



Leader en exploration pétrolière au Québec



Management Report  
for the period ended  
December 31, 2012



## **INTERIM MANAGEMENT REPORT FOR THE FIRST QUARTER ENDED DECEMBER 31, 2012**

This interim management report has been approved by the Board of Directors. It is an addition and supplement to the quarterly financial statements and should be read in conjunction with them and the audited financial statements for the fiscal years ended September 30, 2012 and 2011, and the annual management report, where required.

This report presents the view of Management on current Company activities and is accompanied by the financial results as at December 31, 2012. It may also cite significant events that occurred after December 31, 2012 and provides an overview of activities planned for the coming months.

The reporting currency is the Canadian dollar (CAD) and all amounts presented in this report are in Canadian dollars.

### **1. DATE**

The effective date of this management report for the fiscal year ended December 31, 2012 is February 26, 2013.

### **2. INCORPORATION AND MISSION**

Incorporated under Part 1A of the Quebec *Companies Act* and governed by the provisions of the Quebec *Business Corporations Act*, Pétrolia is an oil and gas exploration company. It has been listed 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, and the Company's long-term profitability is tied in part to the cost and success of the exploration programs and subsequent development. The Company has not yet established whether its properties contain economically feasible reserves.

The Company's primary activities are the exploration and development of its oil and gas properties. In order to achieve its objectives, the Company has to form partnerships with other industry stakeholders.

### **3. FORWARD-LOOKING STATEMENTS**

Some of the statements made in this report may constitute 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, a decision to invest in Pétrolia's shares should at no time be based on these forward-looking statements. Pétrolia disclaims any intention or obligation to update these forward-looking statements.

#### **4. HIGHLIGHTS OF THE FIRST QUARTER ENDED DECEMBER 31, 2012**

- Laurentian Bank Securities assigned an analyst to monitor Pétrolia's shares due to the financial sector's growing interest in the Company, its work and its potential, providing investors and shareholders with an additional tool to monitor the Company.
- Hydrogeological research on the Haldimand Peninsula continued. The study is piloted by Professor René Lefebvre of the INRS, in collaboration with Technorem. A second agreement was also reached with the INRS to carry out a hydrogeological study of the water table on Anticosti Island.
- Three stratigraphic surveys were performed on Anticosti Island and the initial results of the geochemical analyses confirm the Macasty source rock's capacity for hydrocarbon production (press release dated January 14, 2013).
- Drilling at the Bourque 1 and Bourque 2 wells ended in mid-December. The drill-stem tests indicated the presence of reservoirs containing oil, condensate and natural gas. Drilling has currently been suspended in order for Pétrolia to develop a long-term production testing program (press release dated December 19, 2012).
- The analysis results on Bourque 1 indicate the presence of a vuggy reservoir holding substantial quantities of hydrocarbons associated with weathered zones located near a major fault. Sproule Associates has been contracted to assess the quantity of hydrocarbons initially in place (press release dated January 30, 2013).
- The economic spinoffs of the Bourque 1 drilling are calculated at \$2.6 million province-wide, of which more than \$1.2 million (45%) has benefited workers and companies in the Gaspé region. The drilling campaign drew upon the services of 50 different business sectors.
- A private placement of \$1 148 460 comprising 957 050 in flow-through shares was completed and will be put towards the Bourque well assessment project, particularly the production testing.



- In anticipation of drilling at the Haldimand 4 well, the people of Gaspé were invited to an information night on December 12, 2012.
- Pétrolia has established two websites dedicated to the Bourque and Haldimand projects, where visitors can obtain information on the projects and track their progress.
- Drilling at Haldimand 4 was temporarily suspended following the adoption of a municipal by-law in Gaspé (see Section 9.1).

## **5. STRATEGY AND OUTLOOK**

The Company's objective is to discover marketable oil resources and put them into production as quickly as possible, with the goal of becoming profitable. In the pursuit of this mission, the Company never loses sight of the importance of the safety of individuals, environmental protection and community relations. Pétrolia achieves this objective by holding rights over promising licences and signing agreements with partners with the necessary technical and financial expertise. The Company installs wells according to scientific and technical principles, relying on best industry practices for its drilling activities. It also pays particular attention to community relations and the local socio-economic context in which it operates.

## **6. FINANCING**

On December 10, 2012, Pétrolia announced that an engagement letter had been signed with Marquest Capital Markets as co-lead agent with Casimir Capital Ltd. The private placement is made up of a maximum of 2,500,000 flow-through shares, at a price of \$1.20 per share, for maximum gross proceeds of \$3,000,000. The proceeds of the private placement will be put towards exploration and specifically the extended production testing of two wells drilled under the Bourque project in 2012. On February 2013, The Company has decided not to hold a second closing of its private placement.



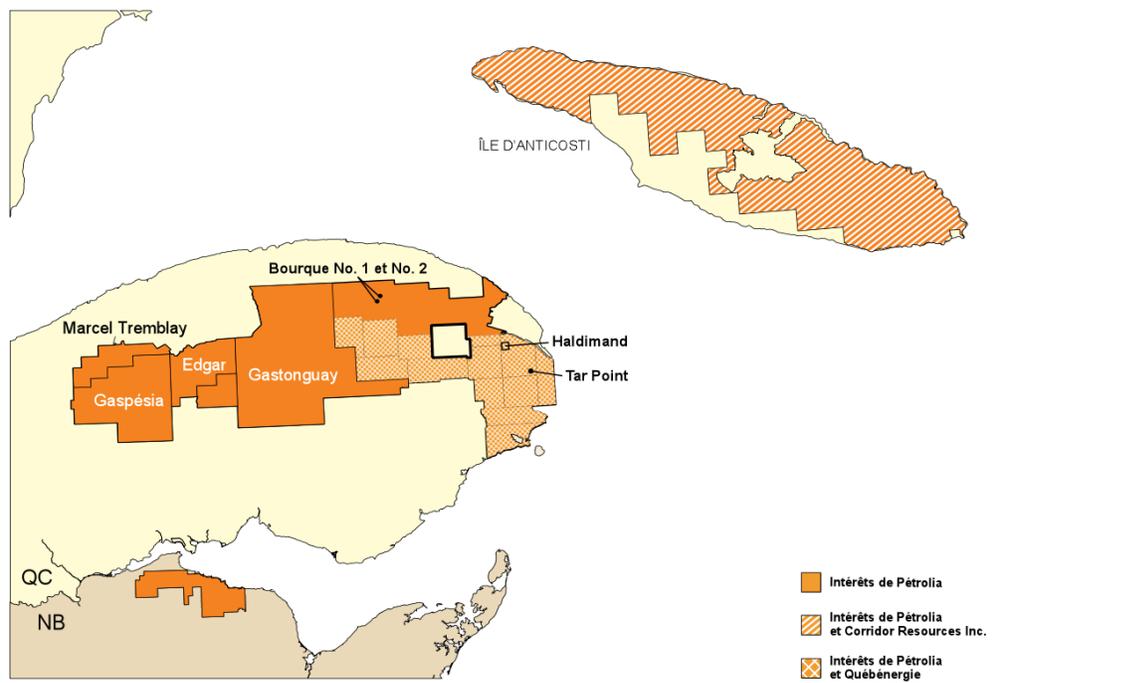
## 7. LICENCES AND PARTNERSHIPS

Pétrolia holds licences for and interests in over 14,000 km<sup>2</sup>, i.e. close to 20% of the Quebec territory under lease.

On Anticosti Island, Pétrolia holds interests in 35 licences, covering an area of over 6,000 km<sup>2</sup>. Pétrolia has a 25% stake in six of the licences and a 50% stake in the other 29 licences. Corridor Resources Inc. holds the remaining interests. All of the licences on Anticosti Island are covered by a joint operating agreement (JOA) whereby Pétrolia is the operator for 26 licences.

In addition, in December 2011, Pétrolia entered into an agreement with Québénergie, a subsidiary of SCDM (Paris), to accelerate development of the Haldimand deposit and the development of the area surrounding the deposit. Each partner holds a 50% interest in the 13 licences covered by the agreement.

The following map shows the areas in which Pétrolia hold interests, as well as those covered by the partnership agreements.



Pétrolia interests; Interests of Pétrolia and Corridor Resources Inc.; Interests of Pétrolia and Québénergie  
ANTICOSTI ISLAND; Bourque No. 1 and No. 2



## **8. A DOMINANT POSITION**

In Quebec, oil resources are mainly found in the east of the province, in the Gaspé region, on Anticosti Island, and perhaps in the Gulf of St. Lawrence. The licences in which Pétrolia holds interests cover over 70% of Quebec's land-based oil and gas potential.

Keys to Pétrolia's leadership position:

- Strategic decision to focus on oil exploration;
- Acquisition of licences conducive to the discovery of oil;
- The rise in oil and gas prices;
- The Company's level of activity; and
- Its innovative approach to the environment and community relations.

The results achieved to date indicate promising development prospects for the Company.

Pétrolia prides itself on being a responsible Quebec oil and gas company whose goal is to produce oil to meet a significant portion of Quebec's energy needs.

## **9. PROPERTIES AND WORKS**

### **9.1. Haldimand property**

Discovered in 2006 by Pétrolia, the Haldimand light oil deposit (53° API) is located on the peninsula of the same name on the outskirts of the town of Gaspé. The resources initially in place have been estimated at nearly 70 million barrels by an independent expert (Sproule Associates), which placed the quantity of potentially recoverable oil at 7.7 million barrels.

### **Objectives**

In accordance with its corporate strategy, putting the Haldimand deposit into production is a priority for the Company. Pétrolia would like to achieve this by using conventional oil extraction methods.



## Studies and projects

Upon completion of lab and field 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 low permeability sandstone intersected by a network of natural fractures that ensure the free flow of oil. As a result of this work, the Company is able to consider conventional production of the deposit.

The work on the Haldimand 4 well, which began in fall 2012, is aimed at confirming the hypothesis that conventional production methods are possible and profitable.

The following diagram illustrates the main steps leading to production of the deposit.



Steps to production:

1. Meet with the general public
2. Drill Haldimand well (without fracturing)
3. Conduct profitability study
4. Prepare development plan
5. Hold consultation (town and residents)
6. Hold public hearings
7. Apply for production lease



## **Public information**

At the public information session held by Pétrolia in Gaspé on December 12, 2012 at Polyvalente C.E. Pouliot school, many visitors walked through the booths, which were set up in trade show fashion. Those in attendance had the opportunity to meet with experts from all exploration-related fields, who were there to answer visitors' questions.

Pétrolia announced at the event that it had launched a website dedicated to the Haldimand project in Gaspé. The site provides answers to a broad range of questions and will allow people to monitor the step-by-step development of work on Haldimand 4. A pamphlet containing all the information has been uploaded to the project website at [haldimand.petroliagaz.com](http://haldimand.petroliagaz.com).

## **Work**

Because of a dispute between Pétrolia and the Town of Gaspé related to a new municipal by-law prohibiting drilling, the Company felt it wise to suspend drilling operations at Haldimand 4. The decision gives the various stakeholders in the issue time to find common ground and enable the exploration work to continue.

Based on the legal opinion it obtained, Pétrolia could challenge the validity of the by-law adopted by the Town of Gaspé in court. At the time of this report and in the interests of a political resolution to the dispute, the Company has not yet made a decision to take court action.

It should be pointed out that the drilling licence for Haldimand 4 was issued by the Bureau des hydrocarbures at the Ministère des Ressources naturelles on June 4, 2012, after the Company had complied with all of the rules and obligations in effect. The well is located at a distance of more than 380 m from the nearest dwelling, i.e. 3.8 times the minimal distance prescribed by Quebec regulations, and 2.5 times the most stringent regulation in North America (152 m or 500 feet). As an illustration, the Haldimand 4 well is located more than 850 metres from the nearest artesian well. These distances are actually much greater than those in effect in western Canada (Saskatchewan, Alberta and British Columbia), where tens of thousand of wells are drilled annually. An expert in hydrogeology at the Institut national de la recherche scientifique (INRS-ETE) has categorically stated that water supply source contamination for the town of Gaspé is "inconceivable," because movement in that direction is scientifically impossible.

Particular attention is being paid to site development. An 1,800-square metre section has been covered with a permanent watertight membrane that will contain any accidental spill of oil during both drilling and production. In addition, a noise abatement wall has been erected to reduce the noise from the pumps and generator during drilling.



It should also be pointed out that the preparation of the Haldimand 4 drilling site was completed during the quarter and that conductor casing was installed using a small service rig. Precision Drilling Corporation's 501 drilling rig was then brought to the well site on December 17, 2012.

Under the agreement with Québénergie, the partners will assume most of Pétrolia's participation costs for the Haldimand No. 4 well. Pétrolia's share in the financing of the third well will come from the private financing announced in April 2012.

### **Environmental studies and work**

The Company is also developing a scientific and environmental monitoring information acquisition program.

Pétrolia is working with scientists at Quebec universities. Professor René Lefebvre and his team at the INRS-ETE have developed a program to acquire specific knowledge about the effect of the work on the physical environment. Launched in November 2011, the program will run for five years.

In the fall of 2011, the INRS began to evaluate the hydrogeological system of the Haldimand peninsula, as well as to put environmental monitoring mechanisms in place related to the Company's oil and gas activities. A number of observation wells have been drilled to take samples and logs in order to build a hydrogeological model of the peninsula. The first phase work has progressed significantly since the program was launched, as shown in the table below:

#### **Monitoring of Haldimand hydrogeological work**

<b>Work</b>	<b>Planned</b>	<b>Completed to date</b>
Observation wells	15	15
Hydraulic tests	17	17
Water samples and analyses	83	76
Water table monitoring	1	1
Environmental logs	13	13

The INRS-ETE is responsible for developing the program and monitoring the work. The information and results from these studies and five-year monitoring program will be released regularly.



Pétrolia is very proud of the innovative and promising relationship it has developed with Quebec's universities from the earliest stages of its activities, as well as the universities' involvement with industry stakeholders.

## **9.2. Bourque property**

The Bourque property is very important to Pétrolia, because of its characteristic very representative of the other licences held by Pétrolia in the Gaspé area, where similar geological conditions exist. Drilling carried out during year 2012 has confirmed the strong potential of this property.

### **Objectives**

The Bourque property is located 30 km east of the town of Murdochville. The main objective is to evaluate the potential of the reservoir zones identified in drilling the Bourque 1 and Bourque 2 wells.

Confirming the commercial natural gas, condensate and oil potential in the naturally fractured zone is therefore a new exploration target for this property.

In this region, hydrocarbon production would promote substantial economic development associated with raw material processing and the influx of other industries to the region.

### **Drilling work**

In the first quarter, the Company completed drilling at Bourque 1 and Bourque 2.

Drilling at Bourque 1 began on July 19, 2012 and was completed on October 25, 2012. The well, which has a measured depth of 3,140 metres, reached a vertical depth of 2,921 metres. During drilling operations, eight drill-stem tests were taken at various intervals.

Upon completion of the program, a production casing was inserted in the well with a view to performing production testing over a 914-metre interval at depths between 1,832 and 2,746 metres. During the drilling and drill-stem testing, this area gave a number of indications of the presence of hydrocarbons (see press release dated October 31, 2012).

In addition, the analysis conducted by Schlumberger Canada of the imaging log (FMI) confirmed the presence of a reservoir holding sizeable quantities of hydrocarbons, including oil,



condensates and natural gas, over an interval of 355 metres, between depths of 1,465 and 1,820 metres.

Located in the Forillon Formation, the reservoir is characterized by numerous vugs, some very large (up to several dozen centimetres), which are associated with open fracture zones. This type of porosity in carbonates is often associated with weathered zones located near major faults, such as the Northwest Arm fault, which extends for over 60 kilometres and transects the Bourque property.

Over that interval (1,465 to 1,820 metres), two drill-stem tests were conducted during drilling, confirming the presence of hydrocarbons. One of the tests, carried out at the top of the interval, yielded light oil (53°API). The second test, at the centre of the interval, yielded an initial flow of 1.4 million cubic feet of condensates, natural gas and oil (see press release dated January 30, 2013).

Given these results, a production testing program is now being developed and Sproule Associates has been contracted to evaluate the volume of hydrocarbons initially in place in the reservoir.

Drilling on Bourque 2 began on October 31, 2012 and was completed December 13, 2012, reaching a depth of 2,680 metres. The well indicated the existence of two zones, each approximately 300 metres thick, which display reservoir characteristics. Two of the three drill-stem tests yielded natural gas, condensates and oil mixed with drilling mud.

In the shallowest zone, over an interval of 325 metres, drilling confirmed the presence of open fractures saturated with hydrocarbons, already identified at Bourque 1. These results are very encouraging, as the regional context suggests that the network may cover a vast area, given its association with the Northwest Arm regional fault. Bourque 2 is located just a few kilometres from the fault.

In the deepest section, the logs and drill-stem tests indicate a 270-metre-thick zone saturated with hydrocarbons, with low permeability and low primary porosity. An 18-metre core and a number of sidewall cores were taken and analyzed in the laboratory (see press release dated December 19, 2012).

Drilling has been suspended to allow the analyses to be completed and the areas of production testing to be identified.



### 9.3. Anticosti property

On Anticosti Island, the partners took the initiative to evaluate the development of hydrocarbon source rock, which is attracting the greatest attention due to its immense potential.

The 35 licences in which the Company holds an interest cover more than 6,000 km<sup>2</sup>, or about 75% of the Island's total area.

#### **Hydrocarbon source rock: a primary exploration target**

Since the analysis results of the core taken in 2010 from the Chaloupe well were released, the potential for oil in the Macasty Formation has attracted a great deal of interest in Quebec and on the financial markets. Pétrolia and its partner have thus unveiled a new concept in geological exploration on Anticosti Island.

The Macasty Formation, which is present in all Pétrolia's licence holdings, is the lateral equivalent of the Utica Formation in Ohio, which has garnered significant industry attention, as it has shown that it is capable of producing substantial volumes of oil and gas.

Pétrolia has reported the following results to date:

- The petrophysical parameters of the Macasty shale in the Chaloupe well provide positive indications of the Formation's oil-producing capacity. Analyses were performed by Weatherford Labs and the data were incorporated by Schlumberger Canada to determine the reservoir properties (press release dated February 9, 2011).
- The best estimate (P50) provided by Sproule Associates sets the volume of hydrocarbons initially in place at 30.9 billion barrels in the Formation in which Petrolia has interests (press release dated June 29, 2011).
- According to an independent oil company recognized as a leader in exploration and production, the petrophysical parameters of the Macasty shale are better than initially revealed (press release dated December 1, 2011).
- The petrophysical parameters of the Macasty shale compare favourably to those of the Utica shale in Ohio (press release dated February 21, 2012).
- The results of analyses on two of the three cores taken during the drilling campaign show superior properties to those used in the resource calculation (press release dated January 14, 2013).



## **Work**

The Company completed its drilling program on Anticosti Island during the first quarter. During the work, cores were taken from the Princeton Lake, Highcliff and Oil River sites, all of which are located in the western part of the Island.

The program was designed to acquire greater knowledge about the formation by performing new lab analyses using the data already available and the new samples taken from the Macasty shale.

The initial results of the analyses of the cores from the Macasty Formation on Anticosti Island, taken at the Princeton Lake and Highcliff sites by Pétrolia and Corridor Resources in the fall of 2012, indicate higher values than those used previously in calculating the resources for that area of the Island. The estimates will therefore be revised (press release dated January 14, 2013).

The results of the two cores indicate remarkable average values for total organic carbon (TOC) of 4% for the entire thickness of the Macasty shale. These data regarding amount of hydrocarbons present in the rock (S1) indicate very strong potential for hydrocarbon production in the Macasty Formation of 4.48 mg/g at Princeton Lake and 3.20 mg/g at Highcliff. The results of the analyses performed by the Weatherford and TerraTek labs are provided in the table below.

The results are taken from geochemical analyses and compare favourably with those of the Chaloupe 1 well taken on Anticosti in 2010 and those taken in Ohio, which is recognized for its hydrocarbon source rock production.



	<b>Anticosti</b>			<b>U.S. – Ohio</b>
<b>Corehole</b>	Chaloupe	Princeton Lake	Highcliff	Production wells
Drilling year	2010	2012	2012	
<b>Properties analyzed</b>				
Macasty thickness	40 m	<b>91.5 m</b>	<b>57 m</b>	40 m
Average <sup>TOC</sup> 1	4.34%	<b>4.02%</b>	<b>3.99%</b>	Between 2 and 4%
(including best 10 m <sup>2</sup> interval)		<b>5.90%</b>	<b>5.50%</b>	
Average S <sub>1</sub> <sup>3</sup>	3.08 mg/g	<b>3.48 mg/g</b>	<b>3.20 mg/g</b>	>2 mg/g
(including best 10 m <sup>2</sup> interval)		<b>5.71 mg/g</b>	<b>4.59 mg/g</b>	

1. TOC stands for total organic carbon.

2. The 10-m interval is a part of the Macasty Formation where the TOC and S1 values are the highest. The value presented in the table is an average.

3. S1 is the amount of hydrocarbon present in the rock.

Over the past quarter, Pétrolia pursued its work to determine the hydrocarbon source rock potential at Macasty. The purpose of the work was to:

- Analyze samples of drill cuttings and cores available from the Ministère des Ressources naturelles core sample library to enhance its knowledge of Macasty's total organic content (TOC) and thermal maturity (Ro). These data will make it possible to more accurately determine where the greatest oil potential is on the Island and identify the best locations for upcoming drilling.
- Initiate a study of the hydrogeological system, similar to the one conducted in the Gaspé. This study was again performed by Professor René Lefebvre and his team at the INRS-ETE and required drilling of 14 water wells at about 10 sites.



## **Potential of conventional reservoirs**

Although the Company is currently focusing its exploration efforts on evaluating the potential of the source rock in the Macasty Formation, conventional reservoirs will still be considered for drilling targets when planning future work.

Oil companies have been looking for oil in conventional structures on the island since 1960 but no conclusive results have been found to date.

Shell and later Hydro-Québec and Corridor Resources Inc. have all searched for fault structures. These structures, commonly referred to as "sags," were extremely 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 high-quality reservoirs.

For now, the Company would rather focus on developing Macasty's oil potential. However, it is not ruling out the possibility that this type of more conventional trap will be assessed at a later date.

## **Search for partners**

The exploration program for the Macasty hydrocarbon source rock is currently in the early stages. More extensive exploratory work is required to determine the potential for commercial recovery of resources in place in this Formation.

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

## **Environmental research**

Pétrolia continued its support, as a private-sector partner, of the work of 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 adapt practices so as to promote eco-friendly development. Our contribution to this work (\$200,000 over five years) attests to the Company's involvement in the communities in which it operates.



In keeping with Pétrolia's desire to develop oil resources responsibly and the importance placed on water resources, the discovery of the hydrocarbon potential of the Macasty Formation justifies carrying out hydrogeological work. As in the Gaspé region, Pétrolia has entered into an agreement with the INRS-ETE to conduct this study, which will be piloted by Professor René Lefebvre.

Pétrolia is supporting work on Anticosti Island that is similar to the work currently underway on the Haldimand Peninsula aimed at characterizing the regional hydrogeological system and monitoring the exploration work. Over the past quarter, Pétrolia's support for the INRS-ETE's work made it possible to put in place the initial infrastructure required for this study. While not mandatory, this work is consistent with the responsible approach adopted by Pétrolia vis-à-vis the physical and social environments in which the Company operates.

This work is intended to enhance the Company's knowledge, more specifically:

- Whether there is a connection between the formation where oil resources are located and the subsurface hydrogeological system;
- If, and how, exploration activities, particularly drilling, affect water resources;
- What mitigation measures could be put in place to minimize the impact of oil operations on the hydrogeological system.

It is precisely to expand its scientific knowledge that Dr. Lefebvre has been asked to conduct this study. Pétrolia's work provides the basis for the research and will enable scientists to determine whether oil exploration and production affect the quality and quantity of subsurface water.

More specifically, the three-year study will:

- Drill 14 subsurface water observation wells on 10 sites
- Obtain a detailed characterization of the existing geological and hydrogeological conditions
- Monitor the change in water quality during the work performed by Pétrolia
- Put in place a system to detect and correct potential problems
- Integrate the results and make recommendations to minimize the potential impact of oil activities on subsurface water

This study, which involves a partnership between academia, the oil industry and the regional community, is an innovative and responsible initiative. A hydrogeological study of this magnitude is a first on Anticosti Island.



### **Monitoring of hydrogeological work on Anticosti Island**

<b>Work</b>	<b>Planned</b>	<b>Completed to date</b>
Observation wells	14	14
Hydraulic tests	1	1
Water samples and analyses	37	37
Water table monitoring	2	2
Logging	10	7

### **9.4. Tar Point property**

Drilled in 2009 and located 15 kilometres southeast of the Haldimand wells, Tar Point 1 bottomed out at 2,434 metres. This well 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 in February 2010 during a production test on a naturally fractured zone in the Indian Cove Formation.

Pétrolia is also developing a program for Tar Point to acquire scientific and environmental monitoring information. The hydrogeological study mentioned in the previous section also includes Tar Point. The following table shows the progress of the work in this sector.

### **Monitoring of hydrogeological work at Tar Point**

<b>Work</b>	<b>Planned</b>	<b>Completed to date</b>
Observation wells	3	3
Hydraulic tests	4	4
Water samples and analyses	6	6
Water table monitoring	1	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 target in the Gaspé.

## **Studies and projects**

The drilling results for Tar Point 1 confirm the oil potential of the Indian Cove Formation, which is a naturally fractured reservoir. The results of the injectivity test conducted in the first quarter have been analyzed. An evaluation of the various options that will allow development of this formation has, however, been postponed to allow the Company to focus all its attention on its 2012 drilling campaign.

## **9.5. Other properties**

### **Gaspésia**

In 2011, a seismic program was planned for the Gaspésia property to identify a drilling target on a potential trap discovered during a 2008 seismic survey. On July 16, 2012 the Ministère des Ressources naturelles issued the geophysical surveying licence required to carry out this work. The Company had planned to conduct the survey in 2012 but decided instead to focus its efforts on the Anticosti drilling campaign.

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 rekindle the Company's interest in the gas potential on the Gaspé property.

### **New Brunswick**

The status of licences in New Brunswick has not changed since the last annual report. Pétrolia will continue monitoring the situation in this province.

## **10. Changes to the legislative and regulatory framework**

Pétrolia has not been affected by the results of the provincial election in September as the new government is also committed to fostering the development of Quebec's oil resources. Pétrolia's Management is monitoring the situation closely and plans to cooperate with the newly elected government so that it can put in place conditions conducive to developing Quebec's oil potential and creating an oil industry service sector.



## **11. Human resources**

Pétrolia is proud that it can rely on the vast experience of its technical team, whose members are all recognized for their expertise. Its personnel are highly skilled in the fields of geology, geochemistry, geophysics, petrophysics and engineering and are comfortable dealing with the concepts involved in oil and gas exploration. The Company's technical expertise is one of its strong points, and places Petrolia in a position of leader in Quebec.

## **12. Operating results and cash position**

For the first quarter, the Company's income consisted of interest income from cash of \$38,133 and rental income of \$2,994, compared with \$59,219 and \$2,994 for the first quarter of 2011.

During the quarter, the Company issued 957,050 flow-through shares for a consideration of \$1,148,460, and 60,000 shares for a consideration of \$44,400. These 60,000 shares were issued during the exercising of share options.

As at December 31, 2012, the Company had cash and cash equivalents of \$6,414,870, a decrease of \$3,827,392 since September 30, 2012. The Company spent \$3,805,124 on exploration and evaluation assets and \$853,728 on its operating activities and deposited \$831,460 in net share issue proceeds.

As at December 31, 2012, working capital stood at \$8,392,196. Management does not believe it will have sufficient cash to meet its obligations and projected expenses until September 30, 2013. However, the Company is in the process of finalizing a loan guaranteed by its reimbursable tax credits to enable it to meet its short-term obligations. Any shortfall may be met in a number of ways in the future, including but not limited to the issuance of new debt or equity instruments, additional cost-cutting measures and/or the introduction of new partners.

### **Analysis of operating and administrative expenses**

Operating and administrative expenses rose \$790,923, mainly due to an increase in the Company's exploration activities and costs associated with social acceptability of its projects.

The main differences in the operating and administrative expenses are:

- Share-based payments: 2,220,000 options valued at \$913,906 were granted in December 2012, compared with 1,266,000 options in December 2011 for a value of \$558,992.
- Salaries and benefits: Operations-related payroll increased slightly. Administrative staff was hired to respond to the needs of the community and government authorities.



- Promotion and entertainment: Advertising and promotional expenses increased from the first quarter of 2011, mainly due to social acceptability activities.
- Professional fees: The professional fees expense is mainly related to settlement of legal disputes.
- Depreciation of property, plant and equipment: The increase in the depreciation expense is mainly due to the depreciation of five reservoirs and of leasehold improvements to the new office space.

### Summary of quarterly results

The information for the summary of quarterly results is based on International Financial Reporting Standards (IFRS).

	2012				2011			
	December	September	June	March	December	September	June	March
	\$	\$	\$	\$	\$	\$	\$	\$
Income	41,127	93,806	50,430	48,451	78,489	75,160	51,373	45,386
Profit or loss	(1,141,104)	(494,129)	(675,032)	(699,230)	(1,150,642)	(443,251)	(672,511)	(512,133)
Net earnings per share								
Basic	(0.017)	(0.010)	(0.012)	(0.013)	(0.022)	(0.010)	(0.013)	(0.035)
Diluted	(0.017)	(0.010)	(0.012)	(0.013)	(0.022)	(0.010)	(0.013)	(0.035)



Income essentially consists of interest earned and project revenue for each quarter. Operating and administrative expenses were fairly stable from quarter to quarter. The main changes in quarterly losses or earnings are explained as follows:

2010 – December	Recognition of share-based payment of \$82,800 and a \$5,158,607 gain on disposal of interests in certain licences;
2011 – February	Recognition of share-based payment of \$71,400;
2011 – May	Recognition of share-based payment of \$160,750;
2011 – September	Restatement of all share-based payment for the year using the graded vested method; this restatement had a non-monetary impact of \$185,258;
2011 – December	Recognition of share-based payment of \$558,992;
2012 - February	Recognition of share-based payment of \$80,700;
2012 - December	Recognition of share-based payment of \$913,906.

### **Related party transactions**

The Company's related parties include other related parties and key management personnel, as described below.

Unless otherwise indicated, none of the transactions involve special terms or conditions and no guarantees were given or received. Outstanding balances are usually settled in cash.



## Transactions with key management personnel

Key management personnel remuneration includes the following expenses:

	Three-month period ended December 31,	
	2012	2011
	\$	\$
Short-term employee benefits:		
Salaries and benefits	244,108	113,442
Attendance fees	31,667	29,449
Total short-term benefits	275,775	142,891
Share-based payments	608,400	330,244
Total remuneration	884,175	473,135

During the 2012 reporting period, key management exercised 2,220,000 options (1,266,000 in 2011) granted under the share-based compensation plan.

## Related parties

Transactions were carried out with two companies whose main officer (holding a minority interest) also serves on Pétrolia's Board:

	Three-month period ended December 31,	
	2012	2011
	\$	\$
Statement of financial position:		
Exploration and evaluation assets	0	2,394
Statement of comprehensive income:		
Other expenses		



The balance due from these companies is \$0 at December 31, 2012 (December 31, 2011 – \$26,366).

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

	<b>Three-month period ended December 31,</b>	
	<b>2012</b>	<b>2011</b>
	<b>\$</b>	<b>\$</b>
Statement of financial position:		
Exploration and evaluation assets	<u>0</u>	<u>2,062</u>

The balance owing this director is \$0 on December 31, 2012 (December 31, 2011 – \$2,349).

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

	<b>Three-month period ended December 31,</b>	
	<b>2012</b>	<b>2011</b>
	<b>\$</b>	<b>\$</b>
Statement of comprehensive income:		
Salaries and benefits	674	1,188
Office supplies and transportation	200	300

The balance owing this company is \$1,091 at December 31, 2012 (\$2,349 at December 31, 2011).

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

	<b>Three-month period ended December 31,</b>	
	<b>2012</b>	<b>2011</b>
	<b>\$</b>	<b>\$</b>
Statement of financial position:		
Property, plant and equipment	0	8,607
Statement of comprehensive income:		
Office maintenance	<u>0</u>	<u>0</u>

The balance owing this supplier is \$0 at December 31, 2012.  
(December 31, 2011 – \$0).

These transactions took place in the normal course of business and were measured at their exchange value, which is the consideration established and accepted by related parties.



## **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:

#### **Credit risk**

Financial instruments that potentially subject the Company to credit risk consist primarily of cash and cash equivalents and trade and other receivables. The Company's cash and cash equivalents are held with or are issued by first-class financial institutions. The majority of receivables are sums owed by governments, partners and related parties. Therefore, Management considers the risk of non-performance on these instruments to be very minimal.

#### **Liquidity risk**

Liquidity risk is the risk that the Company will be unable to meet its financial obligations as they fall due or do so only at excessive cost. The Company finances its growth by issuing shares and selling 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 its exploration activities. All of the Company's financial liabilities have a maturity of less than one year.

#### **Market risk**

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate due to 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 interest rate risk.

##### **a) Interest rate risk**

Interest rate risk refers to the impact of interest rate fluctuations on the value of investments.

The Company is exposed to interest rate risk on its fixed-rate financial instruments. For the period ended December 31, 2012, an increase or decrease of 1% in the interest rates in effect at that date, with all other variables remaining equal, would have generated a profit or loss of \$11,226 (2011 – \$13,183).



## **Fair value**

The fair value of investments is determined as follows:

Guaranteed investment certificates: Given their recent issuance, the fair value corresponds to their cost.

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

As regards the loan, the carrying value approximates the fair value due to the variable interest rate on the debt.

### **Fair value hierarchy**

Financial instruments recognized at fair value on the statement of financial position are classified using a fair value hierarchy that reflects the significance of the inputs used in making the fair value measurements.

The three levels of the fair value hierarchy are:

Level 1– Quoted prices (unadjusted) in active markets for identical assets or liabilities: cash is found at this level.

Level 2 – Inputs other than quoted prices included within level 1 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 found at this level.

Level 3 – Inputs for the asset or liability that are not based on observable market data (unobservable inputs).

Determination of fair value and the resulting hierarchy requires the use of observable market data whenever available. The classification of a financial instrument in the hierarchy is based upon the lowest level of input that is significant to the measurement of fair value.

There was no transfer in the valuation of financial assets between levels 1 and 2 during the period.

## **Judgments, estimates and assumptions**

For a complete description of the judgments, estimates and assumptions made by Management in the preparation of its annual financial statements for the year ended September 30, 2012, see Note 5 of the Financial Statements.



### **Future changes in accounting policies**

For a complete description of future changes in accounting policies, see Note 3 of the Financial Statements for the year ended September 30, 2012.

### **Significant accounting policies and transition to IFRS**

For a complete description and detailed presentation of the significant accounting policies used by the Company and the transition to IFRS, see Notes 4 and 26 of the Financial Statements for the year ended September 30, 2012.

### **Capital management**

For a complete description of the Company's capital management policy, see Note 20 of the Financial Statements for the year ended September 30, 2012.

### **Internal controls**

Given that the Company is an emerging issuer, the officers do not have to make any certifications concerning the establishment and maintenance of control, or the disclosure of information and internal controls related to financial reporting as defined in Regulation 52-109.

The issuer's certifying officers are responsible for ensuring that processes are in place to provide them with sufficient knowledge to support the representations in the certificates, more specifically, that the documents filed on SEDAR are reliable. The officers will ensure that once the convergence process is completed, they will still be able to sign their certification.



## Other information

### a) Supplemental documents

Certain supplemental documents, including prior management reports and press releases, are available online at [www.sedar.com](http://www.sedar.com) in the documents section or on Pétrolia's website at [www.petroliagaz.com](http://www.petroliagaz.com).

### b) Regulation 51-102 Section 5.2

Exploration expenses for the quarter ended December 31, 2012 are detailed as follows:

	Geology	Geophysics	Drilling	Analysis	Fracturing	General expenses	Options	Provision	Site maintenance	Total
	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$
Anticosti	7,001	-	834,183	6,259	-	8,786	21,500	-	-	877,729
Gastonguay	-	-	-	-	-	-	39	-	-	39
Gaspésia Marcel-Tremblay Edgar	450	-	-	-	-	-	2,618	-	-	3,068
Gaspé	5,741	-	-	2,398	-	29,431	3,406	-	-	40,976
Bourque	2,880	-	8,055,935	-	-	3,867	40,089	-	21,756	8,102,772
Haldimand	188,724	1,360	298,549	-	51,470	5,159	35,264	-	-	602,281
Tar Point	-	-	-	-	-	1,619	8,577	-	-	10,196
Dalhousie	-	-	-	-	-	-	460	-	-	460
	<b>204,796</b>	<b>1,360</b>	<b>9,188,667</b>	<b>8,657</b>	<b>51,470</b>	<b>48,862</b>	<b>111,953</b>		<b>21,756</b>	<b>9,637,521</b>



Deferred exploration expenses for the quarter ended December 31, 2011 are detailed as follows:

	Geology	Geophysics	Drilling	Analysis	Fracturing	General expenses	Options	Provision	Site maintenance	Total
	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$
Anticosti	11,134	10,186	10,878	-	-	-	26,364	(37,500)	-	21,065
Gastonguay	-	-	-	-	-	-	62	-	-	62
Gaspésia Marcel-Tremblay Edgar	5,529	5,489	-	-	-	50	4,027	-	-	15,095
Gaspé	1,440	9,871	133	-	560	20,528	3,860	-	-	36,393
Bourque	8,705	1,854	1,781	6,930	-	1,645	2,079	-	-	22,993
Haldimand	111,832	55,211	23,164	1,260	729,448	8,770	40,477	-	33,116	1,003,277
Tar Point	4,710	-	-	-	247,636	728	11,710	-	4,099	268,883
Dalhousie	1,563	23	1,500	-	-	(290,714)	669	-	-	(286,958)
	<b>144,913</b>	<b>82,634</b>	<b>37,456</b>	<b>8,190</b>	<b>977,644</b>	<b>(258,993)</b>	<b>89,251</b>	<b>(37,500)</b>	<b>37,215</b>	<b>1,080,810</b>

c) Regulation 51-102 Section 5.3

***Information on shares issued, warrants and share options as at February 28, 2013:***

Common shares: 68,002,800 shares have been issued and are outstanding.

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

- 327,500 options exercisable at a price of \$1.25 per share until July 7, 2013
- 60,000 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
- 672,500 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
- 75,000 options exercisable at a price of \$1.51 per share until February 22, 2017
- 2,220,000 options exercisable at a price of \$1.02 per share until February 22, 2017



### **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 International Financial Reporting Standards and audited by the Company's auditors. The financial statements include certain amounts that are based on the use of 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, February 28, 2013  
On behalf of the Board

(signed) André Proulx  
André Proulx  
President