

Consolidated Financial Statements of

## **PetroKamchatka Plc**

As at February 28, 2011 and May 31, 2010  
and for the three and nine month periods ended February 28, 2011 and 2010  
(United States Dollars)  
(Unaudited)

# PetroKamchatka Plc

Consolidated Balance Sheets  
(Unaudited)  
(United States Dollars)

As at	February 28, 2011	May 31, 2010
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 3,122,111	\$ 7,915,415
Accounts receivable	1,749,063	2,758,064
Prepaid expenses	32,023	27,958
	<u>4,903,197</u>	<u>10,701,437</u>
Property and equipment (note 3)	10,886,817	27,375,366
	<u>\$ 15,790,014</u>	<u>\$ 38,076,803</u>
<b>Liabilities and Shareholders' Equity</b>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 1,572,060	\$ 3,249,580
Shareholders' equity:		
Share capital (note 6(b))	91,806,942	91,755,940
Share purchase warrants (note 6(c))	7,038,779	7,038,779
Contributed surplus (note 6(e))	4,267,277	3,903,396
Currency translation adjustment	1,018,864	1,018,864
Deficit	(89,913,908)	(68,889,756)
	<u>14,217,954</u>	<u>34,827,223</u>
Going concern (note 2)		
Commitments (note 9)		
	<u>\$ 15,790,014</u>	<u>\$ 38,076,803</u>

*See accompanying notes to financial statements*

# PetroKamchatka Plc

Consolidated Statements of Operations, Comprehensive Loss and Deficit

Unaudited

(United States Dollars)

	Three Months Ended		Nine Months Ended					
	February 28,		February 28,					
	2011	2010	2011	2010				
Interest income	\$	–	\$	64	\$	–	\$	19,361
Expenses:								
Equipment operating costs and other (note 3(a)(ii))	999,800	–	1,696,855	–				
General and administration	503,411	734,071	1,673,267	3,714,175				
Reorganization and listing costs	–	–	–	1,173,758				
Financing and other costs	–	(432,388)	–	(432,388)				
Foreign exchange (gain) loss	14,894	186,364	17,830	(138,066)				
Stock-based compensation (note 6(e))	88,863	217,000	363,881	594,000				
Depreciation	5,511	288,700	258,387	493,800				
Writedown of property and equipment (note 3(a))	17,013,932	–	17,013,932	982,582				
	18,626,411	993,747	21,024,152	6,387,861				
Net loss and comprehensive loss for the period	(18,626,411)	(993,683)	(21,024,152)	(6,368,500)				
Deficit, beginning of period	(71,287,497)	(35,810,827)	(68,889,756)	(30,264,850)				
Transaction costs	–	–	–	(171,160)				
Deficit, end of period	\$(89,913,908)	\$(36,804,510)	\$(89,913,908)	\$(36,804,510)				
Net loss per share	\$	(0.04)	\$	(0.00)	\$	(0.04)	\$	(0.02)
Weighted average number of common shares outstanding:								
Basic and diluted	490,345,076	488,498,041	489,850,074	410,721,730				

See accompanying notes to financial statements

# PetroKamchatka Plc

Consolidated Statements of Cash Flows  
Unaudited  
(United States Dollars)

	Three Months Ended February 28,		Nine Months Ended February 28,	
	2011	2010	2011	2010
Cash provided by (used in):				
Operations:				
Net loss and comprehensive loss for the period	\$(18,626,411)	\$ (993,683)	\$(21,024,152)	\$ (6,368,500)
Items not involving cash:				
Depreciation	5,511	288,700	258,387	493,800
Stock-based compensation	88,863	217,000	363,881	594,000
Shares issued for services	19,127	–	51,002	49,653
Shares issued for bonuses	–	–	–	593,334
Unrealized foreign exchange (gain) loss	(38,361)	185,971	(20,676)	(270,734)
Writedown of property and equipment	17,013,932	–	17,013,932	982,582
	(1,537,339)	(302,012)	(3,357,626)	(3,925,865)
Change in non-cash working capital (note 8)	(324,843)	346,004	(1,248,079)	176,144
	(1,862,182)	43,992	(4,605,705)	(3,749,721)
Investing:				
Property and equipment	(18,888)	(2,234,940)	(783,770)	(4,349,762)
Change in non-cash working capital (note 8)	(423,348)	(1,112,344)	582,734	(2,205,448)
	(442,236)	(3,347,284)	(201,036)	(6,555,210)
Financing:				
Issue of share capital and warrants for cash, net	–	–	–	19,812,261
Shareholder loans repayment	–	–	–	(395,051)
Change in non-cash working capital (note 8)	–	(228,795)	–	–
	–	(228,795)	–	19,417,210
Foreign exchange gain (loss) on cash held in foreign currencies	27,929	(130,349)	13,437	248,175
Increase (decrease) in cash and cash equivalents	(2,276,489)	(3,662,436)	(4,793,304)	9,360,454
Cash and cash equivalents, beginning of period	5,398,600	15,131,712	7,915,415	2,108,822
Cash and cash equivalents, end of period	\$ 3,122,111	\$ 11,469,276	\$ 3,122,111	\$ 11,469,276

See accompanying notes to financial statements

# PetroKamchatka Plc

## Notes to the Consolidated Financial Statements

Three and nine months ended February 28, 2011 and 2010  
(United States Dollars, unless otherwise stated)

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### 1. Basis of Presentation:

The interim consolidated financial statements of PetroKamchatka Plc (the "Corporation" or "PKP") have been prepared by management in accordance with Canadian generally accepted accounting principles ("GAAP") consistent with the accounting policies and methods of application used in the preparation of the audited consolidated financial statements of the Corporation as at May 31, 2010 and the year then ended. The disclosures included below are incremental to those included with the annual consolidated financial statements. The interim consolidated financial statements should be read in conjunction with the Corporation's consolidated financial statements and notes thereto for the year ended May 31, 2010.

In the preparation of these consolidated financial statements, management has made estimates and assumptions that affect the recorded amounts of certain of the Corporation's assets, liabilities and expenses. The most significant estimates relate to the cost recovery assessment for property and equipment. While it is the opinion of management that these consolidated financial statements have been properly prepared within reasonable limits of materiality and within the framework of the significant accounting policies summarized below, actual results could differ from the estimates made.

### 2. Going concern:

These consolidated financial statements have been prepared on the basis of accounting principles applicable to a going concern, which assumes that the Corporation will realize its assets and discharge its liabilities in the normal course of operations. If the going concern assumption was not appropriate for these consolidated financial statements, then adjustments would be necessary to adjust the carrying value of assets and liabilities, reported expenses and to revise the balance sheet classifications used.

The Corporation presently does not have sufficient funds to meet all of its exploration and drilling commitments on its licenses in Kamchatka, Russia (note 3). During the year ended May 31, 2010, the Corporation drilled two dry holes on the Tigil License, which has negatively impacted the ability of the Corporation to raise additional capital.

On March 24, 2011, the Corporation and its joint venture partner agreed to seek an early relinquishment of the Icha exploration license located in Kamchatka Russia. The Joint Venture Partnership determined that the existing mapped prospects were non-commercial on a fully risked basis and it was decided not to drill an exploration well on the Icha license. Effective February 28, 2011, the Corporation recorded a writedown of \$17,013,932 in the carrying value of its full cost pool relating to the Icha license.

The Corporation's working capital at February 28, 2011 was \$3,331,137 (May 31, 2010 - \$7,451,857). If the Corporation is unable to raise additional funds as needed, the Corporation may be in breach of its funding obligations under its agreements with KNOC Kamchatka

# PetroKamchatka Plc

## Notes to the Consolidated Financial Statements

Three and nine months ended February 28, 2011 and 2010  
(United States Dollars, unless otherwise stated)

Petroleum Limited ("KKPL") and may not be able to meet all of its license commitments on its remaining licenses in Kamchatka. It could therefore lose all or part of its interests in the remaining Russian properties. Management believes the going concern assumption to be appropriate for these consolidated financial statements.

### 3. Property and equipment:

February 28, 2011	Cost	Accumulated depreciation	Accumulated impairment	Net book value
Petroleum and natural gas properties:				
Russia	\$ 46,838,128	\$ -	\$(46,773,581)	\$ 64,547
Canada	5,184,840	-	(5,184,840)	-
	52,022,968	-	(51,958,421)	64,547
Drilling rig and equipment - Russia	7,498,228	(886,795)	-	6,611,433
Joint interest in drilling rig	8,567,260	-	(4,430,000)	4,137,260
Office furniture and equipment	376,613	(303,036)	-	73,577
	\$ 68,465,069	\$ (1,189,831)	\$(56,388,421)	\$ 10,886,817

May 31, 2010	Cost	Accumulated depreciation	Accumulated impairment	Net book value
Petroleum and natural gas properties:				
Russia	\$ 46,054,358	\$ -	\$(29,759,649)	\$ 16,294,709
Canada	5,184,840	-	(5,184,840)	-
	51,239,198	-	(34,944,489)	16,294,709
Drilling rig and equipment - Russia	7,498,228	(644,942)	-	6,853,286
Joint interest in drilling rig	8,567,260	-	(4,430,000)	4,137,260
Office furniture and equipment	376,613	(286,502)	-	90,111
	\$ 67,681,299	\$ (931,444)	\$(39,374,489)	\$ 27,375,366

#### (a) Russia

The ultimate recovery of property and equipment costs is dependent upon the existence and commercial exploitation of petroleum and natural gas reserves or a sale of equipment to a third party. The Corporation presently does not have sufficient cash to fund all expenditure commitments under the terms of its Russian exploration licenses (note 2). Uncertainties regarding the political, legal, tax or regulatory environment, including the potential for adverse and retroactive changes with respect to the Corporation's operations in Russia could significantly affect the Corporation and the ultimate cost recovery of its assets.

# PetroKamchatka Plc

Notes to the Consolidated Financial Statements

Three and nine months ended February 28, 2011 and 2010  
(United States Dollars, unless otherwise stated)

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### 3. Property and equipment (continued):

#### (a) Russia (continued):

Exploration licenses in Russia are issued by the federal Ministry of Natural Resources ("MNRF") and grant the holder of the license the right to explore for oil and natural gas reserves within the area specified in the license. In the event of a commercial discovery, the Corporation has the right to convert parts of the exploration license into a production license. Exploration licenses have an associated license agreement, which specifies a required geological and geophysical work program to be completed.

#### (i) Exploration licenses:

In September 2009, the Corporation acquired 100% interest in the Pustaretskaya, Palanskaya, Ichinskaya and Vorovksaya exploration licenses. The licenses, each with a five year term, require minimum seismic, drilling and completion programs in the first two to three years of the license term. In August 2010, the Corporation surrendered the Pustaretskaya and Palanskaya exploration licenses back to the MNFR along with the Urginskaya license, which was acquired in February 2008. The accumulated impairment includes a writedown at May 31, 2010 of \$18,012, \$34,617 and \$237,873 of the Pustaretskaya, Palanskaya and Urginskaya licenses respectively.

On December 31, 2010, the Tigil exploration license expired and reverted back to the MNRF.

At February 28, 2011, the Corporation held interests in exploration licenses in the Icha, Ichinskaya, and Vorovskaya areas of Kamchatka.

Upon further evaluation of the existing prospects on the Icha license, the Joint Venture Partnership determined that the mapped prospects were non-commercial on a fully risked basis. As a result, it was determined not to drill an exploration well on the Icha license.

On March 24, 2011, the Corporation and KKPL agreed to seek an early relinquishment of the Icha exploration license. Effective, February 28, 2011, the Corporation recorded a writedown of the carrying value of its full cost pool relating to the Icha license of \$17,013,932.

# PetroKamchatka Plc

Notes to the Consolidated Financial Statements

Three and nine months ended February 28, 2011 and 2010  
(United States Dollars, unless otherwise stated)

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### 3. Property and equipment (continued):

(a) Russia (continued):

(ii) Mobile drilling rig:

The Tigil joint interest entity owns a mobile drilling rig and other equipment located in Russia. In periods when the drilling rig and equipment are idle and not assigned to a specific drilling location, certain costs are expensed when incurred. Such costs include rig and equipment mobilization expenditures, storage expenditures and other amounts. During the three and nine month periods ended February 28, 2011, these costs, which amount to \$999,800 and \$1,696,855 respectively, were expensed as 'equipment operating costs and other'. No depreciation is provided for when the rig is not in use and held in storage.

(b) Joint interest drilling rig:

The aggregate cost amount of \$8,567,260 (May 31, 2010 - \$8,567,260) represents the Corporation's 46.25% share of the original purchase price for a new drilling rig (the "HighKelly rig") of \$17,533,000 plus the Corporation's share of other costs. The Corporation and KKPL determined that this rig is not suited for the Russian drilling program and purchased a separate mobile rig and other ancillary equipment to drill in Russia. As at May 31, 2010, the estimated fair market value of the drilling rig as indicated by an independent appraisal was \$9,223,200 gross. On that basis, the carrying value of the Corporation's 46.25% interest was written down in the fiscal year ended May 31, 2010 by \$2,023,000 to \$4,137,260, which amount is net of estimated selling costs. There was no writedown during the nine months ended February 28, 2011. For the nine months ended February 28, 2010, the Corporation recorded a writedown of \$982,582 relating to this asset.

The Corporation is informed that KKPL has not yet obtained all of the information that it requires to be assured that the rig meets the contracted specifications. On August 18, 2009, KKPL initiated an arbitration proceeding in The International Court of Arbitration against the manufacturer of the rig in respect of the claim by KKPL that the manufacturer failed to comply with its contractual obligations to manufacture and deliver a customized rig to KKPL in compliance with specific contracted requirements. Pursuant to KKPL's request for arbitration, KKPL is seeking damages for the alleged breach. Upon resolution of this dispute, the Corporation and KKPL have undertaken to sell the rig.

(c) Canada:

The Corporation is not active in Canada and its properties in British Columbia have been fully written down.

# PetroKamchatka Plc

## Notes to the Consolidated Financial Statements

Three and nine months ended February 28, 2011 and 2010  
(United States Dollars, unless otherwise stated)

#### 4. Joint ventures:

The Corporation's net interests in Tigil and Icha are accounted for on a proportionate consolidation basis.

At February 28, 2011 and May 31, 2010, the Corporation's net contributions to the joint ventures were as follows:

	Tigil	Icha	Total
<b>Balance Sheet as at February 28, 2011:</b>			
Cash and cash equivalents	\$ 672,879	\$ 664,976	\$ 1,337,855
Accounts receivable	388,828	1,168,533	1,557,361
Property and equipment, cost	29,469,147	17,013,932	46,483,079
Accumulated impairment	(29,469,147)	(17,013,932)	(46,483,079)
Drilling rig and related equipment	5,955,102	–	5,955,102
Accounts payable	(6,389)	(45,756)	(52,145)
Net contribution to joint venture	\$ 7,010,420	\$ 1,787,753	\$ 8,798,173
<b>Balance Sheet as at May 31, 2010:</b>			
Cash and cash equivalents	\$ 1,500,332	\$ 349,206	\$ 1,849,538
Accounts receivable	1,428,262	–	1,428,262
Property and equipment, cost	29,469,147	16,267,828	45,736,975
Accumulated impairment	(29,469,147)	–	(29,469,147)
Drilling rig and related equipment	6,196,956	–	6,196,956
Accounts payable	(186,039)	(5,778)	(191,817)
Net contribution to joint venture	\$ 8,939,511	\$ 16,611,256	\$ 25,550,767

# PetroKamchatka Plc

## Notes to the Consolidated Financial Statements

Three and nine months ended February 28, 2011 and 2010  
(United States Dollars, unless otherwise stated)

#### 4. Joint ventures (continued):

For the three month periods ended February 28, 2011 and 2010, the Corporation's proportionate share of net loss and changes in cash flows from the joint ventures were as follows:

	Tigil	Icha	Total
Three months ended February 28, 2011			
Income Statement			
Revenues	\$ -	\$ -	\$ -
Expenses	342,421	17,752,791	18,095,212
Proportionate share of net loss	\$ (342,421)	\$ (17,752,791)	\$ (18,095,212)
Three months ended February 28, 2011			
Cash flows			
Operating activities	\$ 517,361	\$(1,252,576)	\$ (735,215)
Financing activities	(341,533)	1,682,220	1,340,687
Investing activities	-	-	-
Proportionate share of increase in cash	\$ 175,828	\$ 429,644	\$ 605,472

	Tigil	Icha	Total
Three months ended February 28, 2010			
Income Statement			
Revenues	\$ -	\$ (1,008)	\$ (1,008)
Expenses	497,457	50,339	547,796
Proportionate share of net loss	\$ (497,457)	\$ (49,331)	\$ (546,788)
Three months ended February 28, 2010			
Cash flows			
Operating activities	\$ (105,647)	\$ (49,331)	\$ (154,978)
Financing activities	2,360,391	(281,276)	2,079,115
Investing activities	3,169,216	2,924,796	6,094,012
Proportionate share of increase in cash	\$ 5,423,960	\$ 2,594,189	\$ 8,018,149

# PetroKamchatka Plc

## Notes to the Consolidated Financial Statements

Three and nine months ended February 28, 2011 and 2010  
(United States Dollars, unless otherwise stated)

#### 4. Joint ventures (continued):

For the nine month periods ended February 28, 2011 and 2010, the Corporation's proportionate share of net loss and changes in cash flows from the joint ventures were as follows:

	Tigil	Icha	Total
Nine months ended February 28, 2011			
Income Statement			
Revenues	\$ -	\$ -	\$ -
Expenses	630,723	18,280,404	18,911,127
Proportionate share of net loss	\$ (630,723)	\$ (18,280,404)	\$ (18,911,127)
Nine months ended February 28, 2011			
Cash flows			
Operating activities	\$ 470,913	\$ (1,897,899)	\$ 64,696
Financing activities	(2,031,271)	2,959,772	(563,181)
Investing activities	732,905	(746,104)	(13,199)
Proportionate share of increase (decrease) in cash	\$ (827,453)	\$ 315,769	\$ (511,684)

	Tigil	Icha	Total
Nine months ended February 28, 2010			
Income Statement			
Revenues	\$ -	\$ (1,144)	\$ (1,144)
Expenses	516,413	3,551	519,964
Proportionate share of net loss	\$ (516,413)	\$ (2,407)	\$ (518,820)
Nine months ended February 28, 2010			
Cash flows			
Operating activities	\$ (53,913)	\$ (2,407)	\$ (56,320)
Financing activities	6,579,803	(4,784,682)	1,795,121
Investing activities	(5,298,173)	4,954,246	(343,927)
Proportionate share of increase in cash	\$ 1,227,717	\$ 167,157	\$ 1,394,874

'Investing activities' are net of VAT ("Value Added Tax") recoveries, which were greater than expenditures in some periods.

#### 5. Related party transactions and balances:

At February 28, 2011 and May 31, 2010, there were no amounts receivable from directors or officers. The Corporation's aggregate liabilities owing to directors and officers as at February 28, 2011 for services performed and expenses incurred in the normal course of operations amounted to \$140,200 (May 31, 2010 - \$67,500).

# PetroKamchatka Plc

## Notes to the Consolidated Financial Statements

Three and nine months ended February 28, 2011 and 2010  
(United States Dollars, unless otherwise stated)

### 6. Share capital:

(a) Authorized:

An unlimited number of common shares and an unlimited number of preferred shares.

(b) Common shares issued and outstanding:

	Number Issued	Amount
Share capital, May 31, 2010	489,063,510	\$ 91,755,940
Issued for services (note 6(b)(i) and 6(b)(ii))	1,332,627	51,002
Share capital, February 28, 2011	490,396,137	\$ 91,806,942

(i) On July 7, 2010, the Corporation issued 676,130 common shares to directors at a price of CAD \$0.05 per share for services rendered for the three months ended June 30, 2010 in the amount of \$31,875, representing a portion of the fees owed.

(ii) On December 8, 2010, the Corporation issued 656,497 common shares to directors at a 'deemed price' of CAD \$0.05 per share pursuant to the rules and regulations of The Toronto Stock Exchange, which was approximately CAD \$0.02 per share higher than the 'actual trading price' at the time of issue. The shares were issued for services rendered for the three months ended September 30, 2010 in the amount of \$19,127, representing only a portion of the fees owed.

(c) Warrants:

There were no warrants issued or expired during the nine months ended February 28, 2011.

	Number Issued	Amount
Balance, May 31, 2010 and February 28, 2011	20,882,774	\$ 7,038,779

# PetroKamchatka Plc

Notes to the Consolidated Financial Statements

Three and nine months ended February 28, 2011 and 2010  
(United States Dollars, unless otherwise stated)

## 6. Share capital (continued):

### (c) Warrants (continued):

The following table summarizes information on warrants issued to investors to purchase common shares that were outstanding as at February 28, 2011:

Exercise Price		Outstanding and	
\$	£	exercisable	Contractual life
	£0.525	5,760,809	December 10, 2011
CAD 1.25		7,590,000	December 10, 2011
Balance, end of period		13,350,809	

The following table summarizes information about warrants issued to brokers to purchase common shares that were outstanding as at February 28, 2011:

Exercise price		Outstanding and	
\$	£	exercisable	Contractual life
CAD 0.50		28,800	December 10, 2011
	0.42	614,105	December 10, 2011
CAD 1.00		607,200	December 10, 2011
USD 0.50		4,916,026	December 10, 2011
USD 0.15		1,365,834	November 19, 2011
Balance, end of period		7,531,965	

### (d) Stock options:

The Corporation has a stock option plan for employees, consultants, officers and directors. On October 16, 2009, the Board of Directors of the Corporation adopted a new stock option plan. Under the terms of the option plan, the Corporation may grant options up to 10% of the aggregate number of common shares outstanding, with no one optionee permitted to hold more than 5% of the total options outstanding in any twelve month period. The options granted may not be for a term exceeding five years and vest one-third each year from the date of grant. The exercise price of options is approved by the Board and cannot be less than the market price of its common shares on the day the option is granted.

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## Notes to the Consolidated Financial Statements

Three and nine months ended February 28, 2011 and 2010  
(United States Dollars, unless otherwise stated)

### 6. Share capital (continued):

#### (d) Stock options (continued):

The following table summarizes changes to options granted since May 31, 2010:

	Nine months ended February 28, 2011
Outstanding, beginning of period	21,625,000
Expired	(200,000)
Forfeited	(2,772,000)
Outstanding, end of period	18,653,000
Exercisable, end of period	9,006,959

No stock options were issued in the nine month period ended February 28, 2011. The fair value of stock options granted and warrants issued during the fiscal years ended May 31, 2010 and 2009 was estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions:

	Warrants	Options
Fair value of stock options granted in the year ended May 31, 2009 (per option)	–	\$ 0.30
Fair value of stock options granted in the year ended May 31, 2010 (per option)		\$ 0.06
Fair value of warrants granted in the year ended May 31, 2009 (per warrant)	\$ 0.24	–
Fair value of warrants granted in the period ended May 31, 2010 (per warrant)	\$ 0.06	–
Expected volatility	84%	69%
Risk free rate of return	3.2% to 4.3%	2.9% to 4%
Expected option life	2 to 5 years	5 years
Forfeiture rate	nil%	nil%
Dividend yield	nil%	nil%

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## Notes to the Consolidated Financial Statements

Three and nine months ended February 28, 2011 and 2010  
(United States Dollars, unless otherwise stated)

### 6. Share capital (continued):

#### (d) Stock options (continued):

The following table summarizes stock options outstanding and exercisable at February 28, 2011:

Exercise price	Stock options outstanding			Stock options exercisable	
	Number outstanding	Weighted-average contractual life	Weighted-average exercise price	Number exercisable	Weighted average exercise price
\$ 0.50	5,093,000	2.14	\$ 0.50	4,562,003	\$ 0.50
\$ 0.10	13,335,000	3.28	\$ 0.10	4,444,956	\$ 0.10
\$ 0.11	225,000	4.17	\$ 0.11	–	\$ 0.11
	18,653,000	2.76		9,006,959	

Based on the vesting terms of the options, the Corporation recognized stock-based compensation expense for the three and nine months ended February 28, 2010 of \$88,863 and \$363,881 respectively, (February 28, 2010 - \$217,000 and \$594,000) with equal and offsetting amounts recognized as contributed surplus.

#### (e) Contributed surplus:

Changes in contributed surplus are as follows:

	February 28, 2011	May 31, 2010
Balance, beginning of period	\$ 3,903,396	\$ 3,224,396
Stock-based compensation	363,881	679,000
Balance, end of period	\$ 4,267,277	\$ 3,903,396

#### (f) Per share amounts:

Basic income (loss) per share is computed by dividing the net income (loss) available to common shareholders by the weighted average number of common shares outstanding. Diluted income per common share is calculated using the treasury stock method to determine the dilutive effect of stock options and warrants. The treasury stock method assumes that the proceeds received from the exercise of in the money stock options and warrants are used to repurchase common shares at the average market price during the period. At February 28, 2011, 18,653,000 options and 20,882,774 warrants (February 28, 2010 – 21,325,000 and 21,070,122 respectively) were excluded from the calculation as they were anti-dilutive.

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Three and nine months ended February 28, 2011 and 2010  
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## 7. Financial instruments and risk management:

### (a) Capital management:

As an exploration company, the Corporation's operations are financed principally through shareholders' equity. The Corporation's objectives when managing capital are to: finance planned exploration activities; continue as a going concern; maximize returns for shareholders; provide benefits for other stakeholders; and provide resources to facilitate growth.

The Corporation manages the capital structure and responds to changes in economic conditions and planned requirements. It will continue to use cash from equity offerings to fund operations and invest in its capital expenditure program. Future capital strategies may include debt financing and obtaining strategic partners to fund a portion of its projects.

Current economic conditions affect capital markets and the allocation of capital. This situation, together with the impact of unsuccessful drilling results from its first two wells in Russia during the fiscal year ended May 31, 2010, stress the need for greater conservation of capital and careful monitoring of the Corporation's rate of spending on capital projects and to fund general and administrative costs, especially given the absence of adequate financing at February 28, 2011 (note 2).

There are no external restrictions on the Corporation's capital.

### (b) Fair values:

The fair value of the Corporation's financial instruments, including cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities approximated their carrying values as at February 28, 2011 and May 31, 2010.

### (c) Financial instrument risk exposure and management:

The Corporation is exposed to various risks associated with its financial instruments. These risks are categorized as market risk, credit risk and liquidity risk.

#### (i) Market risk:

Market risk is the risk that changes in market conditions, such as commodity prices, exchange rates and interest rates, will affect the Corporation's net earnings or the value of its financial instruments. The objective of market risk management is to manage and control exposures within acceptable limits, while maximizing returns.

# PetroKamchatka Plc

Notes to the Consolidated Financial Statements

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## 7. Financial instruments and risk management (continued):

### (c) Financial instrument risk exposure and management (continued):

#### (ii) Commodity risk:

Commodity price risk is the risk that the fair value of future cash flows will fluctuate as a result of changes in commodity prices. Significant changes in commodity prices can also reduce the Corporation's ability to raise capital. Commodity prices for crude oil are impacted by world economic events that dictate the levels of supply and demand. In the future, the Corporation may attempt to mitigate commodity price risk through the use of financial derivatives. The Corporation does not have any oil or gas production and did not have any risk management contracts in place as at February 28, 2011 and May 31, 2010 or during the nine month periods ended February 28, 2011 and 2010 or thereafter.

#### (iii) Foreign currency risk:

The Corporation is exposed to foreign currency fluctuations as it holds cash and incurs expenditures for property and equipment in foreign currencies. The Corporation incurs expenditures in Russian roubles, Pound sterling, Euros and Canadian dollars and is exposed to fluctuations in exchange rates in these currencies. There were no exchange rate contracts in place as at February 28, 2011 and May 31, 2010 or during the nine month periods ended February 28, 2011 and 2010 or thereafter. A 1% change in foreign exchange rates between the Russian rouble and the U.S. dollar would result in an \$8,000 change in net loss for the nine months ended February 28, 2011 (\$17,000 for the nine months ended February 28, 2010).

#### (iv) Credit risk:

Financial instruments that potentially subject the Corporation to concentration of credit risk consist of accounts receivable. There is low credit risk on accounts receivable. Accounts receivable consists of Russian value added taxes and accounts receivable from the Corporation's joint ventures. At February 28, 2011 and May 31, 2010 the Corporation's receivables were current.

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### 7. Financial instruments and risk management (continued):

(c) Financial instrument risk exposure and management (continued):

(v) Liquidity risk:

Liquidity risk is the risk that the Corporation will not be able to meet its financial obligations as they become due. The Corporation's financial liabilities consist of accounts payable and accrued liabilities. Accounts payable consists primarily of invoices payable to trade suppliers or professionals for capital expenditures and services rendered.

The Corporation prepares budgets for its corporate operations and capital expenditure programs which are regularly monitored and updated as considered necessary.

### 8. Supplemental cash flow disclosures:

Change in non-cash working capital:

	Three Months Ended	
	February 28,	
	2011	2010
Accounts receivable	\$ (411,061)	\$ (1,844,997)
Prepaid expenses	8,436	109,183
Accounts payable and accrued liabilities	(355,998)	796,300
	(758,623)	(939,514)
Unrealized foreign exchange loss (gain) on working capital	10,432	(55,621)
	(748,191)	(995,135)
Less changes in non-cash working capital related to investing	423,348	1,112,344
Less changes in non-cash working capital related to financing	–	228,795
Changes in non-cash working capital related to operations	\$ (324,843)	\$ 346,004

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## Notes to the Consolidated Financial Statements

Three and nine months ended February 28, 2011 and 2010  
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### 8. Supplemental cash flow disclosures (continued):

Change in non-cash working capital:

	Nine Months Ended February 28,	
	2011	2010
Accounts receivable	\$ 1,009,001	\$ (1,337,742)
Prepaid expenses	(4,065)	74,046
Accounts payable and accrued liabilities	(1,677,520)	(1,657,220)
Non-cash working capital acquired from Bluerock	–	(72,320)
Shares issued for accounts payable	–	941,370
	(672,584)	(2,051,866)
Unrealized foreign exchange loss on working capital	7,239	22,562
	(665,345)	(2,029,304)
Less changes in non-cash working capital related to investing	(582,734)	2,205,448
Less changes in non-cash working capital related to financing	–	–
Changes in non-cash working capital related to operations	\$ (1,248,079)	\$ 176,144

Cash interest of \$nil was paid during the three and nine month periods ended February 28, 2011 and \$nil and \$5,051 respectively, for the three and nine months periods ended February 28, 2010.

### 9. Commitments:

Under the terms and conditions of its Russian exploration licenses, the Corporation is committed to completion of seismic work programs and the drilling of exploration wells by certain dates in order to retain its rights under the licenses (note 3).

The Corporation is committed to making payments with respect to its office leases in Canada which expire on June 30, 2013 and October 31, 2013.

Future net minimum lease payments for these leases by fiscal year are as follows:

2011	\$ 71,000
2012	284,000
2013	284,000
2014	59,000
	\$ 698,000