PÉTROLIA

Quebec's Leader in Oil Exploration

together

2011

Annual Report

Management discussion

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The birth of Quebec's oil and gas industry is an opportunity to build together a more environmentally responsible industry.

independence and solidarity

The ability to meet our own needs by exploiting our oil and gas resources is an act of international solidarity.

A word from the President

Pétrolia is the only active oil and gas exploration company in Quebec to see its stock price go up this past year.

The announcement of the analytical results of the cored interval taken from the Chaloupe well in summer 2010 and the assessment of the total petroleum initially in place in the Macasty shale on Anticosti Island are behind the increase in Pétrolia' stock price and was by far the greatest highlight of the last year. This immense potential attracted the attention of the Quebec media, but more importantly, placed Pétrolia on the radar screens of both national and international investors.

In a context of uncertainty that has driven down the principal stock markets, this increase shows that Pétrolia's potential is being recognized, as well as the value of its territories and the wisdom of the choices made in the last few years. In fact, Pétrolia is the only active oil and gas exploration company to see its stock price go up this past year.

Haldimand a top priority

Despite the interest sparked by the Macasty shale, developing Haldimand is still our immediate priority. The work performed this past year has give us a better understanding of the reservoir and its production mechanism, with the result that we can now anticipate commercial production from the Haldimand No. 3 well and achieve our goal to move to the production stage. We acquired tremendous knowledge this year that paves the way to work that could be decisive for the Company.

While it may not be a world-class discovery, the deposit nevertheless holds at least 8 million recoverable barrels. The anticipated success of this well will allow us to develop reserves, generate a stable revenue stream and establish Pétrolia as a credible oil producer. Haldimand can be said to be the catalyst that will speed up Pétrolia's development. At the time of writing, the Ministry of Natural Resources and Wildlife (MRNF) was studying our application for a licence. We will drill the third well once we have the licence and the equipment becomes available.

Relaunch of the Bourque property

This past year we relaunched the Bourque property. The type of targets involved on this property and its production potential could take Pétrolia to new heights.

Two structures have been identified on the property and both are at the drilling phase. The first consists of a pinnacle reef while the second is more like a barrier reef. The Company would like to drill these two structures as soon as possible and is working hard to secure financing for the two wells. However, our priority is to find a balance between risk and return for our shareholders.

We submitted two drilling permit applications to the MRNF at the end of the fiscal year, which were being studied at the time this report was prepared. We have gone to great lengths to place ourselves in a position of control so that we can act when the time is right, a position many would consider enviable.

Strengthening the team

This past year Pétrolia demonstrated its potential, deepened its knowledge and did what it had to do to obtain the necessary authorizations to develop its properties. Next year promises to be one of unprecedented development.

In view of this, Pétrolia has beefed up its technical and administrative expertise to allow it to manage this anticipated development.

Driven to get ahead

The knowledge and skills acquired, together with the drilling permit applications filed, demonstrate the Company's intention to be an economic development actor in Quebec. Today, Pétrolia stands out for its growth potential and willingness to act.

Quebec's oil potential is a formidable development tool that is all the more attractive because it is located in areas where economic development is lacking in many respects. As it stands today, Pétrolia can play a leading role in developing this potential. More than ever, we have the means and resources to become Quebec's foremost oil producer.

André Proulx, president of the Company

From explorer to producer

Quebec's oil potential is a formidable development tool and more than ever, the Company has the means and resources to become Quebec's foremost oil producer.

Vision

Founded in 2003, Pétrolia is proud of its Quebec and regional roots. Our goal is to meet the province's oil needs by tapping into its resources. Pétrolia aspires to become a fully-fledged oil company and in so doing become a key player in the economic development of Eastern Quebec.

To this end, Pétrolia feels strongly about keeping an ownership interest of over 50% in its licences. We are adamant in this regard for two reasons: first, it allows us to maximize shareholder return, and second, social acceptance is easier to come by if Quebec controls the resource.

From its early days, Pétrolia focused on oil prospecting and to this end acquired licences covering over 14,000 km^2. These licences account for more than 70% of Quebec's land petroleum potential.

The discovery of the Haldimand deposit, the relaunch of the Bourque project, where two structures are ready for drilling, and the confirmation of the oil potential of the Macasty shale, among other things, all seem to indicate that Quebec could be self-sufficient for its oil needs. With rising oil demand and prices, there is immense potential for creating wealth by developing Quebec's oil resources.

Respect for the environment and communities where it works are fundamental values at Pétrolia.

As it prepares to move to production, Pétrolia is more determined than ever to achieve its goal.

listening for better integration

The communities have a right to complete, transparent information and assurance that the work will be performed following the best industry practices.

against the tide

Pétrolia is the only active oil and gas exploration company in Quebec to maintain an unrelenting level of activity despite the current economic and political climate.

The year in review

The announcement of the analytical results of the cored interval taken from the Macasty shale and the assessment of its oil potential drew attention to Pétrolia's stock, pushing up its price.

Since this immense potential has barely been tapped, the Company endeavoured to craft a development plan and a financing strategy to ensure its implementation.

At the same time, Pétrolia stepped up its efforts on projects more likely to generate revenues in the near term and to transform the Company into a fully fledged oil producer in keeping with the objective it had set for itself and approved by its shareholders.

Haldimand property

The development of Haldimand, whose recoverable petroleum initially-in-place is estimated at 8 million barrels, is Pétrolia's best bet to quickly achieve this rank. Bringing a first deposit into production is the first step towards establishing a fully-fledged oil company capable of taking charge of its development. Tremendous efforts were made to understand the reservoir and its production system with a view to embarking on another round of drilling and maximizing the chances of success.

This work greatly increased the Company's understanding of the Haldimand deposit. First thought to be an unconventional structure that would require stimulation, Haldimand now appears to be made up of fracture zones that favour the natural flow of oil to the well. This finding is all the more important as it means that conventional production methods can be used, which is what the Company prefers. That said, Pétrolia must proceed on the premise that stimulation will be required. If this turns out to be the case, all the work will be performed in accordance with applicable regulations.

The drilling permit application for Haldimand No. 3 well, which was being studied by the MRNF at the time this report was being prepared, was submitted based on this information. The well will be drilled horizontally in order to intercept as many fractures as possible and thereby maximize the well's productivity. Drilling will begin as soon as the licence is obtained and a drilling rig can get to the site. Pétrolia does not foresee any problems and the field should soon be in production, allowing us to evaluate the reserves.

Bourque property

The Bourque property is very important to Pétrolia and its shareholders in view of the size of the potential discoveries and the interest this would generate in the Company's other properties in the Gaspé region, characterized by similar geological conditions. Moreover, the targets are conventional, which plays in the Company's favour given the current situation. This property could also lead to substantial economic activity associated with raw material processing in a region that could use it.

At the close of the fiscal year ended September 30, 2011, Pétrolia submitted applications to the MRNF to drill two wells, one for each structure identified. The wells were designed to the highest industry standards. At the time of writing, these applications were being analyzed by the MRNF.

By its nature, the Bourque property calls for conventional drilling techniques. In light of the current context in Quebec, this fact will increase its chances of acceptance by the community and at the same time eliminate the delays associated with the government having to study the effects of fracturing.

As well, the Bourque property is located near the Haldimand deposit, which makes the planning and work easier.

Anticosti property

The territory on Anticosti Island, where Pétrolia holds an interest in over 6,000 km^2, has tremendous potential in the long term. Early in 2011, Pétrolia unveiled the results of the core samples taken from the Macasty shale in 2010. Then, based on the information available, it revealed the estimated volume of oil in this deposit. This assessment, prepared by Sproule, pegs at over 30 billion barrels the undiscovered petroleum initially in place in the Macasty shale covered by the licences in which Pétrolia holds ownership interests.

The oil in the Macasty shales opens an entirely new oil play on Anticosti Island. Pétrolia has endeavoured to find the best approach to develop these territories and facilitate the financing of extensive work that will be required to demonstrate the ability to exploit the resources.

Notwithstanding the Macasty shale's immense potential, it is important to understand that the Anticosti exploration program is at an early stage; more work will be required to determine the potential for commercially viable resource recovery before proceeding to any development phase. Pétrolia spent the rest of the year crafting a development plan and weighing its options, more specifically, partnerships for the next exploration steps and to determine the volume of oil available in the shales.

Social and environmental acceptance

During the year, Pétrolia continued its efforts to promote acceptance and integration of its projects into the communities where it works. This acceptance requires that the Company acknowledges these communities' rights to complete, transparent information and assurance that the work will be performed following best industry practices.

It is with this in mind, for example, that the drilling programs proposed to the MRNF were developed, modeled after the practices recommended in the supplemental environmental assessment prepared by New York State's Department of Environmental Conservation. The criteria selected by the Company for its drilling programs exceed current standards.

The Company has also aligned itself with scientists in Quebec universities (INRS, UQAC, Université Laval) in order to better understand the impact of its activities on the environment, both in Gaspé and on Anticosti Island, all with a view to better addressing the legitimate concerns of their communities.

For instance, in fall 2011, the INRS will undertake a hydrogeological assessment of the Haldimand peninsula and set up a monitoring mechanism to assess the effects of Pétrolia's projected work. The INRS is responsible for developing the program and monitoring the work while Pétrolia will defray a portion of the costs. The community has also been invited to take part in this project. Information about and the results of this five-year study and monitoring project will be announced periodically.

In the same vein, Pétrolia has agreed to fund some of the work of Université Laval's NSERC-Forestry Products Industrial Research Chair, more specifically, the cost of the research to determine the effect of exploration work on the behaviour of the whitetail deer. The Chair's mandate was recently renewed and work will begin in 2012.

producin

Environmental stewardship

For economic, environmental and solidarity reasons, Pétrolia advocates responsible use of all forms of energy. Hydrocarbon exploration, especially oil, is right in line with this responsible approach.

While using less energy makes economic sense, the fact is that energy is fundamental to the quality of our lives and as such, it is a demand that must be met. Developing Quebec's energy potential is therefore an economic development opportunity not to be missed.

Be it through more responsible use or local production, replacing all or some of the $12 billion in annual oil imports would generate considerable wealth for the province. Energy efficiency and local oil production are complementary ways of assuring Quebec's economic development.

From an environmental perspective, the practices of Canada's oil industry are among the best in the world. The regulatory framework in Canada and Quebec ensure environmentally responsible resource exploitation, meaning that to meet our energy needs, particularly for oil, we are required to exploit our resources responsibly and continuously improve our practices.

Fossil fuels (oil, natural gas and coal) supply 81.3% of the world's energy needs, a percentage that according to the International Energy Agency will still be as high 25 years from now. The Agency predicts that humanity's energy needs will grow by more than 35% during this period as will demand for all forms of energy. Meeting this demand will be one of the world's greatest challenges. Quebec will not be spared, hence the importance of stepping up the efforts to both limit its dependence on oil and to ensure supply.

The issue becomes all the more critical when you consider that over 1.5 billion people still don't have access to electricity and another billion have no reliable sources of energy to meet their household cooking and heating needs. While meeting the energy needs of industrialized nations is important to maintaining their quality of life, the issue is much more fundamental in developing countries, where access to reliable, affordable sources of energy is the key to economic development, agricultural viability, effective means of communications and a greater life expectancy. From this perspective, the ability to meet our own needs by exploiting our oil and gas resources is an act of international solidarity.

Moreover, exploiting our own natural resources makes us more energy independent. The entire world is worried about the security of energy supply, another issue Quebec cannot escape.

Lastly, the wealth created by exploiting the oil resources in Quebec is not only used to fund public services but can be used to invest in new forms of energy. Oil exploitation is a way to finance the means to build a more responsible world.

Ensuring our energy supply from local resources therefore seems more responsible than importing. And using more energy efficient technologies is clearly the way to go. However, the fact is that in the near and medium terms at least, these technologies will not replace oil. The alternatives, especially if produced locally, are either too expensive, not reliable enough or even more harmful than oil (e.g., farmland used for energy production).

g for a more responsible approach

being proactive

Pétrolia has aligned itself with scientists in order to improve industry practices as well as to develop oil potential in harmony with the communities.

Management discussion and analysis

for the year ended September 30, 2011

This management discussion and analysis report (MD&A) is an addition and supplement to the audited financial statements for the fiscal years ended September 30, 2011 and 2010 and should be read in conjunction with those statements, which were prepared in accordance with Canadian generally accepted accounting principles (GAAP). This MD&A presents Management's views on current Company activities and on the annual financial results, as well as a preview of the activities of the next fiscal year.

1. Date

The effective date of this MD&A is December 5, 2011.

2. Incorporation and mission

The Company, incorporated under Part 1A of the Quebec Companies Act and governed by the provisions of the Quebec Business Corporations Act, is an oil and gas exploration company. The Company has been trading on the TSX Venture Exchange since February 16, 2005 under the symbol PEA.

The Company's oil and gas properties are at the exploration stage. The Company's long-term profitability is tied in part to the cost and success of the exploration programs and subsequent development. Pétrolia has not yet determined whether its properties hold economically profitable reserves.

Pétrolia's core business is exploring and developing oil and gas properties. In order to achieve its objectives, the Company has to form partnerships with other industry actors.

3. Forward-looking statements

Certain statements in this document are "forward-looking statements." Such statements relate to future events or future economic results anticipated by Pétrolia and are therefore subject to known and unknown risks, uncertainties and other factors which may cause actual results, levels of activity and achievements to differ materially from those expressed or implied by such statements. Accordingly, any decision to invest in Pétrolia stock should in no way be based on these forward-looking statements. The Company undertakes no obligation to update or revise any forward-looking statements.

4. Highlights of the year ended September 30, 2011

The increase in Pétrolia's share price as of mid-February is by far the greatest highlight of the year. This increase is all the more impressive considering that none of Pétrolia's counterparts in Quebec saw their stock price go up this last year and that all the stock markets were down.

The announcement of Anticosti Island's potential and the Company's intention to continue developing the potential of the territories in which it holds ownership interests attracted the attention of financial markets here and elsewhere. Other highlights include:

- Signature of a definitive agreement with Québénergie to develop the Haldimand oilfield and surrounding area;
- Unveiling of the coring results for the Macasty Formation on Anticosti Island;
- Unveiling of the preliminary estimate of the oil potential of the Macasty shale on Anticosti Island, established at over 30 billion barrels of undiscovered petroleum initially-in-place;
- Exercise of warrants and options that enabled the Company to cash in $4,804,148 during the year.

5. Strategy and outlook

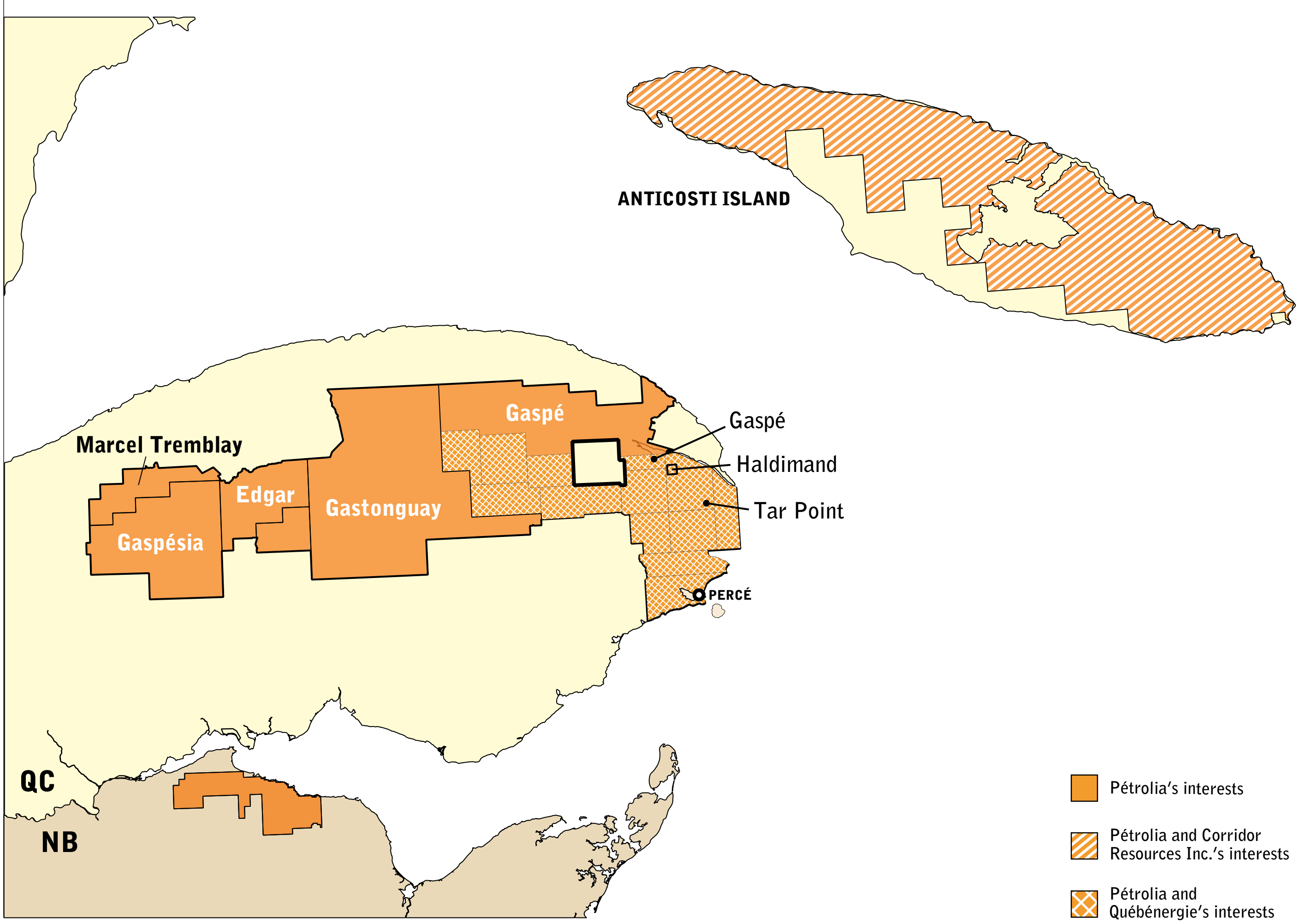
Pétrolia's mission is to discover marketable oil resources and to put them into production as soon as possible in order to ensure its profitability. In the pursuit of this mission, the Company never loses sight of the importance of work safety, environmental protection and community relations. To this end, Pétrolia holds rights in promising licences and associates with partners with the appropriate technical and financial resources. The Company relies on scientific knowledge before it installs its wells, which are drilled using best industry practices and techniques. Special attention is paid to building alliances with the communities where it carries out its activities.

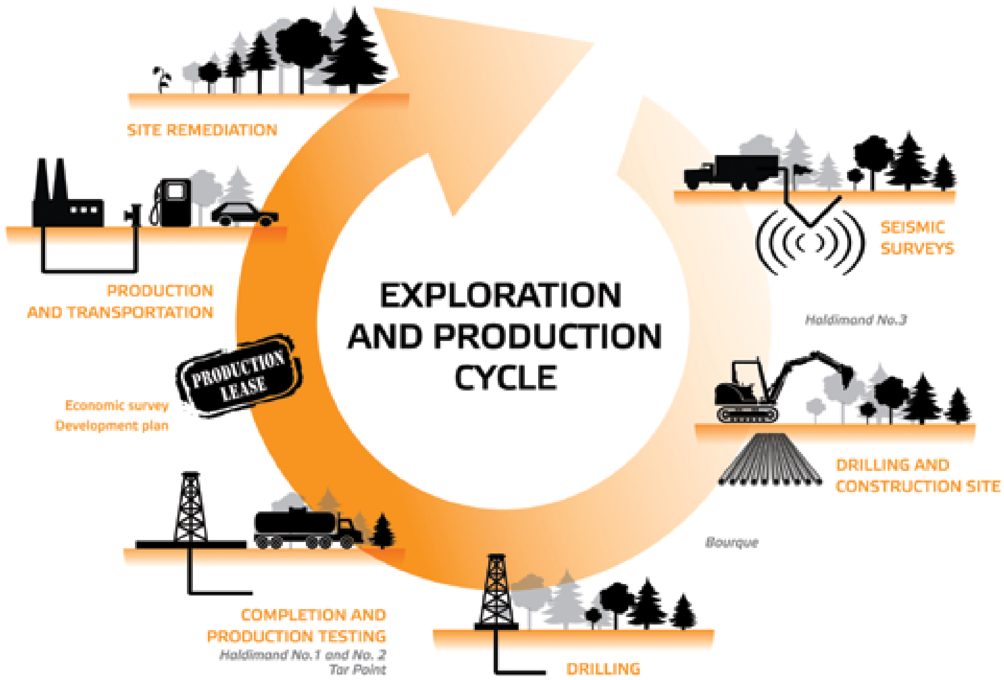
6. Licences and partnerships

Pétrolia holds licences for and interests in over 14,000 km^2. The licence holdings appear in the map below.

On Anticosti Island, Pétrolia holds interests in 35 licences on over 6,000 km^2. Its interest is 25% in six of these licences and 50% in the remaining twenty-nine. Corridor Resources Inc. holds the remainder.

In the first quarter, Pétrolia entered into a partnership agreement with Québénergie, a subsidiary of SCDM (Paris), to speed up the development of the Haldimand deposit and surrounding territory (± 2,500 km^2). Each partner holds a 50% interest. The following map shows the territory covered by the agreement.





7. A dominant position

In Quebec, oil resources are found in the east of the province, in the Gaspé region, on Anticosti Island, and perhaps in the Gulf of St. Lawrence. Since it was founded in 2005, the Company has acquired licences that cover more than 14,000 km², mainly in the Gaspé region and on Anticosti Island. These licences cover more than 70% of Quebec's land petroleum potential.

The Company may have appeared rash when it concentrated its efforts on searching for oil at a time when the industry was enthusiastic about shale gas. However, the recent and foreseeable rise in the price of oil and natural gas has made the Company's decision appear wise in hindsight. The portion of the territory controlled by Pétrolia that has potential for oil makes it a dominant player in Quebec.

8. Properties and works

8.1 Haldimand property

The recoverable oil resources from the Haldimand deposit, near Gaspé, are estimated at 7.7 million barrels on 9 km² (best estimate by Sproule Associates Limited). However, this figure may be higher since the geophysical data indicates that the structure extends beyond this area.

8.1.1 Objectives

In accordance with the Company's strategy, putting the Haldimand deposit into production is the priority. Drilling a horizontal well appears to be the best way to achieve this objective in the short term.

The second objective for Haldimand is to identify additional recoverable resources.

8.1.2 Studies and projects

Putting the Haldimand deposit into production poses numerous challenges that the Company is attempting to resolve with the help of specialized outside firms. The work undertaken to date has revealed low permeability reserves. However, despite this characteristic, the Haldimand No. 1 well naturally produced approximately 10 barrels per day during the production tests conducted all through the year.

Studies were carried out throughout the year to understand the deposit's natural permeability mechanism, the hydrocarbon distribution and the zones likely to be more productive in order to establish the trajectory of the new wells so as to naturally optimize production potential. The next well, Haldimand No. 3, should provide a better picture of the expanse of the Haldimand structure and make it possible to confirm the resources.

In addition to assessing the known part of the field, covered by the 3D seismic survey, work is underway to find out how far the deposit extends beyond the area assessed and to determine its potential.

As a result of these studies and analyses, the Company now has a better understanding of the Haldimand reservoir and its production mechanism. The reservoir appears to be made up of a network of natural fractures that ensure the free flow of oil. This is an important discovery that may allow for conventional exploitation, in other words, without having to resort to fracturing. This knowledge was used to design the Haldimand No. 3 well for which the Company has requested a drilling permit from the MRNF.

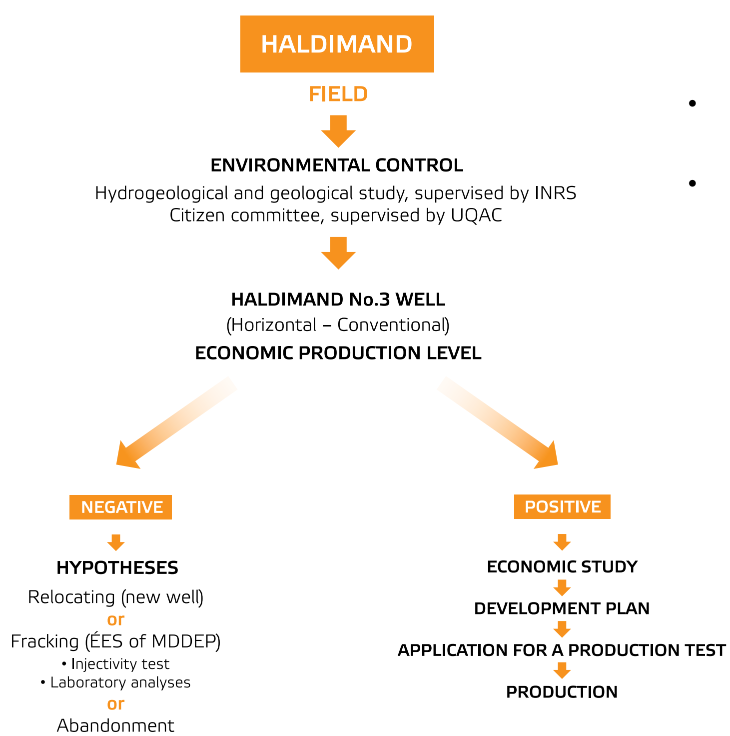
8.1.3 Haldimand No. 3 well

The purpose of drilling a directional well is to verify the production capacity of the natural fractures, which play an important role in the production mechanism, acting as a drain that channels the oil from the low permeability layers towards the well. Data collected from Haldimand No. 2 in 2009 provided information about these fractures. The 3D seismic reprocessing and magnetotelluric survey undertaken during the year will also help optimize the trajectory of the future well so that its horizontal part intersects as many natural fractures as possible from a good angle. A drilling program has been prepared and the application for a drilling permit was being studied by the MRNF at the time this report was prepared. The work will begin as soon as the permit is obtained and the required equipment becomes available. Under the agreement with Québénergie, the latter will assume Pétrolia's participation costs.

The Company favours conventional exploitation of the deposit. However, the assumption that fracturing will be required cannot be eliminated at this stage. Studies in relation to this assumption were conducted during the year and are described in 8.1.7.

The following flowchart illustrates the planned work and possible decisions for the Haldimand property.

DECISION CHART
Haldimand field



8.1.4 Haldimand No. 1 production testing and other works

Pétrolia continued production testing of the Haldimand No. 1 well begun on June 30, 2010 in order to collect additional information on the deposit and to better identify its characteristics. A total of 736 m^3 (4,632 barrels) of oil were produced during this test period. A portion of the well's production was placed in inventory.

Two licences were also granted to consolidate the intermediate casing of the Haldimand No. 1 well. This work, which will take about 30 days to complete, began in mid-October 2011.

8.1.5 Field study

During the quarter, the full range of data on the deposit (including well and seismic data) was compiled into a digital model using Gocad 3D visualization and modelling software to produce a three-dimensional map of the oil accumulation. Future data can be integrated into the model, thus enabling better planning of the work to come.

The studies conducted or started during the past year include:

- Adjustment and calibration of the vertical seismic profile for Haldimand No. 2;
- A study of the fractures observed in the Haldimand No. 2 core samples and the FMI log in order to better understand the field's hydrocarbon flow;
- Reprocessing of 3D data and an anisotropy study based on 3D seismic data;
- A calibration study of the magnetic resonance (CMR) logs that will establish the porosity and permeability values obtained by these logs.

8.1.6 Additional surveys

A magnetotelluric survey was undertaken during the year to obtain more specific data on the deposit's geometry and its extension outside the zone covered by the 3D seismic survey. This method, used to compile the seismic map of the oilfield in zones where seismic data are either missing or unusable, may make it possible to identify the zones most conducive to oil accumulation and the orientation and intensity of the natural fractures.

Good quality data were obtained and early results show that the method has enabled reliable mapping of the top of the reservoir as well as the intensity and orientation of its natural fracturing.

In addition, the licences concerning the 2D seismic data acquired by SOQUIP and Petro-Canada in 1982 in the area close to the Haldimand deposit were purchased and the data reprocessed, resulting in much improved data.

A report on the gravity reversal survey has been received and is being evaluated. This study should make it possible to define new drilling targets outside the Haldimand deposit.

8.1.7 Fracturing tests

The Company prefers to use conventional extraction methods. The Haldimand No. 3 well will play a decisive role in this regard. Still, Pétrolia is studying the possibility of conducting well stimulation tests with hydraulic fracturing with a view to optimizing well productivity. A decision on this matter is still pending.

Laboratory tests were performed to identify the best fracturing fluid to use. As well, Pétrolia obtained a permit from the MRNF to conduct an injectivity test in the Haldimand No. 1 well. This test will provide useful information if a fracturing program is required in the future and will be conducted once the work begun in mid-October (described in section 8.1.4) is completed.

If conducted, the test dates will depend on the results of the analyses, the availability of the required equipment and the government approval process.

8.1.8 Environmental studies

Concurrently with these studies, the Company is working on a plan to acquire scientific and environmental monitoring information. Discussions about establishing a research program are ongoing with various Quebec universities, particularly the Institut national de la recherche scientifique (INRS).

One of the main purposes of this program is to determine the hyrogeological situation at time zero. The research protocol for this particular component will be established by the INRS and the work will be carried out by TechnoRem Inc. starting in fall 2011. This research project was announced in mid-October 2011.

8.2 Tar Point property

Drilled in 2009 and located 15 kilometres southeast of the Haldimand wells, this well has bottomed out at 2,434 metres. It crosses the entire York River Formation as well as part of the Indian Cove Formation.

There were few signs of oil in the York River Formation but light crude was found during a production test on a fractured zone of the Indian Cove Formation.

8.2.1 Objectives

The objective is to demonstrate the Indian Cove Formation's capacity for commercial oil production. Since signs of oil have been systematically observed in this formation, this area offers an interesting exploration opportunity in the Gaspé region.

8.2.2 Studies and projects

The drilling results for Pétrolia-Tar Point No. 1 confirm Indian Cove's high hydrocarbon potential. The characteristics found in this formation indicate a fractured potential reservoir whose eventual exploitation will likely require hydraulic stimulation. The possibility of fracturing tests for the Haldimand project also applies to Tar Point.

Pétrolia obtained a permit from the MRNF to perform an injectivity test in fall 2011. This test will provide useful information if a fracturing program is required in the future. Work will also be performed in fall 2011 to modify the tubing in the wells.

As with the Haldimand property, no decision has yet been made regarding fracturing tests for Tar Point, which if conducted, will depend on the results of the analyses, the availability of the required equipment, and the government approval process.

8.3 Bourque property

The Bourque project is very important to Pétrolia in view of the size of the potential discoveries and the interest that would be raised in the Company's other properties in the Gaspé region where similar geological conditions prevail. The targets in question are conventional in nature.

A 3D seismic survey undertaken by Pétrolia in 2008 suggests the presence of a reef complex in the West Point Formation, an older geological formation than York River. This type of trap can store considerable quantities of hydrocarbons. The first trap is a pinnacle reef, the same as the Leduc reef in Alberta, in which giant oilfields have been discovered, marking a turning point for oil and gas exploration in that province. The second structure is a barrier reef.

8.3.1 Objectives

The property's two structures have completed the early exploration stages and reached the drilling stage. Pétrolia would like to drill a borehole on each of these targets as soon as possible. The drilling programs were submitted at the end of the fiscal year to the MRNF and were still under study at the time of writing.

Located 70 kilometres west of Gaspé City, the Bourque project offers an opportunity to discover a significant deposit. The total depth of the targets ranges from 2,000 to 3,200 metres. This project can also generate significant economic spinoffs associated with raw material processing in an economically depressed region.

8.3.2 Studies and projects

The Bourque No. 1 and No. 2 drilling program was based on the recommendations of the supplemental impact study published by New York State's Department of Environmental Conservation. According to the new regulations of the *Environment Quality Act*, these conventional wells are not affected by the new approval procedures for strategic environmental assessment. This works in our favour in terms of short-term drilling.

8.3.3 Search for partners

Over the last quarter, Pétrolia continued to search for a partner, which Management considers preferable for this project. That said, the Company may decide to drill alone.

8.4 Anticosti Island

Anticosti Island meets the four criteria sought in a petroleum system, namely a highly productive source rock favourable to the production of petroleum, a good quality reservoir, impermeable cap rock, and the presence of numerous large-scale traps. This vast territory offers a number of potential resource plays.

8.4.1 Shale oil

The core sample extracted from the shale in summer 2010 at the Macasty Formation (Pétrolia Corridor Chaloupe No. 1 well) has created a new potential oil play on Anticosti Island. The analyses performed by a laboratory in Weatherford, Houston, and by Schlumberger Canada confirm that the shales contain considerable quantities of oil and that the formation has the characteristics required to develop this potential oil play, which is sparking attention all over the world.

On June 29, Pétrolia unveiled the estimate of the Macasty shale in-place oil reserves conducted by Sproule Associates Limited of Calgary. Sproule's best estimate for the total volume of initially-in-place oil in the shale is 30.9 billion barrels. There is a 10% probability that this volume is equal to or greater than 48.2 billion barrels (high estimate) and a 90% probability that it amounts to at least 19.8 billion barrels. The evaluation focuses on the Macasty shales where Pétrolia's interests cover more than 6,070 km^2.

The table below summarizes Sproule's estimate:

Estimates of total petroleum initially-in-place[1]
Macasty shale, Anticosti Island, Quebec
at June 1, 2011

Classification	Pétrolia interests	Low estimate (P-90)[3] Billions of BOE[6]	Best estimate (P-50)[4] Billions of BOE[6]	High estimate (P-10)[5] Billions of BOE[6]
Undiscovered petroleum initially-in-place[2]	**Pétrolia's gross interests**	**19.8**	**30.9**	**48.2**
	Pétrolia's net interests	**9.1**	**14.1**	**22.0**

1. The petroleum initially in place is the amount of petroleum estimated to exist originally naturally in a shale formation. This includes the estimated quantities that, on a given date, are contained in known accumulations prior to production, plus estimated quantities in accumulations yet to be discovered.
2. Undiscovered petroleum initially in place (equivalent to undiscovered resources) are those quantities of petroleum that are estimated, on a given date, to be contained in accumulations yet to be discovered. The recoverable portion of undiscovered petroleum initially in place is referred to as prospective resources, the remainder as unrecoverable. Undiscovered resources carry risks: there is no certainty that any portion of these resources will be discovered. A recovery project cannot be defined for this volume of undiscovered petroleum initially-in-place at this time. There is no certainty that it will be commercially viable to produce any portion of the resources.
3. The probability that the quantity actually in place is equal to or greater than the estimate is 90%.
4. The probability that the quantity actually in place is equal to or greater than the estimate is 50%.
5. The probability that the quantity actually in place is equal to or greater than the estimate is 10%.
6. BOE – barrel of oil equivalent. The use of the oil-equivalent unit reflects the uncertainty of hydrocarbon type across the island.

8.4.2 Conventional targets

Conventional structural exploration has been carried out on the island since 1960 but to date has yielded no conclusive results.

Semi-conventional fault trough exploration was more recently conducted by Shell, Hydro-Québec and Corridor Resources Inc. This type of exploration, known in industry jargon as "sags," was very successful in the Appalachian Basin (Ontario and New York State). While exploration by Pétrolia and Corridor in 2010 failed to meet expectations in terms of discoveries, it did confirm the existence of reservoirs associated with fault troughs (production of 5,000 barrels of salt water per day in the Pétrolia Corridor Saumon No. 1 well).

8.4.3 Search for partners

The exploration program on Anticosti Island, particularly with regard to the Macasty shales, is currently in the early stage. More work will be required to determine the potential for commercial recovery of shale resources before the development phase can be contemplated. In the second half of the year ended September 30, 2011, the Company prepared a development plan, scheduled to begin implementation next year.

Developing Anticosti Island will require significant capital. Finding partners with the requisite financial and technical resources is therefore a priority. Pétrolia is assessing its options in the best interests of its shareholders.

8.4.4 Environmental research

Pétrolia has confirmed that as a private-sector partner, it will support the work of the Université Laval's Anticosti Chair. A project has been developed to determine the impact of oil operations on the behaviour of white-tailed deer, an important economic and tourism resource for Anticosti Island. The Anticosti Chair has received confirmation from the Natural Sciences and Engineering Research Council of Canada (NSERC) that its budget will be renewed. Pétrolia is proud to be associated with the Anticosti Chair's work. This research will provide the knowledge needed to improve practices and promote eco-friendly development. Our contribution ($200,000 over five years) attests to the Company's engagement in the communities in which it operates.

8.5 Other properties

As in recent quarters, Pétrolia focused on the Haldimand and Anticosti projects. As such, while sufficient to meet its obligations, the Company's activities on its other properties were limited.

Organic matter analyses were conducted on field samples from all of its properties in order to enhance Pétrolia's knowledge of the maturity and shale oil potential of rocks in the Gaspé region. Weatherford was retained to carry out this work. The results are now known and will be incorporated into the other data.

A geochemical project using the same approach as the Haldimand survey was undertaken last winter covering portions of the Gaspésia, Edgar and Marcel-Tremblay properties. The results are currently being interpreted.

A seismic program has been prepared to identify a drilling target on a potential trap discovered during a 2008 survey. The program will be carried out in 2012. Given that thermal maturity studies indicate that gas is more likely to be discovered in this target, the Company has made it a priority to develop the Haldimand property. However, the potential emergence of gas projects in the region could cause the Company to rethink its priorities and rekindle interest in a drilling project in the Gaspésia property.

With regards to the Dalhousie property in New Brunswick, there have been no significant developments given an economic and political climate that makes the natural gas market less appealing in that province. The project's status has therefore not changed. Pétrolia will continue monitoring the situation in New Brunswick.

9. Modification of the legislative and regulatory framework

In the past year, the Government of Quebec has made several changes to the legislative and regulatory framework for oil and gas production. Consequently, application processing by government authorities will take longer.

The adoption of Bill 18, an *Act to limit oil and gas activities*, has introduced three changes aimed at:

- banning oil and gas activity on islands in the river and estuary portion of the St. Lawrence;
- exempting holders of exploration permits from performing the work required under the *Mining Act* and submitting a report to the Ministry until June 13, 2014;
- extending the validity of all exploration permits in Quebec for the same period as the moratorium.

For Pétrolia, the adoption of Bill 18 suspends some of its obligations for up to three years and extends the validity of all its permits in Québec by the same amount of time. However, Pétrolia plans to continue its activities regardless of the moratorium.

In addition, the ministère du Développement durable, de l'Environnement et des Parcs (MDDEP) amended the *Regulation respecting the application of the Environment Quality Act*. As a result, an environmental authorization certificate is required for all shale drilling and fracking operations. The amendment also requires companies to hold a public consultation before applying for a certificate for this type of work.

Lastly, concerning strategic environmental assessments, the MDDEP has adopted a regulation aimed at providing information on shale drilling and fracking operations. These provisions have little impact on the Company, which in the near term does not have any projects affected by these regulatory amendments. However, since future projects may be affected, the Company will plan for the additional time constraints that may be imposed by this new regulation.

Management analysis
of financial information

Operating results and cash position

In fiscal 2011, the Company's revenues consisted of interest income on short-term investments of $133,587, compared with $24,321 for fiscal 2010, and project management income of $44,854, compared to $1,781 last year. Revenues from oil reservoir evaluations stood at $107,021, against $109,738 in 2010 and are recorded as a reduction in deferred exploration expenses.

The increase in interest income stems from the increase in cash flow, achieved as a result of the Québénergie transaction, which generated an inflow of $6,690,000, as well as the exercise of warrants and options totalling $4,804,148.

As at September 30, 2011, the Company had cash and cash equivalents of $8,151,034 and working capital of $10,052,854.

For fiscal 2011, the Company recorded a profit of $2,160,668, compared to a loss of $1,358,529 in 2010, primarily due to a gain on the disposal of interests in some of its licences.

Management believes that it has sufficient cash to meet its current obligations. For its financial needs, the Company can rely on its ability to raise capital through public offerings and negotiated private placements.

Analysis of operating and administrative expenses

Operating and administrative expenses rose $501,154, mainly due to an increase in exploration activities.

The main differences in the operating and administrative expenses are:

- Stock-based compensation: 1,495,000 options valued at $500,208 were granted in 2011, as compared to 270,000 options in 2010 for a value of $190,725.
- Salaries and benefits: Operations-related payroll fell slightly. Administrative staff was hired to respond to the needs of the community and government authorities.
- Loan interest: Interest charges of $89,201 were paid on a loan taken out to finance tax credits receivable for 2010.
- Rent: Lease expenses rose in 2011 mainly due to the expansion of the Québec City offices.

Selected annual information

	2011	2010	2009
	$	$	$
Revenue	178,441	26,102	204,644
Net earnings (net loss)	2,160,668	(1,358,529)	(854,911)
Basic net earnings (net loss) per share	0.042	(0.028)	(0.021)
Diluted net earnings (net loss) per share	0.041	(0.028)	(0.021)
Total assets	40,536,750	30,994,857	24,024,439
Dividend per share	N/A	N/A	N/A

Summary of quarterly results

	2011			2010				2009
	September	June	March	December	September	June	March	December
	$	$	$	$	$	$	$	$
Revenue	75,160	51,373	45,386	6,522	(46,658)	47,342	6,646	18,772
Net earnings (net loss)	(443,251)	(488,636)	(384,846)	3,477,401	(330,057)	(244,544)	(402,692)	(381,236)
Net earnings (net loss) per share								
Basic	(0.010)	(0.010)	(0.008)	0.0695	(0.0068)	(0.0053)	(0.0092)	(0.0092)
Diluted	(0.010)	(0.010)	(0.008)	0.0571	(0.0068)	(0.0053)	(0.0092)	(0.0092)

Revenue essentially consists of interest earned for each quarter. Fourth quarter revenue was negative mainly due to the reclassification of petroleum reserve assessment income of the first three quarters of 2010, which was charged against the deferred exploration expense. General and administrative expenses were fairly stable from quarter to quarter. The main changes in quarterly losses or earnings are explained as follows:

2009 – December Loss recorded in connection with a change in fair value of a $458,500 investment and a gain on disposal of $395,163 in shares;

2010 – March Recognition of stock-based compensation expense of $183,600;

2010 – December Recognition of stock-based compensation expense of $82,800 and a $5,158,607 gain on disposal of interest in certain licences;

2011 – February Recognition of stock-based compensation expense of $71,400;

2011 – May Recognition of stock-based compensation expense of $160,750;

2011 – September Restatement of all stock-based compensation for the year using the graded vested method; this restatement had a non-monetary impact of $185,258.

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.

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 $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 as of 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 5-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

Fourth quarter

The fourth quarter closed with a loss of $443,251 ($0.01 per share). Revenue for the quarter was $75,160.

Future accounting standards

IFRS CONVERGENCE

INTERNATIONAL FINANCIAL REPORTING STANDARDS

Canada's Accounting Standards Board (AcSB) 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 therefore 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 uses 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.

Training

The personnel assigned to the convergence with IFRS have undergone and continue to receive training by the Quebec Order of Chartered Accountants. Since modifications are expected to IFRS in 2011, all modifications that could affect the Company will have to be monitored.

Affected accounting standards

An in-depth analysis of the accounting standards affected by the convergence to IFRS was undertaken in fiscal 2010-2011. In general, considerable effort will have to be put into the presentation of financial statements since IFRS require more disclosures.

The Company has identified the following list of areas where the changeover could impact the Company's financial statements. This list of items should not be seen as exhaustive; its aim is to highlight the areas the Company considers most important; however, the analysis of the modifications has not been completed, and the choice of accounting standards under IFRS, if any, has not been determined. 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 following list covers standards that exist under 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:

First-time adoption (IFRS 1)

IFRS 1 provides guidance to entities on the general approach to be taken when first adopting IFRS. The underlying principle of IFRS 1 is retrospective application of IFRS standards in force at the date an entity first reports using IFRS. IFRS 1 acknowledges that full retrospective application may not be practical or appropriate in all situations and prescribes:

- exemptions from specific IFRS in preparing the Company's opening balance sheet; and
- exceptions to retrospective application of certain IFRS.

Additionally, to ensure that the financial statements contain high-quality information that is transparent to users, IFRS 1 contains disclosure requirements to highlight changes made to financial statement items following convergence of financial statements with IFRS.

The following table presents some of the main accounting differences that we believe will have an impact on the recognition and evaluation of certain balance sheet and income statement items. Unless otherwise indicated, all accounting differences will be applied retrospectively.

Accounting item	Main differences in accounting treatment	Potential impact
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 cases of onerous contracts, while according to GAAP, such a liability need only be recognized 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 under IFRS.
Income taxes	The various accounting changes under IFRS will also affect the corresponding deferred tax asset or liability, unless a reduction of value is required. 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. 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. Opening balance sheet: No significant impact is expected on overall 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 cancellations be taken into account when recording stock-based compensation cost at the grant date rather than recognize the cancellation when it occurs. For stock options with graded vesting, IFRS requires that each instalment be measured and recognized separately, as each instalment has a different vesting 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.

Steps in the conversion process

The Company has adopted the four-step approach presented below and has generally completed the first three steps.

First step

Consists of the initial evaluation, i.e. identifying the differences between Canadian GAAP and IFRS, as well as conducting an initial analysis of IFRS 1—regarding exceptions for the changeover to IFRS.

Second step

Consists of the detailed evaluation, and includes the prioritization of accounting issues, the quantification of the impact of the conversion to IFRS, and examination and approval of the accounting principles selected.

Third step

Design: The accounting system and its internal controls are simple since the Company is in the exploration phase and should, seeing as no major challenges are anticipated, be able to operate its accounting systems according to IFRS. That said, some Excel spreadsheets will need to be modified so as to support the changes rendered necessary by the convergence.

The fourth implementation phase is underway, and we are dedicating significant energy to preparing IFRS financial statement models. According to the provisions of IFRS 1, we are required to disclose not only comparative data, but also, during the year in which IFRS are adopted, the opening balance sheet at the start of the comparative period.

Management is in the process of populating the comparative information into the financial statements and notes so that the Company is prepared to produce and file the IFRS financial statements.

We feel that the Company will be in a position to prepare an interim financial report that complies with IAS 34 for the quarter ending December 31, 2011.

Retrospective application (IFRS 1)

- IFRS 1 sets the stage for the transition from Canadian GAAP to IFRS. The standard sets out the procedures that a first-time adopter must follow as a result of measurement and reporting differences that arise as a result of the transition from GAAP to IFRS. The main principle of IFRS 1 is that a first time adopter must present its first IFRS financial statements using IFRSs which are effective at the end of the first IFRS reporting period, September 30, 2012 for the Company. Except for certain exceptions and exemptions discussed below, a retrospective application of IFRS is required as if the Company had always accounted and reported under this framework.
- The guidance identifies nineteen optional exemptions that a “first-time adopter” may elect to not apply IFRS on a retroactive basis. These exemptions apply to items such as business combinations, employee benefits, cumulative translation differences, borrowing costs, share-based payment transactions, and fair value or revaluation as deemed cost. A number of the optional exemptions are beyond the Company’s current operations. In addition to the optional exemptions, IFRS 1 contains certain mandatory exceptions to the retroactive application of IFRS including derecognition of financial assets and liabilities, hedge accounting, revisions to accounting estimates, and non-controlling interest.

The Company is in the process of finalizing its decisions, but anticipates applying the changes as follows:

Share-based payments (IFRS 2)

- A first-time adopter is encouraged, but not required, to apply IFRS 2 to equity instruments that were granted on or before November 7, 2002. A first-time adopter is also encouraged, but not required, to apply IFRS 2 to equity instruments that were granted after November 7, 2002 and vested before the later of (a) the date of transition to IFRSs and (b) January 1, 2005.
- The Company has elected to avail itself of this exemption and apply IFRS for all equity instruments granted after November 7, 2002 that have vested. As a result of this election, at the transition date, the Company will restate the historical Canadian GAAP share-based compensation expenses, resulting in a reclassification of contributed surplus to share capital.

- IFRS requires that stock options that may be sequentially acquired, be measured and recognized on the basis of the valuation of each equity acquisition. Under the Company's current policy, the valuation is determined at the outset of the option grant. IFRS 2 also requires that expected forfeitures be accounted for in the recognition of the compensation cost, whereas currently, forfeitures are recognized when they occur.

Business combinations (IFRS 3)

- A first-time adopter may elect to apply IFRS 3 Business Combination retrospectively to past business combinations that occurred before the transition date to IFRS.

- The Company has not been involved in any significant business acquisitions and therefore will elect not to retrospectively apply IFRS 3 to past business combinations.

Deemed cost (IFRS 1)

- IFRS 1 permits an entity to measure a tangible fixed asset at the date of transition to IFRSs at its fair value and use that fair value as its deemed cost at that date.

- The Company has not elected to use this exemption as it believes that the cost method, currently employed, provides more reliable and relevant information.

Exploration for and evaluation of mineral resources (IFRS 6)

- Under IFRS, the Company would be required to develop an accounting policy to specifically and consistently identify which expenditures on exploration and evaluation activities will be recorded as assets. Unlike IFRS, Canadian GAAP indicates that exploration costs may initially be capitalized if the Company considers that such costs have the characteristics of tangible fixed assets.

- Under IFRS, exploration and evaluation assets shall be classified as either tangible or intangible according to the nature of the assets acquired.

- Other than classification between tangible and intangible assets, the Company believes that the changes of this policy will have no impact on the financial statements on the changeover date and in subsequent years as the Company will continue to use the cost model methodology.

Explanation of changes and impacts on financial statement line items (IFRS 1)

In accordance with the Final Materials and IFRS 1, the Company will be required to include reconciliations and the transition opening statement of financial position in its first interim financial report and the annual financial statements. This disclosure is not required in the second and third interim financial rules under the continuous disclosure rules unless there has been a change in accounting policy. IFRS requires only a statement of cash flows for the year to date period and the corresponding period, whereas current Canadian GAAP requires issuers to present a cash flow statement for each interim period as well as for the year-to-date results. The amendments as reflected in the Final Materials contemplate this change and only require a cash flow statement for the year to date periods.

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 on SEDAR are reliable. The officers will ensure that once the convergence process is completed, they will still be able to sign their certifications.

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 the 2010–2011 fiscal year in order to detect impacts not identified during our initial analysis. No significant impact has materialized to date.

Financial instrument disclosure

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. 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. 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 financial assets and liabilities are classified 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 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.

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

Additional information

a) Supplemental documents

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

b) Regulation 51-102 Section 5.2

Deferred exploration expenses for the fiscal year ended September 30, 2011, are detailed as follows:

	Geology	Geophysical Surveys	Drilling	Analysis	Completion	General expenses	Oil reservoir evaluation	Options	Resource evaluation	Site maintenance	Total
	$	$	$	$	$	$	$	$	$	$	$
Anticosti	118,904	14,107	757,476	2,448	105	34,735	–	11,816	97,057	–	1,036,648
Gastonguay	548	–	–	–	–	540	–	77	–	–	1,165
Gaspésia Marcel-Tremblay Edgar	173,755	804	–	–	–	24,115	–	160	–	–	198,834
Gaspé	25,147	52,109	50,142	20	5,316	47,287	–	5,770	–	–	185,791
Bourque	72,563	2,319	9,225	–	–	4,113	–	616	–	–	88,836
Haldimand	608,676	492,850	263,469	595	49,498	113,315	57 337	8,715	–	220,273	1,814,728
Tar Point	29,776	4,237	153,942	–	5,285	4,329	–	12,910	–	46,172	256,651
Dalhousie	4,523	7,463	7,216	40	–	11,283	–	1,261	–	–	31,786
	1,033,892	573,889	1,241,470	3,103	60,204	239,717	57,337	41,325	97,057	266,445	3,614,439

Deferred exploration expenses for the fiscal year ended September 30, 2011 are detailed as follows:

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

c) Regulation 51-102 Section 5.3

Information on shares issued and stock options as at December 5, 2011:

Common shares: 54,844,198 shares have been issued and are outstanding.

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

- 21,250 options exercisable at a price of $0.74 per share until May 21, 2012;
- 547,500 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;
- 125,000 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;
- 120,000 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;
- 790,000 options exercisable at a price of $0.50 per share until December 8, 2015;
- 75,000 options exercisable at a price of $1.31 per share until February 25, 2016;
- 500,000 options exercisable at a price of $1.69 per share until May 18, 2016;
- 1,266,000 options exercisable at a price of $1.52 per share until December 4, 2016.

Management's responsibility for financial information

Management is responsible for Pétrolia's financial statements, which have been approved by the board of directors on recommendation of the audit committee. The financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles (GAAP) and audited by the Company's auditors. Financial statements are not precise since they include certain amounts based on estimates and judgments. Management has determined such amounts on a reasonable basis in order to ensure that the financial statements are presented fairly in all material respects.

Rimouski, December 5, 2011

On behalf of the Board

André Proulx, president of the Company