé properties

In May 2008, the Company acquired a 100% interest on 6,043 km² of these properties (excluding the Haldimand property), subject to a royalty varying from 0.5% to 2.5% of the future oil and gas production. In June 2010, the Company carried out an asset swap, bringing its interest to 100% in all the licences, i.e. an area of 150 km², with the exception of a 9-km² zone where its interest is 64% (Haldimand project). 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.

Haldimand property

On May 6, 2008, a second agreement set the boundaries of a development area of 9 km² around the Pétrolia Haldimand No. 1 well in which Pétrolia holds a 45% interest, Junex 45%, and Gastem 10%. Some of the licences to these properties are subject to 5% royalties. Under an amendment to the original agreement signed on July 22, 2009, Pétrolia became the operator of the entire 9 km² development area. On October 1, 2009, Pétrolia acquired all of Gastem's interests. Following its decision not to participate in the drilling of a second well, Junex's participation was reduced by 9%. Following the signature of final agreements for the sale of 50% of its interest in the Haldimand discovery, Pétrolia's interest in Haldimand is now 32%, Québénergie's 32%, and Junex's 36%.

Since it did not participate in some of the exploration work on Haldimand deposits 1 and 2, Junex is subject to a heavy penalty. As a result, Pétrolia and Québénergie will share all the revenue from these two deposits until the penalty is paid in full.

Bourque property

The Company had signed a $20 million farm-out agreement with the oil company Pilatus Energy Canada, which is affiliated with the Company. By investing $20 million in exploration and development work, Pilatus could have acquired a 70% interest in the four licences of the Bourque project during the next five years.

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

As a result, Pétrolia has returned to actively looking for a new partner to develop the project.

Anticosti property

The Company has acquired all of Hydro-Québec's rights on Anticosti Island. In return, a priority royalty 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 licences 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 extracted a core sample from the Macasty formation to evaluate its potential as an oil shale reservoir. Once the coring results are obtained, the Company plans to invest in development work to better estimate the oil potential on Anticosti Island.

Notes to financial statements

September 30, 2011

10. Deferred exploration expenses

	2011 September 30 $	Additions $	2010 September 30 $
Quebec			
Anticosti	6,341,925	1,036,648	5,305,277
Gastonguay	74,638	1,165	73,473
Gaspésia – Edgar – Marcel-Tremblay	3,730,267	198,834	3,531,433
Gaspé	2,450,597	185,791	2,264,806
Bourque project	3,668,983	88,836	3,580,147
Haldimand project	11,198,581	1,814,728	9,383,853
Tar Point No.1 project	4,955,679	256,651	4,699,028
New Brunswick			
Dalhousie	1,143,494	31,786	1,111,708
	33,564,164	3,614,439	29,949,725
Less			
Exploration subsidies and partner contributions			
Anticosti	2,280,008	349,376	1,930,632
Gastonguay	18,796	381	18,415
Gaspésia – Edgar – Marcel-Tremblay	411,354	69,536	341,818
Gaspé	550,176	66,948	483,228
Bourque project	3,060,535	32,987	3,027,548
Haldimand project	3,667,265	1,496,746	2,170,519
Tar Point No. 1 project	796,565	170,071	626,494
Dalhousie	6,922	–	6,922
	10,791,621	2,186,045	8,605,576
Oil reservoir evaluation income			
Anticosti	–	–	–
Gastonguay	–	–	–
Gaspésia – Edgar – Marcel-Tremblay	–	–	–
Gaspé	–	–	–
Bourque project	–	–	–
Haldimand project	216,759	107,021	109,738
Tar Point No.1 project	–	–	–
Dalhousie	–	–	–
	216,759	107,021	109,738
	22,555,784	1,321,373	21,234,411

	2010			2009
	September 30	Additions	Exchange (Note 9)	September 30
	$	$	$	$
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
Oil 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

Notes to financial statements

September 30, 2011

11. Loan

The Company has access to an authorized bank loan of $2,500,000, of which $2,243,310 has been drawn upon as at September 30, 2011, 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 accounts receivable, 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. Provision for future site restoration

Management calculates provisions for future site restoration based on the Company's net share of the estimated costs of abandoning and reclaiming its wells and facilities and the schedule of estimated future costs.

As at September 30, 2011, the estimated amount required to settle site restoration obligations, indexed at 3.5%, was $369,178. Of this amount, $135,500 will be settled over the next fiscal year. The total future amount was discounted at the weighted average rate of 5.25% over a 1- to 30-year period. The estimated undiscounted cash flows required to settle the obligations is $436,000.

The following table sets out the provision for future site restoration:

	2011	2010
	$	$
Balance, beginning of year	–	–
Incurred liabilities	369,178	–
Balance, end of year	369,178	–
Portion of liability to be settled during next fiscal year	135,500	–
	233,678	–

13. Capital stock

Authorized

Unlimited number of common, participating, voting shares without par value.

Issued

54,579,477 (2010 – 50,067,287) common shares.

Stock-based compensation

The Company has a stock option plan for its directors, officers, key employees and suppliers. The maximum number of shares reserved for issuance under the stock option plan is 10%. The exercise price is the market price or discounted market price on the day before the option was granted. The maximum term of granted options may not exceed five years. Options may be exercised immediately upon allocation for directors and according to a three-year vesting schedule for other participants.

The following table summarizes the assumptions used with the Black-Scholes valuation model for the determination of the stock-based compensation for the stock options granted during the year ended September 30, 2011:

	2011		2010	
	May	February	December	February
Risk-free interest rate	3%	3%	3%	2.25%
Expected volatility	94%	94%	94%	102%
Lifetime granted (years)	5	5	5	5
Rate of return of shares	Nil	Nil	Nil	Nil

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

	2011	2010
	$	$
Statement of income	458,883	183,600
Deferred exploration expenses	41,325	7,125
Total	500,208	190,725

Notes to financial statements

September 30, 2011

13. Capital stock (continued)

The outstanding options and the activity relating to these options are as follows:

	2011		2010	
	Number of options outstanding	Weighted average exercise price $	Number of options outstanding	Weighted average exercise price $
Outstanding, beginning of year	2,965,000	0.64	4,090,000	0.58
Granted	1,495,000	0.94	270,000	0.89
Exercised	(558,750)	0.53	(1,192,500)	0.43
Expired	(625,000)	0.40	(202,500)	1.03
Outstanding, end of year	3,276,250	0.84	2,965,000	0.64

The weighted average fair value of options granted during the year was $0.59 (2010 – $0.68).

As at September 30, 2011, the number of exercisable options was 2,198,750 (2010 – 2,965,000) at a weighted average exercise price of $0.80 (2010 - $0.64).

As at September 30, 2011, the stock options granted as part of the Plan are allocated as follows:

Weighted average exercise price $	Number	Weighted average remaining years	Expiration date
0.74	21,250	0.7	May 21, 2012
0.40	547,500	0.8	June 21, 2012
0.60	400,000	1.3	February 12, 2013
0.60	125,000	1.4	March 3, 2013
1.25	427,500	1.8	July 7, 2013
0.74	120,000	2.7	May 21, 2014
0.89	270,000	3.4	February 25, 2015
0.50	790,000	4.2	December 8, 2015
1.31	75,000	4.4	February 25, 2016
1.69	500,000	4.6	May 18, 2016

Warrants

Outstanding warrants can be exercised as follows:

Exercise price $	Number	Expiration date
1.30	264,721	December 4, 2011

14. Future income taxes

The Company's effective tax rate differs from the combined statutory rate (federal and provincial). The difference is attributable to the following items:

	2011	2010
	$	$
Gain (loss) before income taxes	3,075,991	(1,793,404)
Income tax at combined statutory rate of 26.9% (2010 – 28.4%)	827,442	(509,327)
Capital cost allowance on issuance costs	(68,563)	(89,696)
Stock-based compensation	123,439	52,142
Revaluation of future tax assets and liabilities	85,349	145,768
Non-deductible expenses and others	13,356	25,240
Non-taxable portion of capital gain	–	(62,423)
Difference due to the rate change	(65,700)	(67,465)
Unrealized capital loss	–	70,886
	915,323	(434,875)

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

	2011	2010
	$	$
Future tax assets:		
Deferred losses	(1,229,491)	(1,396,141)
Share issuance costs	(116,233)	(194,865)
Others	(29,263)	(37,883)
	(1,374,987)	(1,628,889)
Future tax liabilities:		
Properties	846,814	28,373
Deferred exploration expenses	2,767,303	2,924,099
	3,614,117	2,952,472
Net future tax liabilities	2,239,130	1,323,583

As at September 30, 2011, fiscal losses available to reduce future taxes and for which tax benefits have been recorded amount to approximately $4,866,028 and $4,196,595 at the federal and provincial levels respectively. The expiration dates of the losses carried forward are as follows:

	Federal	Provincial
	$	$
2015	14,675	–
2026	574,450	389,776
2027	648,473	514,153
2028	660,423	524,691
2029	1,367,495	1,235,683
2030	1,600,512	1,532,292

Notes to financial statements

September 30, 2011

15. Commitments

Under the terms of exploration licences granted by Quebec's Ministry of Natural Resources and Wildlife and the New Brunswick Ministry of Natural Resources, the Company has agreed to pay fees in the amount of $401,000 between now and 2013. The minimum payments due during the upcoming fiscal years are as follows:

2012	2013
$	$
200,500	200,500

In addition, the Company must undertake work on its properties in Quebec on a yearly basis, for which the minimum costs vary with the age of the licences; the cost is $0.50 per hectare for the first year of the licence and increases annually by $0.50, ultimately reaching $2.50 per hectare for the fifth year. The minimum work to be initiated is $586,485 in 2012, $653,983 in 2013 and $875,311 in 2014.

The adoption of Bill 18 in Quebec suspends some of these statutory work obligations for up to three years while at the same time extending the validity of all the licences for the same period. Pétrolia may, however, still continue its activities despite the suspended obligation.

The Company has signed leases with four companies for the rental of offices and a house until 2016. The balance of the commitments under these leases, excluding escalation clauses, is $1,284,545 of which $5,000 is payable to a company in which a director holds a minority interest.

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

2012	2013	2014	2015	2016
$	$	$	$	$
275,306	275,247	275,247	275,247	183,498

The Company has undertaken to support the renewal of the NSERC-Anticosti Forest Products Industrial Research Chair by contributing $200,000 over a five-year period. A portion of these costs could potentially be assumed by a partner.

The minimum payments due over the next five years are as follows:

2012	2013	2014	2015	2016
$	$	$	$	$
40,000	40,000	40,000	40,000	40,000

16. Contingencies

Financing

The Company is partially financed through the issuance of flow-through shares and has fulfilled all of its commitments in respect of future exploration work. 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 respect to these shares will be qualified by the tax authorities in the event that they conduct an audit. The rejection of certain expenses by the tax authorities may have negative tax consequences for investors.

Environment and letter of guarantee

The Company's operations are subject to environmental protection legislation. 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. Letters of guarantee in the amount of $930,000 were issued in favour of the Ministry of Natural Resources and Wildlife to guarantee that certain sites will be shut down.

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

17. Related-party transactions

The Company entered into transactions with two companies whose main officer, holding a minority interest, is also a director of Pétrolia:

	2011	2010
	$	$
Balance sheet:		
Deferred exploration expenses	–	51,532
Statement of income:		
Salaries and benefits	–	938
Other expenses	9,426	11,847

As at September 30, 2011, an amount of $37,500 is due from these companies (2010 – $35,915).

The Company entered into transactions with a director who acts as a consultant for the Company:

	2011	2010
	$	$
Balance sheet:		
Deferred exploration expenses	3,469	22,905

The balance due to this director is $0 as at September 30, 2011 (2010 – $0).

The Company entered into the following transactions with a company whose director also sits on Pétrolia's board:

	2011	2010
	$	$
Statement of income:		
Salaries and benefits	20,438	101,724
Office supplies	1,208	2,600
Telecommunications	–	5,322

The balance due from this company as at September 30, 2011 is $2,516 (2010 – balance due of $161).

The Company entered into the following transactions with a close relative of Management, who provided services to the Company:

	2011	2010
	$	$
Balance sheet:		
Tangible fixed assets	49,021	–

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.

Notes to financial statements

September 30, 2011

18. Additional cash flow information

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

	2011	2010
	$	$
Receivables related to deferred exploration expenses	(1,578,519)	(1,158,284)
Stock-based compensation related to deferred exploration expenses	41,325	7,125
Payables and accrued expenses related to deferred exploration expenses	229,956	(902,635)
Payables and accrued expenses related to tangible fixed assets	8,031	5,390
Future taxes related to share issuance costs	224	844,909
Shares issued for debt	33,750	–

Cash flows related to operating activities include interests paid in the amount of $84,470 (2010 – $0).

19. Events subsequent to the balance sheet date

On October 5, 2011, a motion for compensatory and punitive damages was filed against the Company as part of proceedings that had been instituted by Pétrolia against Ugo Lapointe and *Le Soleil* newspaper. The amount of the suit is estimated at $400,000. The Company intends to contest the demands made in the motion.

20. Comparative figures

Certain comparative figures have been reclassified to conform with the current year's presentation.

Appendices

For the fiscal year ended September 30	2011	2010
	$	$
A - ADMINISTRATIVE EXPENSES		
Stock-based compensation (Note 13)	458,883	183,600
Salaries and benefits	717,137	599,801
Insurance	52,546	53,146
Travel	134,940	112,407
Maintenance and office supplies	64,329	52,532
Board of directors expenses	141,546	137,869
Information for shareholders	74,493	84,231
Rent	105,395	35,457
Promotion and entertainment	121,421	126,717
Professional fees	177,335	219,497
Capital tax	3,000	60,505
Telecommunications	15,095	18,885
Loan interest	89,201	2,458
Depreciation of tangible fixed assets	69,362	51,929
Other expenses	36,374	20,869
	2,261,057	1,759,903

For the fiscal year ended September 30	2011	2010
B - OPERATING EXPENSES		
Stock-based compensation (Note 13)	41,325	7,125
Salaries and benefits	875,685	999,763
Insurance	2,913	2,203
Travel	38,830	8,148
Maintenance and office supplies	32,265	32,946
Training	21,414	4,797
Rent	65,109	72,645
Professional fees	9,144	–
Telecommunications	9,548	8,380
Depreciation of tangible fixed assets	56,752	21,318
Other expenses	6,777	2,747
Allocation to deferred exploration work	(1,159,762)	(1,160,072)
	–	–

Pétrolia

Board of directors

André Proulx
President and Chief Executive Officer

David Mc Callum
Director

Albert Wildgen
Director

Erick Adam
Director

Myron A. Tétreault
Administrateur

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

54,579,477 common shares issued
as at September 30, 2011

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Français ›

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