

Consolidated Financial Statements of

PETROKAMCHATKA RESOURCES LTD.

(formerly CEP International Petroleum Ltd.)

As at May 31, 2009 and 2008

For the years ended May 31, 2009, 2008 and 2007

(United States Dollars)

AUDITORS' REPORT TO THE DIRECTORS

We have audited the consolidated balance sheets of PetroKamchatka Resources Ltd. (formerly CEP International Petroleum Ltd.) as at May 31, 2009 and 2008 and the consolidated statements of operations, comprehensive loss and deficit and cash flows for each of the years in the three-year period ended May 31, 2009. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free from material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at May 31, 2009 and 2008 and the results of its operations and its cash flows for each of the years in the three-year period ended May 31, 2009 in accordance with Canadian generally accepted accounting principles.

(signed) "KPMG LLP"

Chartered Accountants

Calgary, Canada

October 23, 2009

PetroKamchatka Resources Ltd.

(formerly CEP International Petroleum Ltd.)

Consolidated Balance Sheets

United States Dollars

As at May 31

	2009	2008
Assets		
Current assets		
Cash and cash equivalents	\$ 2,108,822	\$ 5,295,320
Short-term investments (note 3)	–	9,425,204
Share subscriptions receivable (note 7)	–	6,615,000
Accounts receivable (note 4)	1,514,742	30,138
Prepaid expenses	146,527	43,528
	<u>3,770,091</u>	<u>21,409,190</u>
Property and equipment (note 5)	53,857,598	40,123,812
	<u>\$ 57,627,689</u>	<u>\$ 61,533,002</u>
Liabilities and Shareholders' Equity		
Current liabilities		
Accounts payable and accrued liabilities	\$ 6,562,053	\$ 11,769,904
Rig loan (note 5)	–	4,108,758
Shareholder loan (note 6)	395,051	–
	<u>6,957,104</u>	<u>15,878,662</u>
Shareholders' Equity		
Share capital (note 7(b))	\$ 69,731,912	\$ 57,799,682
Share purchase warrants (note 7(c))	6,960,263	8,021,512
Contributed surplus (note 7(d))	3,224,396	1,266,573
Currency translation adjustment	1,018,864	1,018,864
Deficit	(30,264,850)	(22,452,291)
	<u>50,670,585</u>	<u>45,654,340</u>
	<u>\$ 57,627,689</u>	<u>\$ 61,533,002</u>

Going concern (note 1)

Commitments and contingencies (notes 1, 5, 7 and 11)

Subsequent events (notes 1, 5, 6, 7, and 12)

(signed) "Jonathan Morley-Kirk"

Director

(signed) "Graeme Phipps"

Director

See accompanying notes to consolidated financial statements

PetroKamchatka Resources Ltd.

(formerly CEP International Petroleum Ltd.)

Consolidated Statements of Operations, Comprehensive Loss and Deficit

United States Dollars

Years ended May 31

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Interest Income	\$ 37,980	\$ 76,631	\$ 126,914
Expenses			
General and administration	3,606,204	4,830,753	1,661,558
Financing and other costs	271,486	830,120	487,000
Foreign exchange loss	870,978	300,911	1,145,317
Stock-based compensation (note 7(e))	574,630	231,436	-
Depreciation	44,824	33,753	23,844
Write-down of property and equipment (note 5)	2,482,417	124,617	1,795,849
	<u>7,850,539</u>	<u>6,351,590</u>	<u>5,113,568</u>
Loss before income taxes	(7,812,559)	(6,274,959)	(4,986,654)
Income taxes (note 8)	-	-	-
	<u>(7,812,559)</u>	<u>(6,274,959)</u>	<u>(4,986,654)</u>
Net loss and comprehensive loss for the year	(7,812,559)	(6,274,959)	(4,986,654)
Deficit, beginning of year	<u>(22,452,291)</u>	<u>(16,177,332)</u>	<u>(11,190,678)</u>
Deficit, end of year	<u>\$ (30,264,850)</u>	<u>\$ (22,452,291)</u>	<u>\$ (16,177,332)</u>
Net loss per share	<u>\$ (0.05)</u>	<u>\$ (0.09)</u>	<u>\$ (0.12)</u>
Weighted average number of common shares: Basic and diluted	154,969,626	72,225,660	41,778,105

See accompanying notes to consolidated financial statements

PetroKamchatka Resources Ltd.

(formerly CEP International Petroleum Ltd.)

Consolidated Statements of Cash Flows

United States Dollars

Years ended May 31

	2009	2008	2007
Cash provided by (used in):			
Operations			
Net loss and comprehensive loss for the year	\$ (7,812,559)	\$ (6,274,959)	\$ (4,986,654)
Items not involving cash:			
Depreciation	44,824	33,753	23,844
Stock-based compensation	574,630	231,436	–
Shares issued for services (note 7(b))	141,523	533,934	–
Shares issued for bonus	–	1,250,000	–
Shares issued for settlement of claim (note 7(b))	350,000	–	–
Unrealized foreign exchange loss	10,172	608,513	323,524
Write-down of property and equipment	2,482,417	124,617	1,795,849
	<u>(4,208,993)</u>	<u>(3,492,706)</u>	<u>(2,843,437)</u>
Change in non-cash working capital (note 10)	<u>(274,091)</u>	<u>(1,425,069)</u>	<u>(317,428)</u>
	(4,483,084)	(4,917,775)	(3,160,865)
Investing			
Property and equipment expenditures	(16,261,027)	(12,745,473)	(19,840,267)
Short-term investments, net	9,425,204	(9,243,890)	2,803,670
Rig loan	(4,108,758)	4,108,758	–
Change in non-cash working capital (note 10)	<u>(6,596,544)</u>	<u>992,300</u>	<u>7,586,055</u>
	(17,541,125)	(16,888,305)	(9,450,542)
Financing			
Issue of share capital and warrants, net	11,762,651	35,001,718	5,893,988
Bank loan	–	(1,548,383)	1,548,383
Shareholder loan	395,051	–	–
Change in non-cash working capital (note 10)	<u>6,615,000</u>	<u>(6,615,000)</u>	<u>–</u>
	18,772,702	26,838,335	7,442,371
Foreign exchange gain on cash held in foreign currencies	<u>65,009</u>	<u>144,157</u>	<u>999</u>
(Decrease) increase in cash and cash equivalents	(3,186,498)	5,176,412	(5,168,037)
Cash and cash equivalents, beginning of year	<u>5,295,320</u>	<u>118,908</u>	<u>5,286,945</u>
Cash and cash equivalents, end of year	<u>\$ 2,108,822</u>	<u>\$ 5,295,320</u>	<u>\$ 118,908</u>

See accompanying notes to consolidated financial statements

PetroKamchatka Resources Ltd.

(formerly CEP International Petroleum Ltd.)

Notes to the Consolidated Financial Statements

United States Dollars, unless otherwise stated

May 31, 2009, 2008 and 2007

General:

PetroKamchatka Resources Ltd. (the "Company" or "PetroKamchatka") was incorporated on November 23, 1998 under the Business Corporations Act (Yukon). The name was changed from CEP International Petroleum Ltd. to PetroKamchatka Resources Ltd. on December 31, 2008. The Company was redomiciled to Cyprus on August 25, 2009 (see note 12) as "PetroKamchatka Resources Plc".

The Company is principally engaged in the acquisition, development and exploration of petroleum and natural gas in the Russian Federation. Since inception, the efforts of the Company have been devoted to identifying and acquiring exploration and production licenses and conducting exploration activities thereon. To date, the Company has received no revenue from these operations.

1. Going concern:

These consolidated financial statements have been prepared on the basis of accounting principles applicable to a going concern, which assumes that the Company will realize its assets and discharge its liabilities in the normal course of operations.

The Company presently does not have sufficient funds to meet all of its exploration and drilling commitments on its licenses in Kamchatka, Russia (see note 5).

Subsequent to May 31, 2009 (see note 12), the Company raised cash proceeds of \$11,477,979 and settled \$880,000 of accounts payable by issuing Class A common shares.

The Company plans to become a listed public company and raise additional equity capital sufficient to meet its obligations when they fall due under its licenses in Russia. If the Company is unable to raise funds, the Company may be in breach of its funding obligations under its agreements with KNOC Kamchatka Petroleum Limited ("KKPL") and therefore would lose part of its interest in the Russian properties.

Management believes the going concern assumption to be appropriate for these consolidated financial statements. If the going concern assumption was not appropriate for these consolidated financial statements, then adjustments would be necessary to the carrying value of assets and liabilities, reported expenses and the balance sheet classifications used.

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May 31, 2009, 2008 and 2007

2. Significant accounting policies:

The consolidated financial statements of the Company have been prepared by management in accordance with Canadian generally accepted accounting principles ("GAAP"). In the preparation of these consolidated financial statements, management has made estimates and assumptions that affect the recorded amounts of certain of the Company'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.

(a) Basis of presentation:

All consolidated financial statement amounts are stated in United States currency. The Company determined that, effective at the beginning of the 2007 fiscal year, the United States dollar was its functional currency.

The consolidated financial statements include the accounts of PetroKamchatka Resources Ltd. and its subsidiaries as well as its proportionate share of the accounts of its joint interest corporations. The Company conducts certain of its oil and gas exploration activities on a joint interest basis. These consolidated financial statements reflect only the Company's proportionate interest in such activities (see note 5).

(b) Petroleum and natural gas properties:

At present, all activities of the Company are in the exploration stage. The Company follows the full cost method of accounting for oil and gas properties whereby all costs of exploring for and developing oil and gas reserves are capitalized in cost centers on a country-by-country basis. Such costs include land acquisition costs and geological and geophysical expenses. All general and administrative costs are expensed as incurred. Carrying costs directly attributable to property and equipment under construction are capitalized.

Upon the commencement of commercial production, capitalized costs, less the carrying value of unevaluated properties, will be depleted within each cost centre using the unit-of-production method based upon estimated proven reserves before royalties as determined by independent reservoir engineers. For the purposes of this calculation, natural gas will be converted to oil on an energy equivalent basis. The cost of acquiring and evaluating unproven properties are initially excluded from the depletion calculation. These properties are assessed periodically for impairment. When proved reserves are assigned or the property is considered to be impaired, the cost of the property or the amount of the impairment is added to the costs subject to depletion. Proceeds from the sale of petroleum and natural gas properties will be accounted for as an adjustment to capitalized costs, with no gain or loss recognized, unless such adjustment would alter the rate of depletion and depreciation by more than 20%.

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Notes to the Consolidated Financial Statements

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2. Significant accounting policies (continued):

(b) Petroleum and natural gas properties (continued):

In applying the full cost method, the Company will calculate a ceiling test whereby the carrying amount of property and equipment is compared to the sum of the undiscounted cash flows expected to result from the future production of proved reserves and the sale of unproved properties. Cash flows are based on third party quoted forward prices, adjusted for transportation and quality differentials. Should the ceiling test result in an excess of the carrying amount, the Company would then measure the amount of impairment by comparing the carrying amounts of property and equipment to an amount equal to the estimated net present value of future cash flows from proved plus probable reserves and the sale of unproved properties. The Company's risk-free interest rate will be used to arrive at the net present value of the future cash flows. Any excess carrying amount would be recorded as impairment and included in depletion and depreciation.

(c) Asset retirement obligations:

The Company recognizes the fair value of an asset retirement obligation in the period in which it is incurred when a reasonable estimate of the fair value can be made. The fair value of the estimated obligation is recorded as a liability, with a corresponding increase in the carrying amount of the related asset. The capitalized amount is depleted on the unit-of-production method based on proved reserves. The liability amount is increased each reporting period due to the passage of time and the amount of accretion is expensed to income in the period. Actual costs incurred upon the settlement of the obligation are charged against the liability.

(d) Drilling rig and equipment - Russia:

On the drilling rig equipment acquired during the year ended May 31, 2009 depreciation will be calculated using the straight-line method over seven years, the estimated useful life of the asset. The costs of normal maintenance and repairs will be charged to expense as incurred. Material expenditures that increase the life of an asset will be capitalized and depreciated over the estimated remaining useful life of the asset. The cost of equipment sold, or otherwise disposed of, and the related accumulated depreciation will be removed from the accounts and any gain or loss will be reflected in current operations. The rig was not used during the year ended May 31, 2009 and therefore no depreciation was recorded.

(e) Office furniture and equipment:

Office furniture and equipment is recorded at cost upon acquisition. Depreciation is provided for on a declining basis with rates ranging from 30% to 100% per annum. Additions during the period are depreciated at 50% of the assigned rate.

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2. Significant accounting policies (continued):

(f) Stock-based compensation:

The Company uses the fair value method for accounting for all stock and other stock-based payments, which requires the use of the fair value method of valuing all stock options granted and other stock-based payments whether they be to employees, directors or non-employees. The fair value is recognized in earnings over the vesting period of the options as stock-based compensation expense with a corresponding increase to contributed surplus. Stock-based compensation for options granted to directors and employees is based on the estimated fair value at the time of the grant. Stock-based compensation for options granted to consultants is based on the estimated fair value at each balance sheet date until the related options are fully vested. Upon the exercise of the stock options, consideration paid together with the amount previously recognized to contributed surplus is recorded as an increase to share capital.

(g) Foreign currency translation:

As the Company's activities are principally international in nature and are primarily denominated in United States dollars, the Company has determined effective June 1, 2006, that the functional currency of its operations is United States dollars. Foreign currency amounts are expressed in United States dollars using the temporal method. Under this method, monetary assets and liabilities are translated at the rates of exchange at the balance sheet date; non-monetary assets and related depreciation, amortization and write-downs are translated at historic rates; revenues and expenses are translated at rates in effect as they have occurred. Foreign exchange gains and losses are recognized in earnings.

(h) Cash and cash equivalents:

Cash and cash equivalents are comprised of cash and highly liquid investments with original maturities of three months or less.

(i) Future income taxes:

The Company uses the asset and liability method of accounting for income taxes. Under this method, income tax liabilities and assets are recognized for the estimated tax consequences attributable to differences between the amounts reported in the consolidated financial statements and their respective tax basis, using income tax rates substantively enacted at the balance sheet date. The effect of a change in rates on future income tax liabilities and assets is recognized in the period in which the change occurs. A valuation allowance is recorded against any future income tax assets if it is more likely than not that the asset will not be realized.

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2. Significant accounting policies (continued):

(j) Revenue recognition:

Revenues associated with the sale of crude oil, natural gas and natural gas liquids will be recorded when title passes to the customer. Revenues from properties in which the Company has an interest with other producers will be recognized on the basis of the Company's net working interest.

(k) Per share data:

Basic per share amounts are computed by dividing net loss and comprehensive loss by the weighted average number of common shares outstanding during the year. Diluted per share amounts reflect the potential dilution that would occur if securities or other contracts to issue common shares were exercised or converted to common shares. The treasury stock method is used to determine the dilutive effect of stock options and other dilutive instruments.

(l) Measurement uncertainty:

The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires management to make assumptions and estimates that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from and affect the results reported in these consolidated financial statements.

(m) Accounting changes:

Effective June 1, 2007 the Company adopted the following new accounting standards issued by the Canadian Institute of Chartered Accountants ("CICA"): Section 3855 "Financial Instruments – Recognition and Measurement", Section 1530 "Comprehensive Income", Section 3865 "Hedges" and Section 3861 "Financial Instruments – Disclosure and Presentation". These new standards were adopted prospectively. Adoption of these standards had no impact on the consolidated financial statements for the years ended May 31, 2008 and 2009.

Under the new standards, financial assets and financial liabilities are initially recognized at fair value and are subsequently accounted for based on their classification as described below. The classification depends on the purpose for which the financial instruments were acquired and their characteristics. Except in very limited circumstances, the classification is not changed subsequent to initial recognition.

Financial assets that are purchased and incurred with the intention of generating profits in the near term are classified as 'held-for-trading'. These instruments are accounted for at fair value with the change in the fair value recognized in net income during the period. Cash and cash equivalents and short-term investments are classified as 'held-for-trading'.

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May 31, 2009, 2008 and 2007

2. Significant accounting policies (continued):

(m) Accounting changes (continued):

Financial assets classified as 'available-for-sale' are carried at fair value with the changes in fair value recorded in other comprehensive income. When a decline in fair value is determined to be other than temporary, the cumulative loss included in accumulated other comprehensive income is removed and recognized in net income. Gains and losses recognized on disposal of 'available-for-sale' securities are recognized in other income. The Company does not have any financial assets classified as 'available-for-sale'.

Financial assets that have a fixed maturity date and which the Company has the intention and the ability to hold to maturity are classified as 'held-to-maturity' and accounted for at amortized cost using the effective interest rate method. The Company does not have any financial assets classified as 'held-to-maturity'.

Loans and receivables are accounted for at amortized cost. This classification is consistent with the classification under the prior accounting standards. Share subscriptions receivable and accounts receivable are classified as loans and receivables.

Other liabilities are accounted for at amortized cost and include all liabilities, other than derivatives. This classification is consistent with the classification under the prior accounting standards. Accounts payable and accrued liabilities and the rig loan are classified as other liabilities.

Derivative instruments, including embedded derivatives, are recorded on the balance sheet at fair value. Changes in the fair values of derivative instruments are recognized in net loss.

Comprehensive income (loss) is the change in shareholders' equity during a period from transactions and other events and circumstances from non-owner sources. When amounts are recorded in accordance with this new standard, the Company will report a new category, accumulated comprehensive income, in the shareholders' equity section of the balance sheet.

Effective June 1, 2008 the Company adopted the following new accounting standards issued by the CICA: Section 1535 "Capital Disclosures", Section 3862 "Financial Instruments – Disclosures" and Section 3863 "Financial Instruments – Presentation". These new sections replace financial instruments – disclosure and presentation, revising and enhancing the disclosure requirements, and carrying forward unchanged the presentation requirements. These new sections place increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks.

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2. Significant accounting policies (continued):

(m) Accounting changes (continued):

Section 1535 specifies the disclosure of information about an entity's objectives, policies and processes for managing capital; quantitative data about what the entity regards as capital; whether the entity has complied with any externally imposed capital requirements; and if the entity has not complied, the consequences of non-compliance. Adoption of this standard has resulted in additional note disclosures in the Company's consolidated financial statements (see note 9).

Section 3862 and Section 3863 specify the standards of presentation and enhanced disclosures on financial statements, particularly with respect to the nature and extent of risks arising from financial instruments and how the entity manages those risks. The standards have resulted in increased disclosures provided in the Company's consolidated financial statements (see note 9).

Effective June 1, 2008 the Company adopted the new accounting standard, Section 3064 "Goodwill and Intangible Assets", issued by the CICA, replacing Section 3062 "Goodwill and Other Intangible Assets" and Section 3450 "Research and Development Costs". Section 3064 establishes standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets subsequent to its initial recognition. Standards concerning goodwill are unchanged from the standards included in the previous Section 3062. Adoption of these standards had no impact on the Company's consolidated financial statements for the year ended May 31, 2009.

In April 2008, the CICA published the exposure draft "Adopting IFRSs in Canada". The exposure draft proposes to incorporate International Financial Reporting Standards ("IFRS") into the CICA Accounting Handbook effective for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. At this date, publicly accountable enterprises will be required to prepare financial statements in accordance with IFRS. The International Accounting Standard Board ("IASB") will also continue to issue new accounting standards during the conversion period. As a result, the final impact of adopting IFRS on the Company will only be known once all the applicable IFRS are issued. The Company continues to monitor and assess the impact of convergence of Canadian GAAP and IFRS.

In January 2009, the CICA Accounting Standards Board ("AcSB") issued CICA Handbook Section 1582, "Business Combinations", which replaces former guidance on business combinations. Section 1582 establishes principles and requirements of the acquisition method for business combinations and related disclosures. Section 1582 applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2011 with earlier application permitted. The adoption of section 1582 will affect the accounting for business combinations, if any, by the Company on or after June 1, 2011.

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2. Significant accounting policies (continued):

(m) Accounting changes (continued):

In January 2009, the AcSB issued CICA Handbook Sections 1601, "Consolidated Financial Statements", and Section 1602, "Non-controlling Interests", which replace existing guidance. Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 provides guidance on accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. These standards are effective on or after the beginning of the first annual reporting period beginning on or after January 1, 2011, with earlier application permitted. The Company is currently assessing the impact that the adoption of these Sections may have on its results of operations or financial position.

In June 2009, the CICA issued amendments to CICA Handbook Section 3862, Financial Instruments – Disclosures. The amendments include the enhanced disclosures related to the fair value of financial instruments and the liquidity risk associated with financial instruments. The amendments will be effective for annual financial statements for fiscal years ending after September 30, 2009. The amendments are consistent with recent amendments to financial instruments disclosure standards in IFRS. The Company will include these additional disclosures in its annual financial statements for the year ending May 31, 2010.

3. Short-term investments:

Short-term investments at May 31, 2008 and 2007 represented investments in guaranteed investment certificates bearing interest at rates ranging from 1.10% to 1.50% per annum.

4. Accounts receivable:

Accounts receivable include \$1,492,380 representing the Company's proportionate share of net refunds from the Russian Tax Authority for Russian value added taxes.

PetroKamchatka Resources Ltd.

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5. Property and equipment:

	May 31, 2009			
	Cost	Accumulated depreciation	Accumulated write-down	Net Book Value
Petroleum and natural gas properties:				
Canada	\$ 4,943,573	\$ -	\$ 4,943,573	\$ -
Russia	40,190,403	-	-	40,190,403
	45,133,976	-	4,943,573	40,190,403
Joint interest in drilling rig	8,444,381	-	2,482,417	5,961,964
Drilling rig and equipment - Russia	7,498,228	-	-	7,498,228
Office furniture and equipment	403,365	196,362	-	207,003
	<u>\$ 61,479,950</u>	<u>\$ 196,362</u>	<u>\$ 7,425,990</u>	<u>\$ 53,857,598</u>

	May 31, 2008			
	Cost	Accumulated depreciation	Accumulated write-down	Net Book Value
Petroleum and natural gas properties:				
Canada	\$ 4,943,573	\$ -	\$ 4,943,573	\$ -
Russia	30,715,783	-	-	30,715,783
	35,659,356	-	4,943,573	30,715,783
Joint interest in drilling rig	7,084,117	-	-	7,084,117
Other oil and gas equipment - Russia	2,143,429	-	-	2,143,429
Office furniture and equipment	332,021	151,538	-	180,483
	<u>\$ 45,218,923</u>	<u>\$ 151,538</u>	<u>\$ 4,943,573</u>	<u>\$ 40,123,812</u>

All of the Company's petroleum and natural gas properties in Russia and Canada are considered unevaluated. The ultimate recovery of the property and equipment cost is dependent upon the existence and commercial exploitation of petroleum and natural gas reserves or a sale of properties to a third party. The Company presently does not have sufficient cash to fund all of its planned exploration programs on its Russian properties. Uncertainties regarding the political, legal, tax or regulatory environment, including the potential for adverse and retroactive changes with respect to the Company's operations in the Russian Federation could significantly affect the Company and the ultimate cost recovery of its assets.

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5. Property and equipment (continued):

(a) Russia:

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 Company 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.

The Company, has an effective 42.5% (subsequently increased to 45% - see note 12) indirect interest in, and is the operator of, two exploration licenses (the "Tigil" license and the "Icha" license) located in the Koryakia Autonomous Okrug in the Kamchatka peninsula in the far east of Russia. On January, 29, 2008, the Company obtained a third exploration license ("Urgin") in the Kamchatka peninsula in which the Company has an indirect effective 90% interest (see note 12). The Urgin license covers approximately 2,134 square kilometers and is valid until February 15, 2013. The Urgin license specifies that the license holder must shoot a minimum of 200 kilometers of seismic by February 1, 2010 and drill and complete one well within the first three years of the license term. The Company intends on seeking an extension of these commitments. In the event an extension is not granted, the license will be forfeited.

The Tigil license covers approximately 3,274 square kilometers and was granted to the Company on December 29, 2005. The license is valid until December 31, 2010. The Tigil license specifies that the license holder must shoot 400 kilometers of seismic data during 2005 and 2006 and drill two wells to a depth of 3000 meters during 2006 and 2007. The Company has completed its requirements with respect to the seismic program but has not commenced the drilling of any wells. The Company obtained an extension of its commitment to drill its wells whereby one well needs to be drilled by December 31, 2009 and the remaining well by December 31, 2010.

On December 29, 2006, the Company obtained the Icha license covering approximately 3,777 square kilometers. The requirements for seismic data were completed in April 2007. The license also requires that one well be drilled and completed by October 1, 2011 before the license expires on December 30, 2011.

Effective December 7, 2005 the Company sold 50% of its interests in its Tigil and Icha licenses held at that time to KNOC Kamchatka Petroleum Limited ("KKPL"), a partially owned subsidiary of Korea National Oil Corporation ("KNOC"). Under shareholder agreements which were concluded on February 22, 2006, and the initial share purchase agreements, KKPL was to fund agreed upon amounts for certain initial expenditures incurred by the Company as follows: 50% of certain equipment acquired for use in the projects; 80% of the first \$10,000,000 of exploratory expenditures with respect to the Icha and Tigil licenses; 53.75% of the next \$20,000,000; and for costs in excess of \$30,000,000, KKPL will pay either 50% or 53.75% of these costs.

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5. Property and equipment (continued):

(a) Russia (continued):

On October 5, 2007, the Company and KKPL, together with KNOC, signed a settlement agreement together with an amended and restated rig purchase contract, a rig loan agreement and a pledge agreement (collectively the "Settlement Agreement"). As part of these agreements, it was agreed that international arbitration proceedings initiated by KKPL and KNOC, as a result of disputes concerning the performance of the Company under the original agreements among the parties, was suspended. The principal provisions of these agreements and the status of the agreed transactions are:

KKPL paid \$8.9 million on the project accounts corresponding to cash calls for operations of the projects up to March 31, 2007.

It was agreed that an audit of project expenditures from inception to March 31, 2007 would be conducted by an international firm of accountants. Amounts determined to require adjustment and to be paid into or out of the project accounts as a result of this audit were to be paid within 60 days of receipt of the audit report. The audit report was received and the Company met its obligations within the time period required.

The Company, together with KKPL, committed to acquire a drilling rig for \$16 million. At May 31, 2007 the first installment payment of \$5,000,000 had been made by PetroKamchatka and KKPL in the agreed cost sharing ratios. Under the terms of the Settlement Agreement mentioned above, KKPL paid the second installment on the rig of \$8.5 million, and granted the Company a loan for its share of the payment at Libor plus 3% per annum. During the year ended May 31, 2009, the Company repaid its loan with KKPL and paid all final payments with respect to the rig. Drilling rig costs also include interest of \$4,981 incurred on the rig loan in the year ended May 31, 2009 (2008 - \$177,508 and 2007 - \$nil).

The obligations of the Company under the Settlement Agreement are secured by a pledge of 51% of the Company's shares in the project companies, which own the Russian assets. The pledged shares will be released on satisfaction of the payments required under these contracts and satisfactory performance under the project agreements or provision of acceptable security. The Company's share of the final rig payment was paid in November 2008.

Management considers that the Company's obligations under the Settlement Agreement have been met. This is supported by a letter dated July 29, 2009 from the International Court of Arbitration confirming KKPL's withdrawal of its claims under the Settlement Agreement (see note 12). The Company is requesting a release of the pledged shares and formal recognition of its 46.25% interest in the drilling rig.

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5. Property and equipment (continued):

(b) Joint interest in drilling rig:

The Company paid for a 46.25% interest in a drilling rig which has been acquired by KKPL as outlined above. The Company determined that this rig is not suited for the Russian drilling program, and has undertaken to sell the rig. No firm offers have been received to date. The Company obtained an independent appraisal of the current market value. The carrying value of the Company's 46.25% interest in the drilling rig was written down to its fair value. This has resulted in a write-down of \$2,482,417.

KKPL has not yet been able to obtain all of the information that it requires to be assured that the rig meets the contracted specifications so that it would be in a position to formally accept the rig. On August 18, 2009, KKPL initiated an arbitration proceeding in The International Court of Arbitration against Highkelly, the manufacturer of the rig, in respect of the claim by KKPL that Highkelly 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 to reject the rig and recover the amounts paid or, alternatively, damages for the alleged breach.

(c) Canada:

At May 31, 2008, management reviewed the carrying values of its property and equipment and determined that a writedown of \$124,617 (2007 - \$1,795,849) was required with respect to the Canadian petroleum and natural gas properties and equipment. This represented all of the remaining carrying value of these properties. In 2009, the Company has expensed minimal costs to maintain its Canadian properties but is not currently conducting exploration activities on these properties.

6. Related party transactions and balances:

At May 31, 2009, there were no amounts receivable from directors or officers (2008 and 2007 - \$nil) as advances for expenses. At May 31, 2009, the Company owed amounts to directors and officers totaling \$216,590 (2008 - \$104,714 and 2007 - \$nil) for services performed and expenses incurred in the normal course of operations.

At May 31, 2009, the Company owed a person who is a shareholder, officer and director the aggregate amount of \$390,000 plus interest for two loans made to the Company during the year. A demand loan of \$90,000 was unsecured, bearing interest at a fixed rate of 12% per annum. The second demand loan, in the amount of \$300,000, was secured by a first priority assignment of the assets of the Company bearing interest at a floating rate of Libor plus 3% per annum. The loans together with interest totaling \$5,051 were repaid in full subsequent to May 31, 2009.

A director of the Company was the Executive Chairman of an investment banking firm up to December 31, 2008. The firm has participated in equity financings for the Company and received its market priced share of commissions thereon (note 7(b)). There were no advisory fees paid to this firm for the years ended May 31, 2009, 2008 or 2007.

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7. Share capital:

(a) Authorized:

The Company is authorized to issue an unlimited number of Class A voting common shares .

(b) Class A common shares issued:

	Number of Shares		Amount
Balance, May 31, 2007	48,424,456	\$	22,015,283
Issued for delay in public listing (ii)	3,592,792		–
Issued for cash (iii)	1,200,000		576,848
Less portion representing warrant value	–		(343,560)
Issued for cash, (iv)	31,102,512		15,555,534
Less share issue costs	–		(1,320,331)
Less portion representing warrant value	–		(298,036)
Shares re-acquired (v)	(750,000)		(388,050)
Issued for bonus (vi)	2,500,000		1,250,000
Issued for services (vii)	1,067,974		533,934
Issued on exercise of warrants (viii)	700,000		350,000
Value attributed to exercised warrants	–		200,385
Issued for cash (ix)	43,270,000		21,635,000
Less share issue costs	–		(1,407,283)
Less portion representing warrant value	–		(560,042)
Balance May 31, 2008	131,107,734	\$	57,799,682
Issued for cash (ix)	24,960,000		12,480,000
Less share issue costs	–		(717,349)
Less portion representing warrant value	–		(321,944)
Issued for delay in public listing (ii)	17,562		–
Issued for settlement of claim (x)	1,750,000		350,000
Issued for services (xi)	284,331		141,523
Balance May 31, 2009	158,119,627	\$	69,731,912

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7. Share capital (continued):

(b) Class A common shares issued (continued):

- i) During the year ended May 31, 2007, the Company issued 7,059,453 Class A common shares for cash of \$6,304,742 after expenses. Of these shares, 5,612,035 shares were issued to a company that was previously associated with a director of the Company (note 6). These shares were issued with a right to obtain additional shares without further consideration at the rate of 2% per month of the number of shares purchased to a maximum of 50% of the shares issued or until the Company obtains a public listing. In addition the purchaser was also granted 2,806,017 warrants to purchase the same number of Class A common shares for CAD\$1.25 per share until November 21, 2008 or fifteen days following the listing of the Company on a public exchange. The warrants were ascribed a fair value of \$1,044,160 using the Black-Scholes pricing model, assuming a risk-free interest rate of 3.92%; life of 2 years; dividend yield of nil; and expected volatility rate of 86%.
- ii) Pursuant to a private placement in the year ended May 31, 2006 and a further issuance of 5,612,035 shares in the year ended May 31, 2007, the Company entered into agreements with certain shareholders to issue additional Class A common shares equal to 2% per month of the number of shares purchased during the period when the Company is not publicly listed, up to a maximum of 50% of the number of shares issued. During the year ended May 31, 2007, 6,146,432, Class A common shares were issued to shareholders pursuant to this requirement. During the year ended May 31, 2008 and May 31, 2009, the Company issued 3,592,792 and 17,562 additional Class A common shares under these agreements, respectively. The shareholders holding these agreements agreed to terminate their rights to any further shares under these agreements.
- iii) The Company issued 480,000 Class A common shares in August 2007 at CAD\$1.25 per share and an equal number of warrants which entitled the holder to purchase shares for CAD\$0.50 per share for a period of one year. The agreements provided that in the event the Company subsequently issued shares within one year for a price less than CAD\$1.25 per share the number of shares that were to be issued increased. The Company subsequently issued shares at \$0.50 per share. As a result, an additional 720,000 shares were issued in August 2008 bringing the total number of shares issued to 1,200,000. In addition, an equal number of warrants were issued in August 2008.
- iv) The Company completed a sale of 31,102,512 Class A common shares October 15, 2007 at a price of \$0.50 per share for net proceeds of \$14,235,203. The Company also granted a broker, 1,225,526 share purchase warrants for the purchase of 1,225,526 Class A common shares at a price of \$0.50 per share within a period of two years following a public listing of the Company's shares.

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7. Share capital (continued):

(b) Class A common shares issued (continued):

- v) On November 2, 2007, the Company reached a settlement agreement under which the Company's former president and director resigned and sold his 750,000 shares to the Company at \$0.50 per share. In exchange for signing a non-compete agreement and the payment of certain legal fees, he also received \$162,000 covering severance.
- vi) On December 19, 2007, the Board of Directors approved a one-time bonus to directors, officers, employees and contractors of 2,500,000 Class A common shares.
- vii) During the year ended May 31, 2008, the Company issued 749,224 Class A common shares to a director, former directors, officers and contractors for services rendered in the amount of \$374,559. In addition, the Company issued 318,750 Class A common shares to non-executive directors for service on the board during the year amounting to \$159,375.
- viii) During the year ended May 31, 2008, the Company issued 700,000 Class A common shares for consideration of \$350,000 on the exercise of 700,000 share purchase warrants.
- ix) In May 2008, the Company sold 43,270,000 Class A common shares pursuant to a private placement for consideration of \$0.50 per share, before the agents' 5.5% commission and other costs. At May 31, 2008, \$6,615,000 in subscriptions related to this placement remained unpaid. In addition, 2,343,000 agent warrants were issued representing 5.5% of the number of shares sold by the agent. The agent warrants provide for the purchase of Class A common shares at \$0.50 each for a period of two years following the date on which the Company becomes listed on a recognized stock exchange. In July 2008, the second tranche of the private placement was completed with an additional 24,960,000 Class A common shares being issued at \$0.50 per share and 1,347,500 agent warrants.
- x) On February 13, 2009, the Company issued 1,750,000 Class A common shares at \$0.20 per share as a \$350,000 partial settlement for a total \$750,000 claim (see note 11).
- xi) During the year ended May 31, 2009, the Company issued 135,581 Class A common shares to directors, former directors, officers and contractors for services rendered in the amount of \$67,148. In addition, the Company issued 148,750 Class A common shares to non-executive directors for services during the year in the amount of \$74,375.

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7. Share capital (continued):

(c) Warrants:

The following is a continuity of warrants issued to investors and brokers to May 31, 2009:

	Number	Amount
Balance, May 31, 2007	17,797,691	\$ 7,020,259
Issued to investors (7(b)(iii))	1,200,000	343,560
Issued to brokers (7(b)(iv))	1,225,526	298,036
Issued to brokers (7(b)(ix))	2,343,000	560,042
Exercised (7(b)(viii))	(700,000)	(200,385)
Balance, May 31, 2008	21,866,217	\$ 8,021,512
Issued to brokers (7(b)(ix))	1,347,500	321,944
Expired	(3,946,778)	(1,383,193)
Balance May 31, 2009	19,266,939	\$ 6,960,263

The following summarizes information on warrants issued to investors to purchase Class A common shares that were outstanding as at May 31, 2009:

Exercise Price	Outstanding and	Contractual life
\$	Pounds	
	0.525	Until fifteen days following the listing of the Company on a public stock exchange
CAD 1.25	5,760,809	
	7,589,999	
CAD 1.25	2,806,018	November 30, 2008
US 0.50	750,000	One year from issue date (August 2008)
Expired – CAD 1.25	(2,806,018)	
Expired – US 0.50	(750,000)	
	13,350,808	

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7. Share capital (continued):

(c) Warrants (continued):

The following summarizes information about warrants issued to brokers to purchase Class A common shares that were outstanding as at May 31, 2009:

Exercise Price	Outstanding and		Contractual life	
	\$	Pounds		exercisable
CAD 0.50			28,800	Two years following the listing of the Company on a public stock exchange
		0.42	460,865	
CAD 1.00			760,440	
CAD 1.00			13,160	October 31, 2007
CAD 1.00			377,600	November 30, 2007
US 0.50			4,666,026	Two years following the listing of the Company on a public stock exchange
Expired – CAD 1.00			(390,760)	
			5,916,131	

The following summarizes information about warrants issued to investors to purchase Class A common shares that were outstanding as at May 31, 2008:

Exercise Price	Outstanding and		Contractual life	
	\$	Pounds		exercisable
		0.525	5,760,809	Until fifteen days following the listing of the Company on a public stock exchange
CAD 1.25			7,589,999	
CAD 1.25			2,806,018	November 30, 2008
US 0.50			1,200,000	One year from issue date (August 2008)
US 0.50 - Exercised			(450,000)	
			16,906,826	

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7. Share capital (continued):

(c) Warrants (continued):

The following summarizes information about warrants issued to brokers to purchase Class A common shares that were outstanding as at May 31, 2008:

	Exercise Price		Outstanding and exercisable	Contractual life
	\$	Pounds		
CAD 0.50			28,800	Two years following the listing of the Company on a public stock exchange
		0.42	460,865	
CAD 1.00			760,440	
CAD 1.00			13,160	October 31, 2007
CAD 1.00			377,600	November 30, 2007
US 0.50			3,568,526	Two years following the listing of the Company on a public stock exchange
US 0.50 - Exercised			(250,000)	
			4,959,391	

(d) Stock options:

	Years ended May 31		
	2009	2008	2007
Outstanding options, beginning of year	5,400,000	600,000	1,100,000
Granted	825,000	5,200,000	-
Expired/cancelled	-	(400,000)	(500,000)
Outstanding options, end of year	6,225,000	5,400,000	600,000
Exercisable, end of year	1,933,333	200,000	600,000

During the year ended May 31, 2008, 350,000 options were cancelled and 50,000 options expired. The remainder of the 200,000 options from the 2007 balance are fully vested and exercisable at a price of CAD\$1.25 until expiry on November 14, 2010. On December 19, 2007, the Company granted stock options to acquire 5,000,000 Class A common shares at \$0.50 per share to directors, officers, employees and consultants. The options have a term of five years and vest 1/3 each year from date of grant. The Company granted additional options, with the same terms, to acquire 200,000 Class A common shares to employees on March 27, 2008.

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7. Share capital (continued):

(d) Stock options (continued):

During the year ended May 31, 2009, the Company granted additional options to officers and consultants to acquire 825,000 Class A common shares at \$0.50 per share. The options have a term of five years and vest 1/3 each year from the date of grant.

The fair value of stock options granted and warrants issued during the years ended May 31, 2009, 2008 and 2007 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 2008 (per option)	-	\$ 0.29
Fair value of stock options granted in 2009 (per option)	-	\$ 0.30
Fair value of warrants granted in 2009 (per warrant)	\$0.24	-
Fair value of warrants granted in 2008 (per warrant)	\$ 0.25	-
Fair value of warrants granted in 2007 (per warrant)	\$ 0.37	-
Expected volatility	69%	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%

The following table summarizes stock options outstanding and exercisable at May 31, 2009:

Exercise Price	Stock Options Outstanding			Stock Options Exercisable	
	Number Outstanding	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Number Exercisable	Weighted-Average Exercise Price
\$ 1.25 CAD	200,000	1.46	\$ 1.25 CAD	200,000	\$ 1.25 CAD
\$ 0.50	6,025,000	3.66	\$ 0.50	1,733,333	\$0.50
	<u>6,225,000</u>	<u>3.60</u>		<u>1,933,333</u>	

The following table summarizes stock options outstanding and exercisable at May 31, 2008:

Exercise Price	Stock Options Outstanding			Stock Options Exercisable	
	Number Outstanding	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Number Exercisable	Weighted-Average Exercise Price
\$ 1.25 CAD	200,000	2.46	\$ 1.25 CAD	200,000	\$ 1.25 CAD
\$ 0.50	5,200,000	4.56	\$ 0.50	-	
	<u>5,400,000</u>	<u>4.48</u>		<u>200,000</u>	

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7. Share capital (continued):

(e) Contributed surplus:

Changes in contributed surplus are as follows:

	Years ended May 31		
	2009	2008	2007
Beginning of year	\$ 1,266,573	\$ 1,035,137	\$ 1,035,137
Stock-based compensation	574,630	231,436	-
Expired warrants (note 7(c))	1,383,193	-	-
End of year	<u>\$ 3,224,396</u>	<u>\$ 1,266,573</u>	<u>\$ 1,035,137</u>

8. Income taxes:

The income tax expense (recovery) differs from the income taxes which would result had the Company applied the statutory tax rate to earnings (loss) before taxes. The main differences between expected and actual tax provisions are as follows:

	May 31		
	2009	2008	2007
Computed income tax expense (recovery)	\$ (2,288,000)	\$ (2,016,000)	\$ (1,574,000)
Add (deduct):			
Stock-based compensation	168,000	74,000	-
Foreign loss (income) affected at different tax rates	167,000	105,000	(27,000)
Change in estimates and effective tax rates	271,000	249,000	114,000
Non-deductible costs	99,000	403,000	496,000
Valuation allowance	1,583,000	1,185,000	991,000
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

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8. Income taxes (continued):

The components of future income taxes are approximately as follows:

	May 31		
	2009	2008	2007
Future income tax assets:			
Non-capital loss carries forward	\$ 4,895,000	\$ 3,796,000	\$ 2,581,000
Property and equipment	2,079,000	1,452,000	1,481,000
Share issue costs	725,000	868,000	521,000
	<u>7,699,000</u>	<u>6,116,000</u>	<u>4,583,000</u>
Less valuation allowance	<u>(7,699,000)</u>	<u>(6,116,000)</u>	<u>(4,583,000)</u>
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

The Company has incurred expenditures in various jurisdictions, which are subject to tax authority approval. Any future tax asset would be offset by a valuation allowance due to the uncertainty surrounding the future utilization of the tax pools by the Company.

The Company has losses carried forward for tax purposes in Canada of approximately \$16,835,000 (2008 - \$13,615,000) which expire between 2010 and 2029.

On August 25, 2009, the Company redomiciled to Cyprus. The Company is considered to have disposed of all its assets at fair value on the date of redomiciliation (note 12(v)) and the Canadian tax pools will be lost following the redomiciliation.

9. Financial instruments and risk management:

(a) Capital management

As an exploration company, operations are financed principally through equity. Therefore, the Company's capital consists of shareholders' equity. The Company's objectives when managing capital are to: sustain its ability to continue as a going concern; maximize returns for shareholders and benefits for other stakeholders; and provide resources to enable growth.

The Company 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.

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9. Financial instruments and risk management (continued):

(a) Capital management (continued)

The current economic conditions have significantly affected capital markets. Management is monitoring the Company's rate of spending on its capital projects in Russia and general and administrative costs given the current environment and in the absence of adequate funding at May 31, 2009 (see note 1).

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

(b) Fair values

The fair value of the Company's financial instruments, including cash and cash equivalents, short-term investments, accounts receivable, amount due to joint interest partner, accounts payable and accrued liabilities, bank loan and rig loan approximated their carrying values as at May 31, 2009 and 2008.

(c) Financial instrument risk exposure and management

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

Market risk:

Market risk is the risk that changes in market conditions, such as commodity prices, exchange rates and interest rates, will affect the Company'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.

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 Company'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 Company may attempt to mitigate commodity price risk through the use of financial derivatives. The Company does not have any oil or gas production and does not have any risk management contracts in place as at or during the fiscal years ended May 31, 2009 and 2008.

Foreign currency risk:

The Company is exposed to foreign currency fluctuations as it holds cash and incurs expenditures in property and equipment in foreign currencies. The Company incurs expenditures in Russian rubles and Canadian dollars and is exposed to fluctuations in exchange rates in these currencies. There are no exchange rate contracts in place as at or during the fiscal years ended May 31, 2009 or 2008.

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9. Financial instruments and risk management (continued):

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

A 1% change in foreign exchange rates between the Russian ruble and Canadian dollar would have resulted in approximately \$74,000 change in net loss in 2009.

Credit Risk:

Financial instruments that potentially subject the Company to concentration of credit risk consist of short-term deposits and accounts receivable.

The Company has deposited cash in short-term investments with reputable financial institutions, with which management believes the risk of loss to be remote. There is no credit risk on accounts receivable. Accounts receivable consists of Russian value added taxes (note 4) and amounts due from the Canadian Government. All amounts were received subsequent to the year end.

Liquidity Risk:

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due. The Company's financial liabilities consist of accounts payable and accrued liabilities and a loan to a shareholder and officer of the Company. Accounts payable consists primarily of invoices payable to trade suppliers for capital expenditures and general corporate expenses (see note 1).

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

10. Supplemental cash flow disclosures:

(a) Change in non-cash working capital:

	Years ended May 31		
	2009	2008	2007
Share subscriptions receivable	\$ 6,615,000	\$ (6,615,000)	\$ -
Accounts receivable	(1,426,079)	58,392	(11,313)
Advances due from (to) joint interest partner	-	8,885,646	(6,835,551)
Prepaid expenses	(102,999)	(32,177)	15,114
Accounts payable and accrued liabilities	(5,341,557)	(9,344,630)	14,100,377
	(255,635)	(7,047,769)	7,268,627
Less changes in non-cash working capital related to investing	6,596,544	(992,300)	(7,586,055)
Less changes in non-cash working capital related to financing	(6,615,000)	6,615,000	-
Changes in non-cash working capital related to operations	\$ (274,091)	\$ (1,425,069)	\$ (317,428)

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10. Supplemental cash flow disclosures(continued):

Cash interest of \$182,489 was paid during the year ended May 31, 2009 (2008 - \$107,309 and 2007 - \$29,473).

11. Commitments and contingencies:

Under the Company's Russian exploration licenses the Company is committed to complete seismic programs and drill wells by certain dates in order to retain its licenses (see note 5).

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

Future net minimum lease payments for these leases are as follows for the fiscal years ended:

2010	\$	252,000
2011		252,000
2012		252,000
2013		252,000
2014		52,000
	\$	<u>1,060,000</u>

The Company had an arrangement with an unrelated individual to pay a finder's fee and grant a share option in relation to funds provided by KKPL under the agreements with them. The Company recorded the cost of this arrangement in the financial statements since the arrangement commenced. A dispute arose concerning this arrangement, resulting in a statement of claim being issued against the Company on May 1, 2008. The claim was settled during the year ended May 31, 2009, for cash of \$400,000 and the issuance of 1,750,000 common shares at \$0.20 per share (note 7(b)). The cash portion of the settlement was paid subsequent to May 31, 2009.

12. Subsequent events:

Subsequent to May 31, 2009, the Company:

- i) Raised \$11,477,979 June through August 2009 from the issue of 228,505,044 Class A common shares through an offering to shareholders and others closely associated with the Company.
- ii) Issued 17,600,000 Class A common shares on June 22, 2009 to one of its vendors for settlement of aggregate outstanding invoices of approximately \$880,000.
- iii) Issued 5,200,000 Class A common and paid additional costs to acquire an additional 5% equity ownership of its Russian subsidiary from a minority shareholder on August 11, 2009. After this acquisition, PetroKamchatka owns 90% of its Russian subsidiary. This renders the Company's beneficial ownership of the Tigil and Icha licenses at 45%, after this transaction.

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12. Subsequent events (continued):

- iv) Received notice on July 29, 2009 from the International Court of Arbitration of withdrawal of KNOC and KKPL's claims under the Settlement Agreement (see note 5).
- v) Redomiciled from Canada to Cyprus on August 25, 2009 under the Republic of Cyprus' Company Law.
- vi) Acquired four additional licenses in the Kamchatka peninsula of Russia in September 2009. The Company has an effective 100% interest in these licenses, subject to the right of its joint venture partner to exercise a right of participation under area of mutual interest provision of its joint venture agreements. The licenses are valid until September 2014 and specify minimum seismic, drilling and completion requirements in the first two to three years of the license term.
- vii) Issued 1,851,715 Class A common shares on October 6, 2009 to directors, officers and contractors for services rendered in the amount of \$111,023.
- viii) Declared a bonus on October 1, 2009 of \$1,155,000 to be paid to officers, employees and contractors, \$278,333 in cash and \$876,667 in Class A Common shares at a price of \$0.10 per share.
- ix) Granted a total of 15,100,000 options on October 1, 2009 to directors, officers, employees and contractors at an exercise price of \$0.10 per option. The options have a term of five years and vest 1/3 each year from date of grant.

On December 23, 2008, PetroKamchatka Plc ("PKK") was incorporated in Jersey by directors and officers of the Company with the intent to have it acquire all the shares of the Company.

In October 2009, PKK issued a take-over offer to the shareholders of the Company to acquire 100% of the issued and outstanding Class A Common Shares of the Company on the basis of one common share of PKK in exchange for each Class A Common Share of the Company. The offer is conditional upon 90% of the Common Shares of the Company being tendered. Prior thereto, on October 2, 2009, PKK entered into an Arrangement Agreement with Bluerock Acquisition Corp. ("Bluerock") a capital pool company listed on the TSX Venture Exchange to complete a business combination. The transaction, if successful, will result in PKK issuing approximately 6,626,544 common shares, 0.46837 common shares for each Bluerock common share, to acquire Bluerock and PKK being a listed public company. Bluerock has no operating assets and limited working capital. As a result, the acquisition is not expected to have a material effect on the assets, liabilities, income or expenses of PKK. The transaction is subject to shareholder and regulatory approval and in the event the transaction is not completed as a result of certain conditions, each of PKK and Bluerock is subject to a break fee of \$350,000 CAD.

PetroKamchatka Resources Ltd.

(formerly CEP International Petroleum Ltd.)

Notes to the Consolidated Financial Statements

United States Dollars, unless otherwise stated

May 31, 2009, 2008 and 2007

12. Subsequent events (continued):

On October 6, 2009, PKK and its wholly-owned subsidiary, 1490697 Alberta Ltd., entered into an engagement letter with Canaccord Capital Corporation ("Canaccord") together with Renaissance Securities Ltd. (as Lead Agents) to raise, on a commercially reasonable best efforts basis, a private placement of convertible securities, of up to \$15 million. The convertible securities are convertible, on a one-for-one basis, into Common Shares of PKK upon successful completion of the acquisition of PetroKamchatka by PKK and the Bluerock Arrangement. If these transactions are not completed by December 31, 2009, then the convertible securities will be cancelled and all the subscriptions proceeds will be returned to the subscribers.