

# **Canoel International Energy Ltd.**

Consolidated Financial Statements  
Second Quarter Ended September 30, 2010  
(expressed in Canadian dollars)

## **Notice to the Reader**

The accompanying unaudited interim financial statements of Canoel International Energy Ltd. for the three and six months ended September 30, 2010 have been prepared by management and approved by the Board of Directors of the Company. These statements have not been reviewed by the Company's external auditors.

Approved on behalf of Canoel International Energy Ltd.,

Andrea Cattaneo  
President and Chief Executive Officer

John Arne Farstad  
Chief Financial Officer

Dated November 29, 2010

# Canoel International Energy Ltd.

Consolidated Balance Sheets

As at September 30, 2010 and March 31, 2010

(Expressed in Canadian dollars)

	September 30, 2010	March 31, 2010
	\$	\$
		(Audited)
<b>Assets</b>		
<b>Current Assets</b>		
Cash and cash equivalents	1,114,085	992,599
Accounts receivable	1,085,482	547,542
Prepaid expenditures	69,069	11,727
	<u>2,268,636</u>	<u>1,551,868</u>
Property, plant and equipment (note 6)	3,713,003	986,420
	<u>5,981,639</u>	<u>2,538,288</u>
<b>Liabilities</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities	734,789	261,566
Note payable (note 5)	1,506,918	-
Current portion of convertible notes (note 8)	41,667	-
	<u>2,283,374</u>	<u>261,566</u>
<b>Asset retirement obligation</b> (note 7)	344,514	-
<b>Convertible notes</b> (note 8)	387,892	-
	<u>3,015,780</u>	<u>261,566</u>
<b>Shareholders' equity</b>		
Share capital (note 9b)	4,545,192	3,136,450
Other equity (note 8)	142,280	-
Warrants (note 9c)	505,502	479,283
Contributed surplus	265,160	195,535
Deficit	(2,492,275)	(1,534,546)
	<u>2,965,859</u>	<u>2,276,722</u>
	<u>5,981,639</u>	<u>2,538,288</u>

**Going concern** (note 2)

**Commitments** (note 13)

**Subsequent events** (note 14)

**Approved by the Board of Directors**

(Signed) "Jose Ramon Lopez-Portillo"  
Director

(Signed) "Andrea Cattaneo"  
Director

The accompanying notes are an integral part of these financial statements.

# Canoel International Energy Ltd.

## Consolidated Statements of Loss, Comprehensive Loss and Deficit For the three and six months ended September 30, 2010 and 2009

(Expressed in Canadian dollars)

	Three months ended September 30, 2010 \$	Three months ended September 30, 2009 \$	Six months ended September 30, 2010 \$	Six months ended September 30, 2009 \$
<b>Revenue</b>				
Petroleum revenue	435,263	-	435,263	-
Royalties	(32,200)	-	(32,200)	-
Interest income	169	331	570	884
	<b>403,232</b>	<b>331</b>	<b>403,633</b>	<b>884</b>
<b>Expenses</b>				
Production	151,801	-	151,801	-
Transportation	7,819	-	7,819	-
General and administrative	887,128	182,013	1,112,005	379,100
Stock based compensation (note 9d)	69,625	22,914	69,625	22,914
Depletion, depreciation and accretion	50,755	-	50,755	-
Foreign exchange (gain)	(17,226)	4,552	(30,643)	4,552
	<b>1,149,902</b>	<b>209,479</b>	<b>1,361,362</b>	<b>406,566</b>
<b>Net loss and comprehensive loss</b>	<b>(746,670)</b>	<b>(209,148)</b>	<b>(957,729)</b>	<b>(405,682)</b>
<b>Deficit, beginning of period</b>	<b>(1,745,605)</b>	<b>(675,692)</b>	<b>(1,534,546)</b>	<b>(479,158)</b>
<b>Deficit, end of period</b>	<b>(2,492,275)</b>	<b>(884,840)</b>	<b>(2,492,275)</b>	<b>(884,840)</b>
<b>Basic and diluted loss per share (note 9f)</b>	<b>(0.02)</b>	<b>(0.01)</b>	<b>(0.04)</b>	<b>(0.03)</b>
<b>Weighted average shares outstanding during the period – basic and diluted</b>	<b>31,633,259</b>	<b>16,158,999</b>	<b>26,653,349</b>	<b>15,981,276</b>

The accompanying notes are an integral part of these financial statements.

# Canoel International Energy Ltd.

## Consolidated Statement of Cash Flows

For the three and six months ended September 30, 2010 and 2009

(Expressed in Canadian dollars)

	Three months ended September 30, 2010 \$	Three months ended September 30, 2009 \$	Six months ended September 30, 2010 \$	Six months ended September 30, 2009 \$
<b>Cash flows used in operating activities:</b>				
Net loss for the period	(746,670)	(209,148)	(957,729)	(405,682)
Items not affecting cash:				
Depletion, depreciation and accretion	50,755	-	50,755	-
Stock based compensation	69,625	22,914	69,625	22,914
Accretion of convertible notes (note 8)	9,696	-	9,696	-
	<b>(616,594)</b>	<b>(186,234)</b>	<b>(827,653)</b>	<b>(382,768)</b>
Changes in non-cash working capital				
Changes in accounts receivable	302,221	10,654	297,248	(18,323)
Change in prepaids	(20,952)	(16,029)	(57,342)	(21,765)
Change in accounts payable and accrued liabilities	257,115	11,957	201,978	9,319
	<b>(78,210)</b>	<b>(179,652)</b>	<b>(385,769)</b>	<b>(413,537)</b>
<b>Cash flows used in investing activities</b>				
Corporate acquisition	(1,440,600)	(77,560)	(1,440,600)	(77,560)
	<b>(1,440,600)</b>	<b>(77,560)</b>	<b>(1,440,600)</b>	<b>(77,560)</b>
<b>Cash flows provided by financing activities</b>				
Proceeds from issuance of common shares, net of issue costs	1,223,748	138,272	1,422,105	138,272
Proceeds from issuance of convertible notes	75,000	-	575,000	-
Changes in non-cash working capital	169,786	-	(49,250)	-
	<b>1,468,534</b>	<b>138,272</b>	<b>1,947,855</b>	<b>138,272</b>
<b>Change in cash and cash equivalents</b>	<b>(50,276)</b>	<b>(118,940)</b>	<b>121,486</b>	<b>(352,825)</b>
<b>Cash and cash equivalents, beginning of period</b>	<b>1,164,361</b>	<b>860,180</b>	<b>992,599</b>	<b>1,094,065</b>
<b>Cash and cash equivalents, end of period</b>	<b>1,114,085</b>	<b>741,240</b>	<b>1,114,085</b>	<b>741,240</b>
<b>Supplemental cash flow disclosure</b>				
Interest received	169	-	570	-

The accompanying notes are an integral part of these financial statements.

# Canoel International Energy Ltd.

Notes to the Consolidated Financial Statements

For the three and six months ended September 30, 2010 and 2009

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(Expressed in Canadian dollars)

## 1 Nature of operations

Canoel International Energy Ltd. (the "Company") was incorporated pursuant to the provisions of the British Columbia Business Corporations Act on September 20, 2007. The Company is involved in the exploration for, development of and production of petroleum and natural gas properties in Argentina and Tunisia.

On March 10, 2010, the Company formed Ingenieria Petrolera del Rio de la Plata S.R.L. ("IPRP"), a wholly owned subsidiary of the Company. IPRP was established to negotiate management agreements to operate existing producing properties on behalf of other companies in exchange for a fee and a percentage of profits. As at September 30, 2010, IPRP exists solely as a shell with no assets and liabilities.

On July 22, 2010, the Company acquired 100% of Central Patagonia SRL ("Central Patagonia"), a subsidiary of a U.S. based company, thereby acquiring two adjacent oil producing properties in Argentina (the "Argentina Acquisition"). In anticipation of the completion of the Argentina Acquisition, on July 20, 2010 the Company formed a wholly owned US subsidiary, Ingenieria Petrolera Patagonia Ltd. ("IPP") to act as the acquisition vehicle (note 5). Consequently the Company is no longer classified as a development stage entity as defined by the Canadian Institute of Chartered Accountants ("CICA") Accounting Guideline 11.

## 2 Going Concern

These consolidated financial statements have been prepared in accordance with generally accepted accounting principles applicable to a going concern, which assumes that the Company will be able to realize its assets and meet its obligations and continue its operations for the foreseeable future. Realization values may be substantially different from carrying values as shown and these consolidated financial statements do not reflect adjustments that would be necessary if the going concern assumption were not appropriate. If the going concern basis were not appropriate for these consolidated financial statements, then the adjustments would be necessary in the carrying value of assets and liabilities, the reported revenues and expenses, and the balance sheet classifications used.

As at September 30, 2010, the Company had not yet achieved profitable operations, has accumulated a deficit of \$2,492,275 (March 31, 2010 - \$1,534,546) since its inception, and expects to incur further losses in the development of its business, which is typical of an oil and gas exploration and development company. Current cash resources will not be sufficient to continue the exploration and development activities. These matters raise doubt about the

# Canoel International Energy Ltd.

Notes to the Consolidated Financial Statements

For the three and six months ended September 30, 2010 and 2009

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(Expressed in Canadian dollars)

ability of the Company to continue to meet its obligations as they become due. Continuing operations are dependent on the ability to obtain adequate funding to finance existing operations, attain commercial production from its Tunisian oil and gas properties and attain future profitable operations. Additional financing is subject to the global financial markets and economic conditions, which have recently been disrupted and volatile and the debt and equity markets have been distressed. These factors, together with the current weak economic conditions, have made, and will likely continue to make, it challenging to obtain cost effective funding. There is no assurance this capital will be available and if it is not, the Company may be forced to curtail or suspend planned activity.

### **3 Significant accounting policies**

These unaudited interim financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("Canadian GAAP"), using the same accounting policies and methods as per the annual financial statements for the year ended March 31, 2010. They do not include all of the disclosures required by Canadian GAAP, and should be read in conjunction with the most recent annual financial statements of the Company.

#### *Foreign Currency Translation*

The US subsidiaries and their Argentina operation are considered to be an "integrated foreign operation" for accounting purposes and, therefore, these foreign operations financial statements are translated into Canadian Dollars using the temporal method. Under the temporal method the company translates foreign denominated monetary assets and liabilities at the exchange rate prevailing at the balance sheet date; non monetary assets, liabilities and related depletion and depreciation are translated at historic rate at the balance sheet date; revenue and expenses are translated at the average rate of exchange for the period and any resulting foreign exchange gains or losses are included in earnings.

#### *Property and equipment*

The Argentinean company uses the successful efforts method of accounting for oil and gas activities. Costs to acquire mineral interest in the oil and gas properties, to drill and to equip exploratory wells that find proven reserves and to drill and equip developments wells are capitalized. Costs to drill exploratory wells that do not find proven reserves are expensed at the moment that the exploratory drilling proves to be unsuccessful. Geological and geophysical costs and costs of carrying and retaining unproved properties are expensed as they are incurred. Unproved oil and gas properties are periodically assessed for impairment after considering the remaining term of the lease, drilling results the evaluation of the geological data and other information. A loss is recognized at the time of impairment by providing an impairment

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Notes to the Consolidated Financial Statements

**For the three and six months ended September 30, 2010 and 2009**

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(Expressed in Canadian dollars)

allowance. Capitalized costs of producing oil and gas properties, after considering estimated salvage values, are depreciated and depleted over proved developed reserves using the unit of production method; while acquired resources properties, with proved reserves, are depleted over proved reserves using the unit of production method. Pipelines and associated facilities are depreciated on a straight-line basis over their expected useful lives. Acquisition costs of probable reserves are not depleted or amortized while under active evaluation for commercial reserves. Costs are transferred to depletable costs as proved reserves are recognized.

Expenditures for maintenance, repairs and minor renewals necessary to maintain properties in operating condition are expensed as incurred.

Costs associated with major replacements and renewals are capitalized when the service potential of the reserves have enhanced.

Other property and equipment is carried at cost less accumulated depreciation. Depreciation expenses are computed using the straight line method over the estimated useful lives of the assets. Additions too and major improvements of properties and equipment are capitalized.

The results of operations for the three and six months ended September 30, 2010 are not necessarily indicative of those to be expected for the entire year ending March 31, 2011.

## **Adoption of new accounting policies**

### **Business combinations**

In January 2009, the AcSB issued CICA Handbook Section 1582, "Business Combinations" which replaces previous guidance on business combinations. This Section applies to business combinations entered into on or after January 1, 2011 with earlier adoption permitted. This standard outlines new guidance which states that the purchase price is to be based on trading data at the closing date of the acquisition, not the announcement date, and that most acquisition costs are to be expensed as incurred, not capitalized, as part of the purchase price. As well, under the new standard, the acquirer's unrecognized tax benefits that are recognizable as a result of an acquisition are recognized as a reduction of income tax expense. The new standard also modifies the accounting for contingent consideration and negative goodwill. The Company has elected to prospectively adopt this standard effective April 1, 2010, in advance of the transition to International Financial Reporting Standards ("IFRS") as it substantially aligns with IFRS.

# Canoel International Energy Ltd.

Notes to the Consolidated Financial Statements

For the three and six months ended September 30, 2010 and 2009

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(Expressed in Canadian dollars)

## **Consolidated financial statements**

In January 2009, the AcSB issued CICA Handbook Section 1601, "Consolidations" and 1602, "Non-controlling Interests". Section 1601 carries forward the requirements of Section 1600, "Consolidated Financial Statements", other than those relating to non-controlling interests which would be covered in Section 1602. These standards are effective for annual and interim periods beginning on or after January 1, 2011 with earlier adoption permitted. The Company has elected to adopt the standards effective April 1, 2010.

## **Principles of consolidation**

These consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries IPRP and IPP since its establishment on July 20, 2010 (note 5).

## **4 Future accounting and reporting changes**

### **Equity**

In August 2009, the AcSB issued amendments to CICA Handbook Section 3251: Equity as a result of issuing CICA Handbook Section 1602: Non-controlling Interests. The amendments require non-controlling interests to be recognized as a separate component of equity. The amendments apply only to entities that have adopted Section 1602 and are not expected to have an impact on the Company's financial statements.

## **5 Business combinations**

On July 22, 2010, a Share Purchase Agreement (the "Agreement") was signed to acquire Central Patagonia. Pursuant to the Agreement, IPP completed the Argentina Acquisition of Central Patagonia from Central Argentina Corporation ("Central Argentina") through the purchase of the shares of Central Patagonia Corp ("CPC") and CPC Holdings Inc. ("CPC Holdings"), who together own 100% of Central Patagonia. The purchase price was US \$2,843,003. Central Argentina is the previous parent company of CPC and CPC Holdings. Of the total purchase price, US \$1,400,000 was advanced by the Company through IPP on the closing date. The remaining US \$1,443,003 is repayable under two different promissory notes (collectively the "Notes"). The first note is due to Central Argentina on the maturity date of July 22, 2011 and bears an interest rate of 7.5% per annum, payable quarterly. A second promissory note for the amount of US \$443,003 is due to Central Argentina on the maturity date of March 22, 2011 and bears an interest rate of 7.5% per annum until November 22, 2010, at which point the interest rate increases to 15% per annum.

# Canoel International Energy Ltd.

Notes to the Consolidated Financial Statements

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(Expressed in Canadian dollars)

At its option, IPP may repay any amount of the Notes prior to the respective maturity dates. The Notes are secured by a first lien on the equity interests and all personal and real property of CPC, CPC Holdings and Central Patagonia. Pursuant to the Agreement, the purchase price allocation is subject to change based on the final determination of assets acquired and liabilities assumed, which may be calculated up to December 31, 2010.

Pursuant to the Agreement, for a period of three years from November 30, 2010 IPP will provide Central Argentina with the following: (i) 50% of the annual gross revenue derived from the sale of barrels of oil at a per barrel invoice price that exceeds USD \$42.00, but is less than or equal to USD \$52.00; and (ii) 25% of the annual gross revenue derived from the sale of barrels of oil at a per barrel invoice price that exceeds USD \$52.00.

The Company has accounted for the Argentina Acquisition as prescribed by CICA Handbook section 1582 "Business Combinations". As the acquirer, IPP is required to recognize the assets and liabilities of Central Patagonia as at July 22, 2010. The results of operations of Central Patagonia are included in the consolidated financial statements of the Company from July 22, 2010. Costs associated with the Argentina Acquisition of \$135,600 were expensed and are included in general and administrative expense.

As at September 30, 2009, the Company has recorded \$22,068 in accrued interest payable on the Notes.

As stated above, management is still completing its review of the assets and liabilities acquired in this transaction, and therefore, the purchase price equation shown below is subject to change based in the final determination of the assets acquired and liabilities incurred.

Details of the Argentina Acquisition are:

Purchase price allocation (CDN \$)	
Fair value of net assets acquired:	
Working capital	\$455,850
Property and equipment	2,837,514
Accrued liabilities	(23,400)
Asset retirement obligation	(344,514)
	<hr/>
	\$2,925,450
	<hr/>
Cost of the Argentina Acquisition:	
Cash consideration	\$1,440,600
Notes issued	1,484,850
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	\$2,925,450
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# Canoel International Energy Ltd.

Notes to the Consolidated Financial Statements

For the three and six months ended September 30, 2010 and 2009

(Expressed in Canadian dollars)

## 6 Property, plant and equipment

	<b>September 30, 2010</b>		
	<b>Cost</b>	<b>Accumulated depletion &amp; depreciation</b>	<b>Net book value</b>
	\$	\$	\$
Oil and gas properties	5,201,964	1,504,153	3,697,811
Other fixed assets	39,619	24,427	15,192
	<b>5,241,583</b>	<b>1,528,580</b>	<b>3,713,003</b>

  

	<b>March 31, 2010</b>		
	<b>Cost</b>	<b>Accumulated depletion &amp; depreciation</b>	<b>Net book value</b>
	\$	\$	\$
Oil and gas properties	986,420	-	986,420
	986,420	-	986,420

The Company has not capitalized any general and administrative expense for the period ended September 30, 2010

During fiscal 2008 the Company entered into a Farm-out and Participation Agreement (the "Farm-out and Participation Agreement"). Pursuant to the Farm-out and Participation Agreement, the Company has a right to an 11% participating interest in three production sharing contracts related to unproved oil and gas properties.

Included in oil and gas properties is an amount of \$190,000 paid for an agreement which provides the Company an option to increase their participating interest from 11% up to 45% in two exploration blocks in Tunisia, Bazma and Sud Touzer. The Company must commit to participate in the drilling of the wells proposed under the permits. Pursuant to the Option Agreement, the payment is non-refundable and the original expiry date on the option was April 30, 2009 for Bazma and on June 30, 2009 for Sud Touzer. Such deadlines have been extended by the operator and will remain valid until the Authorization for Expenditure ("AFE") for the first well on each block is issued. If another party commits to operator to earn an interest, then the option will become reduced by the interest assumed by the other party. If the option on either block expires unexercised or another party commits to earn an interest, the Company may need to recognize an impairment in future periods.

# Canoel International Energy Ltd.

Notes to the Consolidated Financial Statements

For the three and six months ended September 30, 2010 and 2009

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(Expressed in Canadian dollars)

## 7 Asset retirement obligation

The Company is legally required to restore its properties to their original condition. Estimated asset retirement costs are based upon engineering estimates of the anticipated method and the extent of site restoration required in accordance with current legislation and industry practices in the various jurisdictions in which the Company has properties.

As at September 30, 2010, the Company estimated the total undiscounted amount of cash flows required to settle its ARO to be \$460,000 (December 31, 2009 - \$nil), which is estimated to be incurred over the next 14 years. The Company calculated ARO using a discount rate of 7.0% and an inflation rate of 2.0%, which resulted in the fair value of the ARO of \$344,514. It is expected that this obligation will be funded from general Company resources at the time the costs are incurred.

	<b>September 30, 2010</b>
	\$
Balance, beginning of period	-
Liabilities assumed on Argentina Acquisition	<b>344,514</b>
Balance, end of period	<b>344,514</b>

## 8 Convertible notes

	<b>September 30, 2010</b>
Convertible note	575,000
Bifurcation of equity component	(142,280)
Value of warrant	(12,857)
Accretion of equity component	8,893
Accretion of warrant value	803
Liability component of the convertible note	429,559

On June 24, 2010, the Company issued 100 convertible notes ("Note A") and on September 2, 2010, the Company issued 15 convertible notes ("Note B"), collectively the "Notes", by way of a private placement for total gross proceeds of \$500,000 from Note A and \$75,000 from Note B. Each Note consisted of one unsecured convertible note, with a principal value of \$5,000, and 5,000 common share purchase warrants (the "Warrants"). The Notes will mature 4 years from the date of issuance, unless earlier redemption or conversion occurs. The principal amount of each Note is convertible into common share of the Company at the option of the holder at any time prior to maturity at a conversion price of \$0.20 per share.

# **Canoel International Energy Ltd.**

Notes to the Consolidated Financial Statements

**For the three and six months ended September 30, 2010 and 2009**

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(Expressed in Canadian dollars)

The Notes bear simple interest at a rate of 15% per annum, payable in arrears in equal quarterly installments. The Notes will be fully due and payable on the maturity date with the repayment of the principal commencing on September 24, 2011 for Note A and December 2, 2011 for Note B, in 12 equal, quarterly installments. Subsequent to one year from the respective issue dates, the Company has the option to repay the principal balance in full at any time provided written notice is given one-month in advance.

Each Warrant entitles the holder to purchase one additional common share of the Company at a price of \$0.50 per share until June 24, 2014 for Note A and September 2, 2014 for Note B, (note 9(c)).

The Notes are a compound financial instrument and as such have been recorded as a liability and as equity. The residual valuation method was used to determine the equity portion of the Notes. Under this approach, the liability component was valued first, and the difference between the proceeds of the Notes and the fair value of the liability was assigned to the equity component. The present value of the liability component was calculated using a discount rate of 8% which approximated the interest rate that would have been applicable to non-convertible debt of the Company at the time the Notes were issued. The fair value of the warrant subsequently reduced the liability portion of the Note. The liability component of the Notes will be accreted to its face value of \$575,000 over the four year life for both the equity component and the value of the warrant.

The Company incurred debt issuance costs of \$40,000 payable to unrelated parties who assisted in sourcing subscribers for the placement. These costs were expensed through the consolidated statement of loss, comprehensive loss and deficit.

The Notes are secured by the Company's interest in all of the rights, title and interest in all shares of the capital of IPP.

# Canoel International Energy Ltd.

Notes to the Consolidated Financial Statements

For the three and six months ended September 30, 2010 and 2009

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(Expressed in Canadian dollars)

## 9 Share Capital

### a) Authorized

Unlimited number voting common shares without par value.

Unlimited number of preferred shares issuable in series and without par value.

### b) Issued

	Number of Common Shares	Amount \$
<b>Outstanding, March 31, 2010</b>	21,618,715	3,136,450
Non-brokered private placements (i)	3,631,217	435,746
Fair value of share purchase warrants (i)	-	(12,202)
Share issue costs (ii)	-	(74,629)
Norwegian private placement (iii)	9,110,729	1,093,287
Share issue costs (iv)	-	(33,460)
<b>Outstanding, September 30, 2010</b>	<b>34,360,661</b>	<b>4,545,192</b>

(i) During the three and six month period ended September 30, 2010, the Company completed three non-brokered private placement (the "Placements"), issuing 1,805,917 and 3,631,217 units for total proceeds of \$216,710 and \$435,746, respectively, (\$0.12 per unit). Each unit consists of one common share of the Company and one-half of one common share purchase warrant (the "Warrant"). Each whole Warrant entitles the holder to purchase one additional common share of the Company at \$0.20 per share, exercisable for 1 year from the date of the Placement. If at any time following four months and one day from the grant of the Warrants, the closing price of the Company's listed shares exceeds \$0.30 for 15 consecutive trading days, the Company may give notice to the holders of the warrants that such unexercised warrants will be terminated 30 days following notice. The Company has allocated \$12,202 of the unit value to warrants (note 9(c)).

(ii) The Company incurred share issue costs to an unrelated Finder of \$74,629 related to the Placements. This includes the value of \$1,160 assigned to 199,030 finders warrants (the "Finders Warrants") (note 9(c)). The Finders Warrants entitles the holder to purchase one common share of the Company at \$0.20 per share, exercisable for 1 year from the date of the Placement.

(iii) During the three month period ended September 30, 2010, the Company completed two Norwegian private placements (the "Norwegian Placement") of 9,110,729 common

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For the three and six months ended September 30, 2010 and 2009

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(Expressed in Canadian dollars)

shares of the Company, at a price of \$0.12 per share, for aggregate gross proceeds of \$1,086,000. The Norwegian Placement was completed in connection with the proposed offer by the Company to purchase the shares of Oren Oil ASA (note 14).

- (iv) The Company incurred share issue costs of \$33,460 related to the Norwegian Placement.

## c) Warrants

Warrants to acquire common shares outstanding at September 30, 2010 are as follows:

	Number of warrants issued and exercisable	Amount \$	Weighted average exercise price \$	Weighted average Remaining life (years)
<b>Balance, March 31, 2010</b>	14,308,361	479,283	0.38	0.62
Share purchase warrants (9b(i))	1,815,609	12,202	0.20	1.00
Finders' share purchase warrants (9b(ii))	199,030	1,160	0.20	1.00
Share purchase warrants issued with convertible notes (note 8)	575,000	12,857	0.50	3.99
<b>Balance, September 30, 2010</b>	<b>16,898,000</b>	<b>505,502</b>	<b>0.36</b>	<b>0.53</b>

The fair value of the share purchase warrants granted during the period are estimated at the grant date using the Black-Scholes option pricing model and have been credited to warrants within shareholders' equity. A weighted average of the assumptions used in the calculation is noted below:

Risk-free rate	1.66%
Expected life	1.67 years
Expected volatility	63.17%
Fair value per warrant	\$0.01

## d) Stock options

The Company established a stock option plan (the "Plan") for the benefit of directors, officers, key employees and consultants. The maximum number of shares available under the Plan is limited to 10% of the issued common shares at the time of granting the options. The full amount of the grant becomes exercisable on the grant date and expire after 5 years from the date of grant.

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Notes to the Consolidated Financial Statements

For the three and six months ended September 30, 2010 and 2009

(Expressed in Canadian dollars)

During the three and six months ended September 30, 2010, there were 1,250,000 stock option granted (September 30, 2009 – 250,000) to directors and advisory committee members, and no cancellations, exercises or expiries. The following table summarizes information about the Company's stock options outstanding at September 30, 2010:

	Number of options Outstanding and exercisable	Weighted average exercise price \$	Weighted average remaining life (years)
Balance, March 31, 2010	1,565,000	0.13	3.84
Granted	1,250,000	0.10	5.00
Balance, September 30, 2010	2,815,000	0.12	4.22

The fair value of the stock options granted during the year is estimated at the grant date using the Black-Scholes pricing model. The assumptions used in the calculation are noted below:

	September 30, 2010	September 30, 2009
Risk-free rate	1.79%	2.32%
Expected life	5 years	5 years
Expected volatility	65.50%	60%
Fair value per warrant	\$0.06	\$0.09

Stock based compensation expense for the three and nine month period ended September 30, 2010 was \$69,625 (September 30, 2009 - \$22,914), all of which has been recorded as a stock-based compensation expense. The total amount has been recorded as an offsetting credit to contributed surplus.

The following table summarizes information about the Company's stock options outstanding at September 30, 2010:

Range of exercise prices (\$)	Option outstanding and exercisable		
	Number of options outstanding	Weighted average remaining contractual life (years)	Weighted average exercise price \$
0.10 - 0.20	2,670,000	4.23	0.11
0.21 – 0.30	145,000	3.95	0.23

# Canoel International Energy Ltd.

Notes to the Consolidated Financial Statements

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(Expressed in Canadian dollars)

e) **Agent Options**

As at September 30, 2010, the Company has 728,161 Agent Options outstanding, which were granted on November 21, 2008 to the Agents of the non-brokered private placement related to the Qualifying Transaction. Each Agent Option is exercisable into one common share and one common share purchase warrant ("Agent Warrant") of the Company at \$0.25. Each Agent Warrant is exercisable into one common share of the Company at \$0.40 per common share. The Agent Options expired unexercised on November 21, 2010.

f) **Per share data**

Basic earnings per share are calculated based on the weighted average number of shares outstanding during the three and six month period ended September 30, 2010 of 31,633,259 and 26,653,349, respectively. Currently, the effect of potential issuance of common shares upon the exercise of options, warrants or agent options would be anti-dilutive since the Company is in a net loss position and accordingly basic and diluted loss per common share are the same.

## 10 **Capital Management**

The Company's objectives when managing capital is to safeguard the entity's ability to continue as a going concern, so that it can continue to provide returns for shareholders and benefits for other stakeholders. The Company manages its common shares, options and warrants as capital. The Company has just come out of the development stage; however its cash flow from the Argentinean operation will be needed in the near term to finance the operations and to repay the vendor loans, and therefore the Company's principal source of funds will still remain the issuance of common shares. It is the Company's objective to safeguard its ability to continue as a going concern, so that it can continue to explore and develop its projects for the benefit of its stakeholders. The Company's ability to raise future capital through equity is subject to uncertainty and our inability to raise such capital may have an adverse impact over the Company's ability to continue as a going concern.

As part of the capital management program the Company monitors its working capital ratio. The Company's objective is to maintain a working capital ratio of greater than 1:1 defined as the ratio of current assets divided by current liabilities. At September 30, 2010, the working capital ratio was 0.99:1.

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## 11 Related Parties

Related party transactions not disclosed elsewhere in these consolidated financial statements are as follows:

During the three months ended September 30, 2010:

- a) Aggregate consulting fees of \$16,200 (September 30, 2009 - \$44,581) were charged by directors and officers of the Company and recorded in the consolidated statement of loss, comprehensive loss and deficit.
- b) Aggregate legal fees of \$7,500 (September 30, 2009 - \$5,292) were charged by a director of the Company and recorded in the consolidated statement of loss, comprehensive loss and deficit.
- c) Aggregate bonus of \$252,265 (September 30, 2009 - \$nil) were paid to certain directors and officers of the Company and recorded in the consolidated statement of loss, comprehensive loss and deficit. These bonuses were paid upon completion of the Argentina Acquisition.

During the six months ended September 30, 2010:

- d) Aggregate consulting fees of \$32,400 (September 30, 2009 - \$107,738) were charged by directors and officers of the Company and recorded in the consolidated statement of loss, comprehensive loss and deficit.
- e) Aggregate legal fees of \$15,000 (September 30, 2009 - \$15,806) were charged by a director of the Company and recorded in the consolidated statement of loss, comprehensive loss and deficit.
- f) Aggregate bonus of \$252,265 (September 30, 2009 - \$nil) were paid to certain directors and officers of the Company and recorded in the consolidated statement of loss, comprehensive loss and deficit. These bonuses were paid upon completion of the Argentina Acquisition.
- g) Included in accounts payable and accrued liabilities at September 30, 2010 was \$51,305 (March 31, 2010 - \$23,284) payable to related parties. These amounts are non-interest bearing and have no specific terms of repayment.

# Canoel International Energy Ltd.

Notes to the Consolidated Financial Statements

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Transactions with related parties are recorded at the exchange amount, being the price agreed between the parties.

## 12 Financial Instruments and Risk Management

The Company's risk management policies are established by the Board of Directors to identify and analyze the risks faced by the Company, to set appropriate risk limits and controls, and to monitor risks and adherence to market conditions and the Company's policy.

### a) Fair values

The Company's financial instruments consist of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, and notes payable. The fair values of these financial instruments approximate their carrying value due to their short-term nature. The Company's cash and cash equivalents have been subject to level 1 valuation.

### b) Credit risk

Credit risk is the risk of an unexpected loss if a party to a financial instrument fails to meet its commercial obligations. This arises principally from joint venture partners.

\$490,000 of the Company's accounts receivable is with the operator of the Tunisian permits, thus exposing the Company to concentration risk. The receivable is a cash call payment made to the operator and is pending utilization as drilling commences. Management believes the risk is mitigated by the reputation of the operator and the operator's intention to continue the development of the Tunisian permits. The Company's maximum credit risk exposure is limited to the carrying value of its accounts receivable of \$1,085,482 and cash and cash equivalents of \$1,114,085.

Approximately \$300,000 of the Company's accounts receivable are due from the purchasers of the Company's petroleum production and are subject to the same industry factors such as commodity price fluctuations and escalating costs. The Company generally extends unsecured credit to these customers and therefore, the collection of accounts receivable may be affected by changes in economic or other conditions. Management believes risk is mitigated by the size and reputation of the companies to which they extend credit. The Company has not experienced any credit loss in the collection of accounts receivable in the period ended September 30, 2010.

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As the Company has not entered into any derivative financial instruments, it is not exposed to credit risk associated with possible non-performance by counterparties to any such derivative financial instrument contracts.

## c) **Market Risk**

Market risk is the risk that changes in foreign exchange rates, commodity prices, and interest rates will affect the Company's net (loss) income or the value of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable limits, while maximizing returns.

Currently the Company does not use financial derivatives or physical delivery sales contracts to manage market risks. If in the future management determines market risk warrants the use of financial derivatives or physical delivery sales contracts any such transactions would be approved by the Board of Directors.

### (i) **Commodity price 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. Oil prices in Argentina are the results of complicated formulas that are set by refineries based on instructions or decrees from the government and crude oil prices in Argentina are capped by the Government at variable levels. In early 2010, the price was fixed at US \$42.00 per barrel but was recently increased to approximately US \$50.00 per barrel.

### (ii) **Interest rate risk**

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. As at September 30, 2010, the Company has interest bearing cash accounts held with an investment grade institutions. A change of one percent on the variable interest rate for the year would not have a significant impact on the Company.

## d) **Liquidity risk**

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they come due. The Company ensures, as far as possible, that it will have sufficient liquidity to meet its liabilities when due, without incurring unacceptable losses or harm to the Company's reputation.

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(Expressed in Canadian dollars)

As at September 30, 2010, the Company's current financial liabilities totaled \$2,283,374, and are comprised of accounts payable and accrued liabilities, the current portion of the Notes (note 8) and the Notes payable (note 5). As at September 30, 2010, the Company's cash and cash equivalent balance is not sufficient to meet the Company's obligations. \$51,305 of the financial liabilities are owed to related individuals and these amounts are subject to the forbearance of the related individuals.

## e) Currency risk

Foreign currency exchange risk is the risk that the fair value of future cash flows will fluctuate as a result of changes in foreign exchange rates. To date the Company has focused on the international market for petroleum and natural gas opportunities where many of the anticipated future expenses will be denominated in United States dollars. A hypothetical change of 10% to the foreign exchange rate between the US dollar and the Canadian dollar applied to the average level of US denominated cash and cash equivalents during the period would have a remote impact on the Company's earnings for the period.

The operational currency of the Argentinean company is the Argentine peso ("peso"), the local currency (AR\$). The peso has steadily depreciated against the USD during the last 5 years, going from 2.98 pesos for 1US\$ on January 2006 to 3.97 pesos for 1 US\$ today. The US\$ is the currency of reference for the oil sales of the Argentinean company to local refineries.

## 13 Commitments

The Company has entered into a farm-out and participation agreement giving it the right to participate in production sharing contracts in Tunisia which will provide the Company with a participating interest in the respective properties. Should the Company elect to participate in these production sharing contracts, it will be required to participate in the drilling of one exploratory well in each of the Jorf, Bazma and Sud Touzer properties. The current production sharing contracts expire in 2016 for Bazma and 2011 for Jorf and 2017 for Sud Touzer. The operator may renew the production sharing contracts for Bazma and Sud Touzer, although it anticipates undertaking the exploration activities prior to renewal of the production sharing contracts. Further renewals of the blocks will be discussed on a project by project basis with the Energy State Authority of Tunisia. Should the Company elect to participate, its estimated share of the expenditures in U.S. dollars is: \$907,000 in Bazma, of which \$426,000 has already been advanced to the operator resulting in a net remaining amount of \$481,000, \$529,000 for Jorf, and \$1,531,000 for Sud Touzer.

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## 14 Subsequent events

The Company entered into the following transactions subsequent to September 30, 2010:

- a) On October 5, 2010, the Company settled \$308,000 of the principal portion of Note A (note 8) through the issuance of 2,566,667 units (the "Units") at \$0.12 per Unit. Each Unit consists of one common share of the Company and one half of one share purchase warrant (the "Warrant"). Each whole Warrant entitles the holder to purchase one common share of the Company at a price of \$0.17 per share for a period of one year from the date of issue. Note A was cancelled in the amount specified upon the issuance of the Units.
- b) On October 1, 2010, the Company announced the acquisition (the "Acquisition") of 602,420,666 shares of Oren Oil ASA ("Oren") from several of Oren's major shareholders. This number of shares (approximately 51% of all the issued and outstanding shares of Oren) was exchanged, on a 1,000 to 1 basis, for 602,420 common shares of the Company (or approximately 1.72% of the Company's total shares). As an integral part of the Acquisition, during the three months ended September 30, 2010, Canoel completed a private placement of its shares to certain of the former Oren shareholders and managers resulting in gross proceeds to Canoel of approximately CAD 1,100,000 with no commission costs. See Note 9 b (iii).

Additionally, and still in connection with the Acquisition, Canoel purchased a company called Promotes Corporation S.A. ("Promotes" or the "Trust") which had been set up as a trust for the benefit of the creditors and shareholders of Oren. Canoel agreed to act as a consultant of the Trust pursuant to a Management Services Agreement dated September 25, 2010 among Canoel, the Trust and Oren.

As another part of the Acquisition, Oren assigned to Canoel (with Canoel's acceptance) a portion of Oren's debts in the aggregate amount of Norwegian Kroner ("NOK") 1,579,167 (approximately CDN\$ 276,000). Canoel intended to settle a portion of such debts (NOK 1,297,917) through the issuance of shares at a deemed price of NOK 0.73 (approximately CDN\$ 0.12 per share). On October 25, Canoel received the approval of the TSX Venture Exchange and issued 1,813,051 common shares to Oren's creditors. In consideration for the assignment of debts and the subsequent issuance of Canoel shares, Oren also transferred to Canoel 27% of the shares held by Oren in its wholly owned Russian subsidiary, Saganef LLC ("Saganef"), as well as rights to 27% of a claim Oren has against Saganef. Subject to the

# Canoel International Energy Ltd.

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approval of its shareholders and creditors, Oren further agreed to transfer some of its Russian assets and liabilities to Promotes.

Subsequent to the above mentioned transactions, on October 18, Canoel announced that it sold for a nominal amount all the 602,420,666 shares of Oren that Canoel had purchased from former shareholders of Oren to WG Utvikling AS (“WG”), a limited venture company registered in Oslo, Norway, whose principal businesses are in healthcare and real estate. Oren in its current structure, as sold to WG, has all the characteristics of a shell company with very few assets and few liabilities.

As previously mentioned, in connection with the original purchase of Oren shares, Canoel also acquired 27% of the shares of Saganeft (which is a part owner of certain Russian oil and gas exploration blocks and has a management and consulting role in all the other assets formerly owned by Oren through its subsidiaries in Russia) all of which will be retained by Canoel notwithstanding its sale of the Oren shares to WG.

Canoel, under certain conditions, will be entitled to a 50% sale commission out of any sales proceeds from the Russian assets, net of trust company, legal and marketing fees. The shares and the related financing of the Russian companies originally cost Oren an amount nearing US\$100,000,000. The current market value of the Russian assets is however uncertain, as considerable deterioration has occurred to these companies, including insolvency for one of them.