



Leader en exploration pétrolière au Québec



**INTERIM MANAGEMENT  
DISCUSSION AND ANALYSIS**

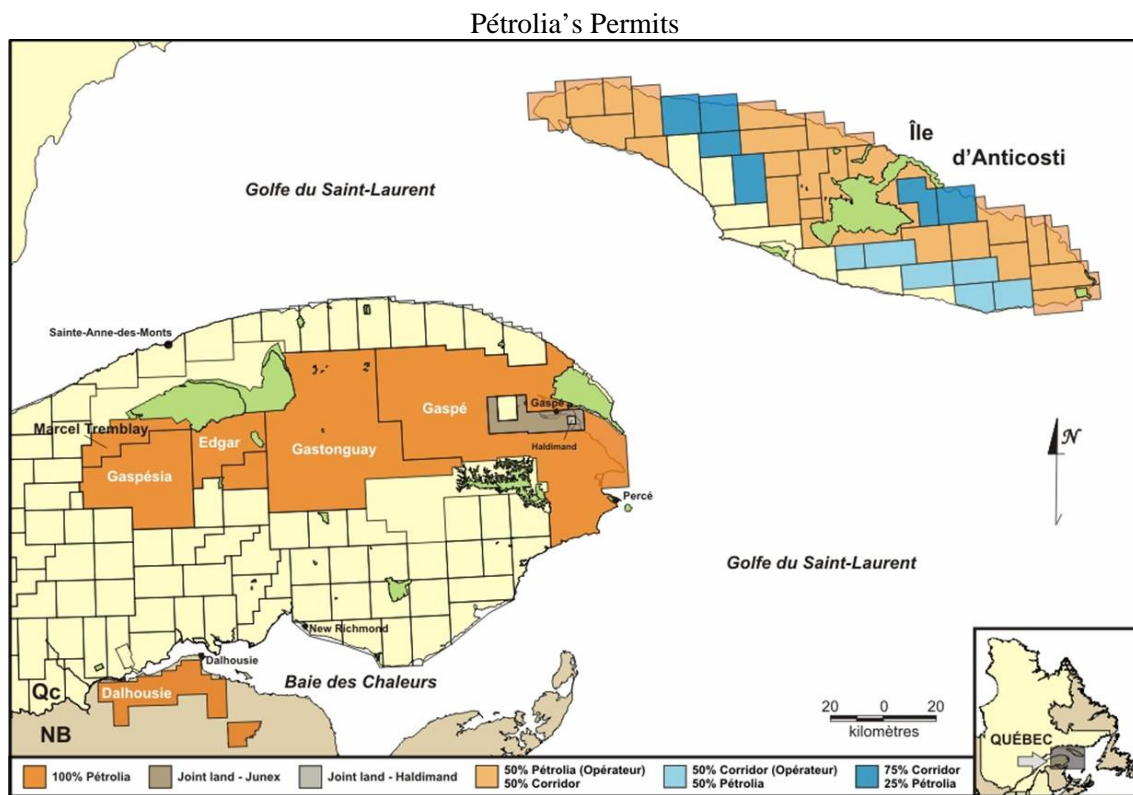
**For the third quarter ended  
June 30, 2008**

## INTERIM MANAGEMENT DISCUSSION AND ANALYSIS FOR THE THIRD QUARTER ENDED JUNE 30, 2008

This interim management discussion and analysis complies with Rule 51-102A of the Canadian Securities Administrators regarding continuous disclosure for reporting issuers. It is an addition and supplement to the quarterly financial statements and should be read in conjunction with them and in parallel with the audited financial statements for fiscal years ended September 30, 2007 and 2006, and the annual management report when required. It presents the view of management on current Company activities and financial results, as well as a preview of the activities during the coming months.

### 1.1 DATE

This management discussion and analysis for the three-month period ended June 30, 2008, is prepared as at August 8, 2008.





## **1.2 NATURE OF ACTIVITIES AND OVERALL PERFORMANCE DURING THE MOST RECENT QUARTER**

The Company is incorporated under Part 1A of the Quebec Companies Act. It has been listed on the TSX Venture Exchange since February 16, 2005. Exploration and development of oil and gas properties are the Company's primary activities. Moreover, as part of achieving these objectives, the Company is called upon to enter into partnership agreements specific to the oil and gas industry.

During this past quarter, the Company devoted a substantial part of its efforts to developing exploration programs for its various properties. Each program was designed based on the exploration maturity level, the geological nature of the land, and the targeted oil objectives. The less mature the project is, the higher the risks associated with exploration. Pétrolia has continued its search for partners in order to pool these risks.

For some time, the interest generated by the oil industry has had repercussions on the demand for oil exploration permits in Quebec. Permits issued by the Province have therefore increased in recent months, decreasing the total area held by Pétrolia from 21% to 18%. However, the Company's permits still represent 70% of Quebec's land territory having recognized oil potential.

### **1.2.1 AGREEMENTS**


#### *Gaspé Property*

On May 6, the Company signed a joint operating agreement with Junex and Gastem for the development of the Haldimand oil project and a comprehensive agreement that amends the sales contract dated July 13, 2005, between Pétrolia and Junex regarding the Gaspé and Gastonguay properties (*Press Release: May 7, 2008*). The first agreement marks the boundaries of a development area of 9 km<sup>2</sup> around the Pétrolia-Haldimand No. 1 well, in which Pétrolia holds a 45% interest, Junex holds 45%, and Gastem holds 10%. Under the second agreement, Pétrolia and Junex have mutually waived their right of first refusal. Junex also waives its right to return (back-in option) on the Pétrolia drillings. In exchange, each party agrees to become a 50/50 partner in a permit block of approximately 291 km<sup>2</sup>, over which Junex will be the "operator" within this territory. Pétrolia shall grant to Junex a royalty fluctuating between 0.5% and 2.5% of the future hydrocarbon production on the remaining 6,043 km<sup>2</sup> of the Gaspé and Gastonguay properties.

#### *Bourque Property*

On August 5, Pétrolia announced the signing of a \$20M farm-out agreement with an oil company (*Press Release: August 5, 2008*). Over the next five years, this company will be able to earn a 70% interest on the Bourque property's four permits by investing \$20M into exploration and development work under the following terms:

- Over the next 18 months, the oil company must carry out a seismic profile of a minimum amount of \$2.5M to secure its right to participate in this agreement;
- Over the next three years, it must invest \$8M into exploration work in order to earn a 24% interest in the property;
- Over the next five years, by investing a cumulative amount of \$16M, it will be able to increase its interest to 48% and, by investing an additional \$4M for a total of \$20M, increase its interest to 70%;

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- In consideration of the \$20M investment, it will be able to claim up to \$6 million from the share of Pétrolia's production income in this property;
  - License fees of 5.5% are payable on production from these four permits;
  - Throughout the entire term of this agreement, Pétrolia will act as "operator" under the control of a two-party management committee.

This agreement allows Pétrolia to pool the risks associated with this type of investment and to benefit from the expertise of its partners. It also helps to limit the issuance of new shares while maximizing exploration work on Pétrolia's permits.

### **1.2.2 FINANCING AND INCOME**

On June 6, the Company completed approximately \$10M in fundraising with the issuance of 6,666,665 shares at \$1.50 per share. These new cash assets will provide the Company with the necessary funds to carry out all of the exploration projects it has pledged to complete before March 31, 2009.

The Company's current income is made up primarily of interest income, since the Company is in the exploration and evaluation stage of the Pétrolia-Haldimand No. 1 well. As such, its financing comes from the issuance of shares of its capital stock.

During the third quarter, the Company performed exploration work totalling \$692,884, including \$514,935 in work for a partner. Net earnings for the quarter were \$1,487,502 (\$0.0448 per share), compared with a net loss of \$390,336 (\$0.0134 per share) for the corresponding quarter of the previous year. These earnings resulted from an unrealized gain of \$1,590,000 recorded on an investment held for trading, compared with an unrealized loss of \$150,000 for the same period in 2007.

### **1.3 STRATEGY AND OUTLOOK**

During the next quarter, Pétrolia's main objectives will be:

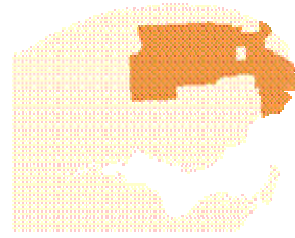
- 1) Together with its partners, to carry out the necessary work to bring the Pétrolia-Haldimand No. 1 well into production as quickly as possible. The agreement signed on May 6, 2008 provides a budget of \$5M to undertake a program to develop the Haldimand field (*Press Release: May 7, 2008*);
- 2) To initiate a variety of exploration work such as drilling, seismic surveys, and geochemical surveys to advance the projects highlighted by Pétrolia and its partners;
- 3) To sign new agreements with partners to accelerate exploration programs aimed at assessing its vast permit area.

Information on the agreements and exploration work is available in the "Press Releases" section of the Company's website ([www.petroliagaz.com](http://www.petroliagaz.com)).



## **Gaspé Property (Haldimand and Bourque Projects):**

The Gaspé Property in the eastern part of the Gaspé region covers the ground with the highest potential for petroleum discoveries in the region. The presence of petroleum is confirmed both by surface seeps and by shows found during drilling. Moreover, several types of reservoir have been identified at depth and on surface.



The Company is focusing its attention on three areas of the Gaspé Property:

- the Haldimand Project;
- the Bourque Project;
- the Haldimand-Extension Project.

### **Characteristics:**

- Discovery of light crude in the Pétrolia-Haldimand No. 1 well;
- Most explored portion of the Gaspé region: 7 wells drilled since 1999;
- Area's demonstrated oil and gas potential;
- Adequate regional seismic coverage.

### *Haldimand Project (45% interest)*

The Pétrolia-Junex-Gastem partnership has set itself the objective of outlining the extent of the productive horizons identified in the Pétrolia-Haldimand No. 1 well. The proposed work, with an estimated cost of \$5M, comprises three separate phases:

- Continuation of analyses and tests in the Pétrolia-Haldimand No. 1 well;
- A 3-D seismic-survey program; and finally
- Drilling of a second borehole targeting the productive zones already identified in the previous well.

Junex, as Operator, will be responsible for the work.

### **Work in progress**

Pétrolia has awarded a contract to INRS-ETE to:

- Characterize the organic matter in the Pétrolia-Haldimand No. 1 well so as to identify its source;
- Conduct a palynologic study of the rocks at the bottom of the Soquip Douglas No. 1 well, located near the Pétrolia-Haldimand No. 1 well, to determine their age. This study is important for an understanding of the chronology of hydrocarbon emplacement.

### **Proposed work**

The proposed operations at the Pétrolia-Haldimand No. 1 well will comprise:

- Recovery of a pressure gauge installed in the well in 2006, and collection of petroleum samples under reservoir conditions;
- An extended production test to confirm the production capacity of the Pétrolia-Haldimand No. 1 well, following analysis of the petroleum samples and the pressure data;
- More detailed geologic studies of the various formations intersected by the drilling. The information thereby obtained will be used to provide a better picture of the reservoir.



A detailed 3-D (or high-density 2-D) seismic survey is already in progress and will be completed by the end of September. This survey, covering a 13-km<sup>2</sup> area around the discovery well, will provide an image of the depths and structures of the various subsurface geologic layers. These data will enable a decision on the site of the second well.

The second hole should be drilled in the fall if drilling equipment is available and the necessary permits can be obtained. The proposed program of sampling and testing at this well should provide confirmation of the extension of the productive horizons identified in the first well, a better characterization of the reservoir rock, and an improved interpretation of the results from the initial well.

### *Bourque Project (100% interest)*

Pétrolia has been conducting preliminary investigations on the Bourque property for nearly two years, and is reinterpreting earlier data to assess its potential for petroleum and to determine the kind of traps to be targeted. This has led to the implementation of an exploration program designed to locate Siluro-Devonian reefs bordering a fault zone. Following discussions with an oil company an agreement was signed on August 5, 2008, and a seismic-acquisition program is already under way.

#### **Work done**

- The proposed seismic survey lines were laid out by our own staff, and field work began in July. This new survey is an essential step in understanding the distribution, shape, and subsurface extent of the reefs;
- Initial results from the maturation study of organic matter in the surface samples collected in 2007 have been delivered by INRS-ETE.

#### **Proposed work**

- Completion of the seismic-acquisition program;
- Interpretation and evaluation of the seismic survey's results.

### *Haldimand-Extension Project (100% interest)*

During the last quarter, the Company has developed an exploration program to assess the possibility of finding other Haldimand-type deposits in this extension of the Haldimand project area, which offers similar geologic environments.

#### **Work done**

- Reassessment of available data and reprocessing of some of the old seismic lines;
- Field geologic studies to add more detail to the published geological maps;
- Preparations for a seismic-acquisition program;
- First phase of a soil-geochemistry survey designed to outline areas located above hydrocarbon reservoirs.

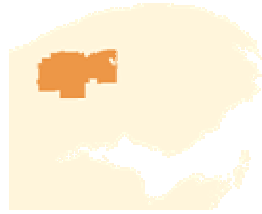
#### **Proposed work**

- Conduct a 2-D seismic survey;
- Complete the soil-geochemistry survey;
- Execute a high-resolution airborne magnetic survey to extend the 1998 and 2004 government surveys farther to the east



### **Gastonguay Property (100% interest):**

This property's subsurface geology is largely unknown, but a comparison with adjacent regions suggests the possibility of traps in Silurian rocks. However, results from studies of the maturation of organic matter indicate that several areas may have gone beyond the stage where hydrocarbons can be preserved.



#### **Characteristics:**

- Low level of exploration in the region;
- 1 well drilled on a seismic target;
- No recent seismic coverage.

#### **Proposed work**

This year, the Company has focused its efforts on properties with more established potential and has therefore postponed assessment work on the Gastonguay property; however, it is still part of its program. If results are encouraging, Pétrolia will proceed to a reconnaissance seismic program.

### **Gaspésia, Edgar, and Marcel-Tremblay Properties (100% interest)**

Before Pétrolia came on the scene, these areas were relatively unexplored. However, the seismic lines acquired by the Company and the Ministry of Natural Resources and Fauna suggest the presence of potential targets in the Silurian formations. These profiles also show major structures that are not expressed on surface, but that could form promising traps.

#### **Characteristics:**

- Uneven regional seismic coverage;
- 1 significant well in the area west of the property.

#### **Work done**

- Preparations for a 2-D seismic survey program to be completed before the fall of 2008;
- Soil-geochemistry survey to detect the presence of hydrocarbons at depth.

#### **Proposed work**

- Acquisition of seismics to identify targets for drilling;
- Participation in the Summer NAPE Expo in Houston on next August 27-28, with the aim of finding a partner.

### **Anticosti Property (Pétrolia's interest: 25 to 50%)**

Anticosti Island is a huge and very promising area, but is relatively unexplored. The island's geologic formations consist of rocks whose composition and age are similar to those in producing areas of the northeastern United States, and also like those in the Saint Lawrence Lowlands, another area where significant discoveries have been made in hydrothermal dolomites. A good source rock is present on the island, and well data show that it did generate petroleum at some point in the basin's history. Porous zones and shows of petroleum have also been encountered





during drilling. A number of structures associated with hydrothermal dolomitization phenomena, like those mentioned above, appear on the seismic records. The permits obtained by Pétrolia and Corridor cover the entire area considered prospective for petroleum. The property is of even greater interest since its exploration has reached the drilling stage, and the Company can thus expect to see results in the near to medium term.

#### **Characteristics:**

- 17 wells drilled, including 8 on seismic targets (5 recent);
- Recent regional seismic survey;
- Region with recognized petroleum potential;
- Limited access to the island.

#### **Work done**

- Analysis of available seismic lines and drilling data;
- Planning of a geochemical survey to be completed during next August and September;
- Preparations for a drill program, scheduled to start by the end of 2008.

#### **Proposed work**

- Completion of work already in progress and assessment of results;
- Completion of a study designed to characterize the organic matter in three wells at the east end of the island.

#### **Dalhousie Property (100% interest):**

Pétrolia is the first oil company to become interested in this portion of New Brunswick. Recent studies on organic matter show that it has potential for oil and gas. Examination of the regional magnetic and gravity surveys suggests the presence of a huge structure. In addition, volcanic rocks that have been fractured and cut by hydrothermal dolomites could form a very attractive – if unconventional – reservoir.

**Pétrolia's interest:** 100%.

#### **Characteristics:**

- Very low level of exploration in the region (no previous drilling or seismics);
- Region has potential for gas;
- Close to a market.

#### **Work done**

- INRS-ETE has been awarded a contract to evaluate the petrophysical properties of the Ordovician volcanic rocks that constitute one of this region's potential objectives;
- Acquisition of a detailed gravimetric survey;
- Three-dimensional (3-D) modeling of potential fields showing the extent of the target structure.







## **Proposed work**

Pétrolia will invest about \$1M for an exploration program, to include:

- A regional geochemical study;
- Acquisition of reconnaissance seismic profiles to identify the locations of potential targets. These targets will then be surveyed in greater detail before possible drilling.

### **1.4 EFFECTIVENESS OF DISCLOSURE PROCEDURES AND CONTROLS**

The President and Chief Executive Officer and the Vice President of Finance have designed or supervised the design of disclosure controls and procedures in order to provide reasonable assurance that material information relating to the Company is made known to them, particularly during the period in which the interim filings are being prepared. They have also designed or supervised the design of internal controls over financial reporting in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian generally accepted accounting principles.

The assessment of the effectiveness of disclosure procedures and controls was conducted as of September 30, 2007, by the Company's officers, specifically the President and Chief Executive Officer and the Vice President of Finance, and under their supervision. Based on this assessment, these officers concluded that the Company's disclosure controls and procedures are effective in reasonably ensuring that the material information relating to the Company is made known to them by other members of the Company's staff on a timely basis.

### **1.5 OPERATING RESULTS AND CASH POSITION**

For the quarter, the Company's revenues were limited to interest income of \$44,908 from short-term investments, compared to \$1,366 for the same quarter in 2007. The \$3,000,000 increase in short-term investments to \$11,713,694 since the start of the fiscal year explains most of this increase in income.

As of June 30, 2008, the Company had cash and cash equivalents of \$11,761,167, an increase of \$8,260,823 for the quarter. Receipts resulting from a capital stock issuance of \$9,376,787 and disbursements related to deferred operating expenses and taxes on properties totalling \$1,022,618 explain much of the change in cash and cash equivalents.

As of June 30, 2008, working capital was \$12,784,281 and should allow the work planned until March 31, 2009, to be performed.

Under the terms of research permits granted by Quebec's Ministry of Natural Resources and Fauna and New Brunswick's Ministry of Natural Resources, the balance of the fees that the Company has agreed to pay to them is \$145,219 by 2012. In addition, the Company must perform work on its properties in Quebec on a yearly basis, with minimum costs varying according to the age of the permits; therefore, they correspond to \$0.50 per hectare for the first year of the permit and increase annually by \$0.50, ultimately reaching \$2.50 per hectare beginning with the fifth year. The minimum amount of work required by Quebec and New Brunswick, net of exploration work already performed, is \$124,508 for the fiscal year 2008, \$822,611 in 2009, \$71,016 in 2010, \$191,355 in 2011 and \$82,913 in 2012.

## **1.6 ANALYSIS OF GENERAL AND ADMINISTRATIVE EXPENSES**

General and administrative expenses for the quarter totalled \$157,474, compared to \$273,544 in 2007. The variance of \$116,070 between this quarter in 2008 and this quarter in 2007 is explained mainly by the \$148,770 in stock-based compensation recorded in 2007.

## **1.7 SUMMARY OF QUARTERLY RESULTS**

	<u>2008</u>		<u>2007</u>				<u>2006</u>	
	<u>June</u>	<u>March</u>	<u>December</u>	<u>September</u>	<u>June</u>	<u>March</u>	<u>December</u>	<u>September</u>
	\$	\$	\$	\$	\$	\$	\$	\$
Revenue	44,908	37,479	43,349	17,008	1,366	12,212	22,338	12,233
Net earnings (Loss)	1,487,502	(107,581)	38,617	(192,054)	(390,336)	315,253	(21,008)	(122,458)
Net earnings (Loss) per share								
Basic	0.0448	(0.0035)	0.0013	(0.0066)	(0.0134)	0.0109	(0.0007)	(0.0049)
Diluted	0.0399	(0.0035)	0.001	(0.0066)	(0.0134)	0.0095	(0.0007)	(0.0049)

The revenue consists of grants and interest earned for each of the quarters. General and administrative expenses have been relatively stable from one quarter to another in 2008. The changes in losses or quarterly profits are explained as follows:

2007 – March: Gain in the amount of \$400,000 resulting from an investment recorded at fair value.

2007 – June: Unrealized loss of \$150,000 on a long-term investment and stock-based compensation of \$148,770 recorded.

2007 – December: Unrealized gain of \$50,000 on a long-term investment recorded.

2008 – June: Unrealized gain of \$1,590,000 on a long-term investment recorded.

## **1.8 RELATED-PARTY TRANSACTIONS**

During the quarter, a company (Géominex Inc.) in which one of Pétrolia's directors holds a minority interest, billed for deferred exploration expenses for a total of \$162,995 (2007 – \$70,000) An amount of \$23,556 is due as at June 30, 2008 (2007 – \$35,340).

The Company shares its administrative expenses with Ressources Appalaches, a company that has the same chief executive officer. It billed the Company for the following expenses:

	<b>2008</b>	<b>2007</b>
	\$	\$
Salaries and fringe benefits	64,745	49,948
Office supplies	900	900
Telecommunications	1,533	1,089

The balance owed to this company as of June 30, 2008, is \$25,852 (2007 – \$15,619).

The Company also shares expenses for the use of a location with Géominex and invoiced it for the following expenses during the quarter:

	<b><u>2008</u></b>
Rent	(12,225)
Salaries	(2,060)
Office supplies	(11,248)
Telecommunications	(4,834)
Other expenses	(330)

In addition, Pétrolia was billed by a company (SEISSERV) whose principal shareholder is a Pétrolia director, for deferred operating expenses totalling \$14,248 (2007 – \$5,964). The amount due as at June 30, 2008, is \$7,042 (2007 – \$0).

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

## **1.9 ACCOUNTING POLICIES**

Readers are asked to refer to the note in the financial statements for the third quarter 2008 for a detailed description of the changes to accounting policies.

## **1.10 FINANCIAL INSTRUMENTS**

### **Credit risk**

The financial instruments that potentially subject the Company to credit risk consist primarily of cash and cash equivalents and receivables. The Company's cash and cash equivalents are held with or issued by first-class financial institutions. Therefore, management considers the risk of non-performance on these instruments to be very minimal.

### **Interest rate risk**

As at June 30, 2008, the Company's exposure to interest rate risk is summarized as follows:

Cash and cash equivalents	Non-interest bearing and fixed interest
Receivables	Non-interest bearing
Excess of outstanding cheques over bank balance	Non-interest bearing
Payables and accrued expenses	Non-interest bearing
Long-term debt	Fixed rates of 2.5% and 4.7%



## 1.11 RISKS AND UNCERTAINTIES

The oil and gas properties held by the Company are in the exploration stage. The Company's long-term profitability is partially linked to the costs and the success of the exploration and subsequent development programs, which may also be influenced by various factors.

Among these factors to be considered are environmental regulations, features of possible oil and gas accumulations, i.e. the quality and quantity of the resources, as well as development costs for a production infrastructure, financing costs, the market value of oil and gas, and the competitive nature of the industry.

Significant investments are necessary to complete the exploration and reserve development programs. In the absence of cash flows generated by an oil and gas exploitation, the Company depends on the capital markets to finance its exploration and development activities. Market conditions and other unforeseeable events may have an impact on the Company's ability to raise the funds required for its development.

## 1.12 ADDITIONAL INFORMATION

### a) Supplemental information

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

### b) Rule 51-102A section 5.3

Details of deferred exploration expenses for the three- and nine-month periods ended June 30, 2008, are presented in the statement of deferred exploration expenses and in note 4 of Company's interim financial statements of the same date.

### c) Rule 51-102A-section 5.4

#### ***Information on shares issued, warrants, and stock options as at August 8, 2008:***

Common shares: 40,914,219 common shares have been issued and are outstanding.

Warrants: Warrants can be exercised as follows:

- 1,750,000 shares at the price of \$1.00 per share until April 26, 2009;
- 3,000,000 shares at the price of \$1.00 per share until July 10, 2009;
- 3,756,665 shares at the price of \$1.50 per share until December 6, 2009.



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

- 25,000 options exercisable at a price of \$0.60 per share until October 10, 2008;
- 270,000 options exercisable at a price of \$0.40 per share until March 15, 2010;
- 1,075,000 options exercisable at a price of \$0.40 per share until February 3, 2011;
- 150,000 options exercisable at a price of \$0.58 per share until May 10, 2011;
- 1,037,500 options exercisable at a price of \$0.40 per share until June 21, 2012;
- 600,000 options exercisable at a price of \$0.60 per share until February 12, 2013;
- 150,000 options exercisable at a price of \$0.60 per share until March 3, 2013.
- 600,000 options exercisable at a price of \$1.25 per share until July 7, 2013.

### **1.13 MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL INFORMATION**

The quarterly financial statements were prepared by management in accordance with Canadian generally accepted accounting principles and were approved by the audit committee. Management is responsible for the fairness and objectivity of these financial statements.

Rimouski, August 8, 2008

On behalf of the Board

(signed) *André Proulx*

André Proulx  
President