Emerald Bay Energy Inc.

Financial Statements

For the three and six months ended June 30, 2013

(expressed in Canadian dollars)

(unaudited)

Emerald Bay Energy Inc.

Statement of Financial Position

June 30, 2013 and December 31, 2012

(unaudited)

	June 30, 2013	December 31, 2012
	$	$
Assets		
Current assets		
Cash and cash equivalents	**237,164**	532,130
Trade and other receivables	**575,720**	521,824
Share subscription receivable (note 11(b)(iii))	**20,000**	80,000
Prepaid expenses and deposits	**67,143**	55,596
Due from related parties (note 14(a))	**31,429**	28,178
Total current assets	**931,456**	1,217,728
Non-current assets		
Long-term investment	**52,590**	49,745
Equity investment in PRI (note 4)	**656,370**	568,306
Exploration and evaluation assets and other intangible assets (note 6)	**1,061,766**	397,668
Property and equipment (note 5)	**743,640**	771,525
Total assets	**3,445,822**	3,004,972
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	**3,313,096**	2,728,097
Shareholder indemnity (note 15(c))	**321,497**	321,497
Related party loan (note 9)	**1,184,105**	1,121,565
Convertible related party debt (note 10)	**89,403**	149,235
Current portion of long-term debt (note 15(b))	**25,389**	24,688
Derivative liability (note 10)	**85,722**	-
Total current liabilities	**5,019,212**	4,345,082
Non-current liabilities		
Long-term debt (note 15(b))	**29,117**	41,978
Decommissioning obligations (note 7)	**178,971**	182,278
Total liabilities	**5,227,300**	4,569,338
Shareholders' deficit		
Share capital (note 11(b))	**10,066,806**	9,806,332
Warrants (note 11(c))	**1,356,670**	1,274,721
Contributed surplus (note 11(f))	**1,152,778**	1,135,960
Deficit	**(14,363,661)**	(13,778,755)
Accumulated other comprehensive income (loss)	**5,929**	(2,624)
Total shareholders' deficit	**(1,781,478)**	(1,564,366)
Total liabilities and shareholders' deficit	**3,445,822**	3,004,972

Going concern (note 1)
Commitments (note 15)
Subsequent events (note 9)

Approved on behalf of the Board of Directors

Signed "Shelby D. Beattie" — Director

Signed "Gibson C. Scott" — Director

Emerald Bay Energy Inc.

Statement of Comprehensive Loss

For the three and six months ended June 30, 2013 and 2012

(unaudited)

	Three months ended		Six months ended	
	June 30, 2013 $	June 30, 2012 $ (restated note 12)	**June 30, 2013 $**	June 30, 2012 $ (restated note 12)
Revenue				
Petroleum and natural gas revenue	**54,748**	26,527	**77,384**	88,456
Royalties	**(6,386)**	12,189	**(6,128)**	6,606
	48,362	38,716	**71,256**	95,062
Operating expenses				
Exploration and evaluation expenditures	**-**	-	**-**	2,409
Production and operating expenses	**35,356**	71,709	**44,298**	118,473
Depletion and depreciation (note 5)	**27,808**	21,981	**46,781**	60,921
General and administrative	**315,429**	327,845	**525,409**	607,594
	378,593	421,535	**616,488**	789,397
Results from operating activities	**(330,231)**	(382,819)	**(545,232)**	(694,335)
Finance expense				
Interest income	**23,580**	1,637	**25,220**	3,271
Interest expense	**(35,503)**	(39,280)	**(70,991)**	(88,053)
Recovery of bad debt expense (note 17(b))	**-**	(15,000)	**-**	-
Foreign exchange loss	-	(2,264)	**(472)**	(6,161)
Accretion of decommissioning obligation (note 7)	**(1,164)**	(1,061)	**(2,194)**	(2,121)
Accretion of convertible debt (note 10)	**(33,267)**	-	**(66,027)**	-
Related party loan financing expense (note 9)	**(31,443)**	-	**(62,540)**	-
Gain on fair value derivative liability (note 10)	**13,650**	-	**49,266**	-
Net finance expense	**(64,147)**	(55,968)	**(127,738)**	(93,064)
Other income and expenses				
Unrealized gain on financial contract (note 17(d)(i))	**-**	-	**-**	161,770
Termination payment on financial contract (note 17(d)(i))	**-**	-	**-**	(116,114)
Equity income on investment in PRI (note 4)	**32,136**	(55,440)	**88,064**	(22,876)
Net other income and expenses	**32,136**	(55,440)	**88,064**	22,780
Net loss and comprehensive loss	**(362,242)**	(494,227)	**(584,906)**	(764,619)
Basic and fully diluted loss per share (note 11(g))	**(0.00)**	(0.01)	**(0.00)**	(0.01)
Weighted average number of common shares outstanding during the period	**140,409,601**	98,199,959	**136,586,882**	94,243,475

The notes are an integral part of these financial statements.

Emerald Bay Energy Inc.

Statement of Changes in Deficit

For the six months ended June 30, 2013 and 2012

(unaudited)

	Share capital	Warrants	Contributed surplus	Deficit (restated note 12)	Accumulated other comprehensive (loss) income	Total deficit
Balance, December 31, 2011	8,491,683	126,644	1,048,656	(11,965,082)	-	(2,298,099)
Issuance of common shares	712,000	-	-	-	-	712,000
Issue of warrants	(346,581)	346,581	-	-	-	-
Exercise of finders options	23,500	-	-	-	-	23,500
Issuance of warrants to acquire shareholder loan	-	147,195	-	-	-	147,195
Fair value reallocation on exercise of finders options	6,353	-	(6,353)	-	-	-
Share issue costs	(56,472)	-	20,272	-	-	(36,200)
Loss for the period	-	-	-	(764,619)	-	(764,619)
Balance, June 30, 2012	8,830,483	620,420	1,062,575	(12,729,701)	-	(2,216,223)
Balance, December 31, 2012	9,806,332	1,274,721	1,135,960	(13,778,755)	(2,624)	(1,564,366)
Issuance of common shares	397,500	-	-	-	-	397,500
Issue of warrants	(141,188)	141,188	-	-	-	-
Share issue costs	(35,515)	(19,562)	16,818	-	-	(38,259)
Fair value reallocation on expiry of warrants	39,677	(39,677)	-	-	-	-
Loss for the period	-	-	-	(584,906)	-	(584,906)
Foreign exchange translation to presentation currency	-	-	-	-	8,553	8,553
Balance, June 30, 2013	10,066,806	1,356,670	1,152,778	(14,363,661)	5,929	(1,781,478)

The notes are an integral part of these financial statements.

Emerald Bay Energy Inc.

Statement of Cash Flows

For the six months ended June 30, 2013 and 2012

(unaudited)

	June 30, 2013 **$**	June 30, 2012 $ (restated note 12)
Cash (used in) provided by:		
Operating activities		
Net loss for the period	**(584,906)**	(764,619)
Adjustments for:		
Depletion and depreciation (note 5)	**46,781**	60,921
Related party loan financing expense (note 9)	**62,540**	-
Accretion of convertible debt (note 10)	**66,027**	-
Gain on derivative liability (note 10)	**(49,266)**	-
Accretion of decommissioning obligation (note 7)	**2,194**	2,121
Unrealized (gain) loss on financial contract (note 17(d)(i))	**-**	(161,770)
Equity pick-up on investment in PRI (note 4)	**(88,064)**	22,876
Unrealized foreign exchange	**17,682**	-
	(527,012)	(840,471)
Change in accounts receivable	**6,104**	(45,282)
Change in prepaid expenses and deposits	**(11,547)**	2,049
Change in accounts payable and accrued liabilities	**250,191**	93,843
Change in due to related party	**(3,251)**	(269)
	(285,515)	(790,130)
Investing activities		
Property and equipment expenditures (note 5)	**(24,397)**	(244,786)
Exploration and evaluation expenditures (note 6)	**(664,098)**	-
Proceeds received on disposal of oil and natural gas interests	**-**	1,500,000
Change in short-term investments	**(2,845)**	(54)
Change in accounts payable and accrued liabilities	**334,808**	362
	(356,532)	1,255,522
Financing activities		
Proceeds from issuance of common shares, net of issue costs	**359,241**	374,643
Repayment of bank loan (note 8)	**-**	(2,675,000)
Receipt of related party loan (note 9)	**-**	1,500,000
Proceeds from exercise of finders options	**-**	23,500
Repayment of long term debt	**(12,160)**	(11,508)
	347,081	(788,365)
Change in cash and cash equivalents	**(294,966)**	(322,973)
Cash and cash equivalents, beginning of period	**532,130**	332,301
Cash and cash equivalents, end of period	**237,164**	9,328

Supplemental cash flow information (note 16)

1 Reporting entity and going concern

Emerald Bay Energy Inc. (the “Company”) was incorporated under the Business Corporations Act of Alberta on May 9, 1997 and is listed on the TSX Venture exchange. The Company is engaged in the exploration for and development of petroleum and natural gas properties principally in Alberta and Texas and is developing a lateral drilling technology. The Company is listed on the TSX Venture Exchange under the symbol “EBY.V”. The Company’s registered head office is located at #1A, 4015 – 1 Street South East, Calgary, Alberta, Canada T2G 4X7.

At June 30, 2013, the Company had not yet achieved profitable operations, had accumulated a deficit of $14,363,661 since its inception (December 31, 2012 - $13,778,755), had negative cash flows from operations of $285,515 (December 31, 2012 - $2,176,975) and had a working capital deficiency of $4,087,756 (December 31, 2012 - $3,127,354) (defined as current assets less current liabilities), and expects to incur further losses in the development of its business. The ability to continue as a going concern is dependent on obtaining continued financial support, completing public equity financing, or generating profitable operations in the future. Management is committed to raising additional capital to meet its exploration and operating obligation, however, additional equity financing is subject to the global financial markets and economic conditions, which have recently been disrupted and are volatile, and the debt and equity markets, which have been distressed, particularly for junior petroleum and natural gas companies. All of these factors, together with weak natural gas prices and the current unstable economic conditions, indicate the existence of material uncertainty related to events or conditions that may cast significant doubt as to whether the Company can continue as a going concern and, therefore, it may be unable to realize its assets and discharge its liabilities in the normal course of business. These interim condensed financial statements do not reflect the adjustments to the carrying value of assets and liabilities, the reported revenues and expenses, and the balance sheet classifications that would be necessary if the going concern assumption was not appropriate. Any adjustments necessary to the financial statements if the Company ceases to be a going concern could be material.

2 Basis of presentation

The interim condensed financial statement have been prepared in accordance with International Accounting Standards ("IAS") 34 – *"Interim Financial Reporting"* as issued by the International Accounting Standards Board ("IASB") using the accounting policies and methods of computation disclosed in the Company's audited financial statements for the year ended December 31, 2012, except for those disclosed in note 3. These interim condensed financial statements should be read in conjunction with the audited financial statements for the year ended December 31, 2012 and exclude certain disclosures required to be included in annual financial statements.

These interim condensed financial statements have not been reviewed by the Company's external auditors and are dated August 30, 2013.

3 Changes in accounting policy

Effective January 1, 2013, the Company adopted the following standards and amendments as issued by the IASB. The Company has reviewed its methodology and disclosure for each standard and has concluded that no additional disclosure or changes are required:

IFRS 10 – "Consolidated Financial Statements", which builds on existing principles and standards and identifies the concept of control as the determining factor in whether an entity should be included within the consolidated financial statements of the parent company.

IFRS 11 – "Joint Arrangements", which establishes the principles for financial reporting by entities when they have an interest in arrangements that are jointly controlled.

IFRS 12 – "Disclosure of Interest in Other Entities", which provides the disclosure requirements for interests held in other entitles including joint arrangements, associates, special purpose entities and other off balance sheet entities.

IFRS 13 – "Fair Value Measurement", which defines fair value, requires disclosure about fair value measurements and provides a framework for measuring fair value when it is required or permitted within the IFRS standards.

IAS 27 – "Separate Financial Statements", which provides amendments to IAS 27 to coincide with the changes made in IFRS 10, but retains the current guidance for separate financial statements.

IAS 28 – "Investments in Associate and Joint Ventures", which revised the existing standard and prescribes the accounting for investments and sets out the requirements for the application of the equity method when accounting for investments in associates and joint ventures.

IFRS 7 – "Financial Instruments: Disclosures" and IAS 32 "Financial Instruments: Presentation", provides amendments to the previously issued IFRS 7 "Financial Instruments: Disclosures" and IAS 32 "Instruments: Presentation", to provide clarity over the current offsetting model and develop common disclosure requirements to enhance the understanding of the potential effects of offsetting arrangements. Amendments to IFRS 7 are effective on January 1, 2013 with required retrospective application and early adoption permitted. Amendments to IAS 32 are effective on January 1, 2014 with required retrospective application and early adoption permitted.

IAS 1 – "Presentations of Items of OCI: Amendments to IAS 1 Presentation of Financial Statements", which provides stipulates for the amendment of the presentation of net earnings and OCI and also requires that items are grouped within OCI based on whether the items may be subsequently reclassified to profit or loss.

4 Equity investment in PRI

The Company continued to have an ownership interest in Production Resources Inc ("PRI") of 25%. The Company has accounted for the investment using the equity method.

The investment in PRI as at June 30, 2013 is as follows:

	CDN $
Net investment, December 31, 2011	459,078
Proportionate share of income for the period	109,228
Net investment, December 31, 2012	568,306
Proportionate share of income for the period	88,064
Net investment, June 30, 2013	656,370

5 Property and equipment

	Oil and natural gas interests	Corporate and Other	Total
	$	$	$
Cost, December 31, 2012	4,241,841	307,436	4,549,277
Additions	40,202	5,546	45,748
Revisions in decommissioning liability	(26,852)	-	(26,852)
Cost, June 30, 2013	4,255,191	312,982	4,568,173
Accumulated depletion, depreciation and impairment	(3,541,668)	(236,084)	(3,777,752)
Depreciation and depletion for the period	(36,306)	(10,475)	(46,781)
Carrying value, June 30, 2013	677,217	66,423	743,640

	Oil and natural gas interests	Corporate and Other	Total
	$	$	$
Cost, December 31, 2011	4,407,246	298,732	4,705,978
Additions	55,494	8,704	64,198
Disposal of oil and natural gas interests	(197,271)	-	(197,271)
Revisions in decommissioning liability	18,869	-	18,869
Disposal of decommissioning liability	(42,497)	-	(42,497)
Cost, December 31, 2012	4,241,841	307,436	4,549,277
Accumulated depletion, depreciation and impairment	(3,481,697)	(209,104)	(3,690,801)
Disposal of oil and natural gas interests	159,267	-	159,267
Depreciation and depletion for the year	(58,271)	(26,980)	(85,251)
Impairment of oil and natural gas interests	(160,967)	-	(160,967)
Carrying value, December 31, 2012	700,173	71,352	771,525

On July 1, 2012, the Company disposed of various US oil and gas interests, forming part of the repayment of the related party loan (note 9). The oil and gas interests were transferred to the related party at a deemed value of $166,155. A gain on the sale of $128,151 was recognized as the proceeds received were greater than the carrying amount of the assets of $38,004.

6 Exploration and evaluation and other intangible assets

	E&E assets
	$
Balance, December 31, 2011	-
Additions	397,668
Balance, December 31, 2012	397,668
Additions	664,098
Balance, June 30, 2013	1,061,766

Exploration and evaluation ("E&E") assets consist of the Company's exploration projects which are pending the determination of technological feasibility and commercial viability. As at June 30, 2013, the Company has incurred an amount of $1,061,766 on E&E expenditures (December 31, 2012 - $397,668). The additions represent the acquisition of undeveloped land and drilling activity within Texas. These E&E assets will be transferred to property and equipment when technological feasibility and commercial viability have been established. As at June 30, 2013, the Company performed an assessment of the indicators of impairment for its E&E properties. Based on the assessment, the Company did not record an impairment charge.

7 Decommissioning obligations

The Company's decommissioning obligations result from its ownership interest in oil and natural gas assets including well sites and gathering systems. The total decommissioning obligation is estimated based on the Company's net ownership interest in all wells and facilities, estimated costs to reclaim and abandon these wells and facilities and the estimated timing of the costs to be incurred in future years. The Company has estimated the net present value of the decommissioning obligations to be $178,971 as at June 30, 2013 (December 31, 2012 - $182,278) based on an undiscounted total future liability of $187,536 (December 31, 2012 - $184,998). These payments are expected to be made over the next 20 years. The obligations have been calculated using an inflation rate of 2% and a discount factor, being the risk-free rate related to the liability, of 2.74% (December 31, 2012 – 2% and 2.17%, respectively).

	June 30, 2013	December 31, 2012
	$	$
Balance, beginning of period	**182,278**	201,664
Disposals	**-**	(42,497)
Liabilities incurred	**21,351**	7,385
Revisions (changes in estimates)	**(26,852)**	11,484
Accretion	**2,194**	4,242
Balance, end of period	**178,971**	182,278

8 Bank loan

On March 20, 2012, the Company terminated the Revolving Loan held with a Chartered Canadian Bank (the "Lender"), which had a balance of $1,500,000, through the sale of certain oil and gas assets. An amending fee of $10,000 was paid to the Lender, and additionally, a $50,000 payable for a previous amendment was also paid to the Lender. Total interest incurred pursuant to the Revolving Loan during the year ended December 31, 2012 was $20,980.

On June 18, 2012, the Company terminated the Non-revolving loan with the Lender, which had a balance of $1,125,000, through the acquisition of a related party loan (note 9). The Company incurred professional fees of approximately $120,000 to payout the Non-revolving Loan. Total interest incurred pursuant to the Non-revolving Loan during the year ended December 31, 2012 was $46,123.

Security for the loans consisted of a $10,000,000 Debenture with a floating charge over all assets of the Company with a negative pledge and undertaking to provide fixed charges on the Borrower's major producing petroleum properties at the request of the bank. The bank also required the Company to submit to them certain reports and to maintain certain covenants.

9 Related party loan

On June 15, 2012, a corporation owned by a related party who has a common significant shareholding (the "Lender") advanced $1,500,000 to the Company under a loan agreement (the "Loan Agreement") with a maturity date of August 15, 2013. The proceeds of the loan were used primarily to repay the Non-revolving Loan with the remaining proceeds used for general working capital. Interest on the loan is 10% per annum, payable monthly, on the outstanding principal amount. Pursuant to the Loan Agreement, the Company was required to make a principal repayment in the amount of $500,000 on or before August 15, 2012, which was amended to require a principal repayment of $300,000 due on November 30, 2012. The Company fulfilled this requirement through a cash repayment of $133,845 and through the transfer of certain of its US assets to the related party at a deemed value of $166,155 (note 5). Subsequent to June 30, 2013, and subject to TSX approval, the maturity date of the loan was extended to August 15, 2014, all other terms and conditions remain unchanged.

The Company may, at any time, repay the loan in full without notice or penalty. If the Company is in default of the requirements included in the Loan Agreement or the Lender believes the Company's ability to repay the loan is impaired, the Lender may demand repayment of the loan or accelerate the date for payment. During the three and six months ended June 30, 2013, pursuant to the loan, the Company had incurred interest of $30,000 and $60,000, respectively (three and six months ended June 30, 2012 - $5,000).

Pursuant to the Loan Agreement, the Company issued to the Lender 5,000,000 share purchase warrants. Each warrant is exercisable into one common share of the Company at a price of $0.10 per common share until the expiry date of August 15, 2013. The warrants have been valued at $147,195 (note 11(c)) and have been treated as a transaction cost, and accordingly have been net against the principal balance of the loan, which is being accreted back up to the principal balance at the maturity date. The accretion is recorded as a non-cash finance expense in the profit or loss.

	Related party loan
	$
Receipt of loan	1,500,000
Transaction costs	(147,195)
Repayment of principal portion	(300,000)
Accretion of transaction costs	68,760
Balance, December 31, 2012	**1,121,565**
Accretion of transaction costs	62,540
Balance, June 30, 2013	**1,184,105**

Security for the loan consists of a $1,500,000 promissory note plus interest at the rate of 10% per annum, compounded monthly, a General Security Agreement in favour of the Lender to include a specific assignment of production proceeds, and security over the US assets of the Company. The Lender has required the Company to submit to them certain reports including monthly production reports.

10 Convertible related party debt

On January 1, 2012, the Company entered into a loan agreement (the “Loan Agreement”) with a corporation owned and controlled by a party who is also a significant shareholder of the Company (the “Lender”) whereby the Company received a $150,000 USD loan with a maturity date of December 31, 2012. On January 1, 2013, it was mutually agreed upon between the Lender and the Company to extend the loan under the same terms to December 31, 2013. The proceeds of the loan were used to continue the Company’s exploration program in Texas. Interest on the loan is 12% per annum, payable monthly, on the outstanding principal amount and compounds monthly. During the three and six months ended June 30, 2013, pursuant to the loan, the Company had accrued interest of $4,647 and $9,228, respectively (three and six months ended June 30, 2012 - $4,844 and $9,835, respectively).

Security for the loan consists of a $150,000 promissory note and monthly production from certain Texas assets equivalent to the principal portion of the loan and any unpaid interest.

At the option of the Lender, and subject to regulatory approval, the entire principal amount, or any portion outstanding, may be converted to shares in the Company with a discount of 25% to the market trading price at the time of conversion, at any time during the term. Accordingly, on the issuance and extension, the loan was split between the liability and the conversion feature, which was recorded on the statement of financial position as a derivative financial liability. The liability portion was determined by subtracting the fair value of the conversion feature from the principal amount of the loan. At January 1, 2013, the $150,000 loan resulted in $20,000 being classified as a liability (January 1, 2012 - $20,000) and $130,000 being classified as a derivative financial liability (January 1, 2012 - $130,000). The fair value of the conversion feature is estimated at every statement of financial position date with changes in the fair value estimate between periods recognized in the profit or loss as finance expense. The liability portion is measured at amortized cost and is accreted up to the principal balance at the maturity date. The accretion is expensed as a finance expense in the statement of comprehensive loss.

At December 31, 2012, the loan had matured and the initial derivative liability that was recognized was removed and recorded as a gain on the derecognition of the derivative financial liability in the statement of comprehensive loss.

The following table summarizes the accounting of the promissory note in USD:

	Liability	**Derivative Financial Liability**	**Total**
	$	**$**	**$**
Receipt of debt	20,000	130,000	150,000
Accretion of debt	130,000	-	130,000
(Gain) on derivative financial liability	-	(130,000)	(130,000)
Balance, at December 31, 2012	150,000	-	150,000
Renewal of debt	(130,000)	130,000	-
Accretion of debt	65,000	-	65,000
(Gain) on derivative financial liability	-	(48,500)	(48,500)
Balance, at June 30, 2013	85,000	81,500	166,500

The fair value of the derivative financial liability is determined using the Black-Scholes valuation model and the following assumptions were used:

	June 30, 2013	**March 31, 2013**	**January 1, 2013**	**January 1, 2012**
Risk-free interest rate	1.25%	1.02%	1.17%	1.00%
Expected life (years)	0.50 year	0.75 year	1 year	1 year
Expected volatility	108.52%	114.47%	165.11%	164.52%
Market price	0.04	0.06	0.06	0.03
Conversion price	0.030	0.045	0.045	0.023

11 Share capital

a) **Authorized**

Unlimited number of common shares with voting rights
Unlimited number of preferred shares, issuable in series

b) **Issued**

	Number of Common Shares	Amount $
Balance, December 31, 2011	83,489,959	8,491,683
Private placement (i)	14,240,000	712,000
Value of warrants issued pursuant to private placement (i)	-	(346,581)
Private placement (ii)	4,841,730	338,921
Value of warrants issued pursuant to private placement (ii)	-	(187,838)
Private placement (iii)	28,080,000	1,404,000
Share subscription receivable (iii)	1,600,000	80,000
Value of warrants issued pursuant to private placement (iii)	-	(668,362)
Shares issued on exercise of Finders Options (11(e))	470,000	23,500
Fair value reallocation on exercise of Finders Options (note11(f))	-	6,353
Fair value reallocation on expiry of warrants (note 11(c))	-	86,967
Share issue costs (iv)	-	(134,311)
Balance, December 31, 2012	132,721,689	9,806,332
Fair value reallocation on expiry of warrants (note 11(c))	-	39,677
Private placement (v)	7,950,000	397,500
Value of warrants issued pursuant to private placement (v)	-	(141,188)
Share issue costs (v)	-	(35,515)
Balance, June 30, 2013	140,671,689	10,066,806

(i) On February 17, 2012, the Company completed a private placement (“Placement A”), issuing 14,240,000 units. Each unit under Placement A was issued at $0.05 for total proceeds of $712,000. Each unit consists of one common share of the Company and one share purchase warrant (“Warrant A”). Each Warrant A entitles the holder to purchase one additional common share of the Company at $0.10 per share, exercisable for 1 year from the original issue date. The Company has allocated $346,581 of the unit value to warrants (note 11(c)). On January 28, 2013, the Company received approval to extend the expiry dates for share purchase warrants with an original expiry date of February 17, 2013 to expire on August 17, 2013. All other terms and conditions of the share purchase warrants have remained the same. The original fair value of the share purchase warrants has been maintained.

(ii) On July 5, 2012, the Company completed a private placement (“Placement B”), issuing 4,841,730 units. Each unit under Placement B was issued at $0.07 for total proceeds of $338,921. Each unit consists of one common share of the Company and one share purchase warrant ("Warrant B"). Each Warrant B entitles the holder to purchase one additional common share of the Company at $0.10 per share, exercisable for 1 year from the original issue date. The Company has allocated $187,838 of the unit value to warrants (note 11(c)).

(iii) On October 25, 2012, the Company completed a private placement ("Placement C"), issuing 29,680,000 units. Each unit under Placement C was issued at $0.05 for total proceeds of $1,484,000. At December 31, 2012, $80,000 of the proceeds had yet to be received from a subscriber of the Placement C, of which $60,000 was collected during the six months ended June 30, 2013. Each unit consists of one common share of the Company and one share purchase warrant ("Warrant C"). Each Warrant C entitles the holder to purchase one additional common share of the Company at $0.10 per share, exercisable for 1 year from the original issue date. The Company has allocated $668,362 of the unit value to warrants (note 11(c)).

(iv) Pursuant to Placement A, Placement B and Placement C, the Company incurred $155,586 in cash share issue costs, of which $83,572 was allocated to share capital and $72,014 was allocated to warrants. Under Placement A and Placement C 650,000 and 2,463,000 finders options were issued, respectively, valued at $93,657 (note 11(e)), of which $50,739 was allocated to share capital and $42,918 was allocated to warrants.

(v) On April 3, 2013, the Company completed a private placement ("Placement D"), issuing 7,950,000 units. Each unit under Placement D was issued at $0.05 for total proceeds of $397,500. Each unit consists of one common share of the Company and one share purchase warrant ("Warrant D"). Each Warrant D entitles the holder to purchase one additional common share of the Company at $0.10 per share, exercisable for 1 year from the original issue date. The Company has allocated $141,188 of the unit value to warrants (note 11(c)).

Pursuant to Placement D, the Company incurred $38,259 in cash share issue costs, of which $24,671 was allocated to share capital and $13,588 was allocated to warrants. 645,000 finders options were issued, respectively, valued at $16,818 (note 11(e)), of which $10,844 was allocated to share capital and $5,974 was allocated to warrants

c) **Warrants**

Warrants to acquire common shares outstanding at June 30, 2013 are as follows:

	Number of warrants issued and exercisable	Amount $	Weighted average exercise price $	Weighted average Remaining life (years)
Balance, December 31, 2011	19,647,701	126,644	0.10	0.41
Share purchase warrants issued (note 11(b)(i), (ii) and (iii))	48,761,730	1,202,781	0.10	0.59
Share issue costs (note 11(b)(iv))	-	(114,932)	-	-
Share purchase warrants issued (note 9)	5,000,000	147,195	0.10	0.62
Expiry of share purchase warrants	(13,413,701)	(86,967)	0.10	-
Balance, December 31, 2012	59,995,730	1,274,721	0.10	0.55
Expiry of share purchase warrants	(6,234,000)	(39,677)	0.10	-
Share purchase warrants issued (note 11(b)(v))	7,950,000	141,188	0.10	0.76
Share issue costs (note 11(b)(v))	-	(19,562)	-	-
Balance, June 30, 2013	61,711,730	1,356,670	0.10	0.29

The fair value of the share purchase warrants granted were 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:

	2013	2012
Risk-free rate	**1.01%**	**1.12%**
Expected life	**1 years**	**1.01 years**
Expected volatility	**140.95%**	**172.05%**
Fair value per warrant	**$0.018**	**$0.025**

Volatility was determined based on the Company's historical share prices.

d) **Stock options**

The Company established a share option plan (the "Plan") for the benefit of officers, directors, employees and consultants of the Company. Under the Plan, the number of common shares to be reserved and authorized for issuance pursuant to options granted under the Plan cannot exceed 10% of the total number of issued and outstanding shares of the Company. The term, the vesting period and the exercise price are determined at the discretion of the Board of Directors. However, the maximum option term shall not exceed five years.

During the three and six months ended June 30, 2013, there were no stock option grants, cancellations, exercises, or expiries. The following table summarizes information about the Company's stock options outstanding at June 30, 2013:

	June 30, 2013		December 31, 2012	
	Number of options	**Weighted Average Exercise price $**	Number of options	Weighted Average Exercise price $
Stock options, beginning of period	**7,380,000**	**0.10**	7,680,000	0.10
Expired	**-**		(300,000)	(0.10)
Stock options outstanding, end of period	**7,380,000**	**0.10**	7,380,000	0.10

The total stock options outstanding at June 30, 2013 are as follows:

Exercise prices ($)	Options outstanding	Weighted average remaining term (years)	Weighted average exercise price ($)
0.10	7,380,000	2.69	0.10

As at June 30, 2013, all outstanding options have vested and are exercisable.

There was no share-based payment expense recognized during the three and six months ended June 30, 2013 (June 30, 2013 - $nil).

e) **Finders Options**

The following table summarizes information about the Company's Finder Options outstanding at June 30, 2013:

	June 30, 2013		December 31, 2012	
	Number of options	**Weighted Average Exercise price $**	Number of options	Weighted Average Exercise price $
Finders Options, beginning of period	**3,113,000**	**0.05**	470,000	0.05
Granted (note 11(b)(v))	**645,000**	**0.05**	3,113,000	0.05
Exercised (note 11(b))	-	-	(470,000)	0.05
Expired	**(650,000)**	**(0.05)**	-	-
Finders Options outstanding, end of period	**3,108,000**	**0.05**	3,113,000	0.05

During the year ended December 31, 2012, the Company issued 3,113,000 Finders Options, respectively, to the those who facilitated Placement A and Placement C (note 11(b)(iv)). Each Finders Option granted pursuant to Placement A and Placement C is exercisable into one unit consisting of one common share and one common share purchase warrant ("Finder Warrant") of the Company at $0.05 per unit. Each Finder Warrant is exercisable into one common share of the Company at $0.10 per common share. The Finders Options expire one year from the original grant date. The Finders Options were valued at an aggregate of $93,657 (note 11(b)(iv)).

During the three and six months ended June 30, 2013, the Company issued 645,000 Finders Options, respectively, to the those who facilitated Placement D (note 11(b)(v)). Each Finders Option is exercisable into one unit consisting of one common share and one common share purchase warrant ("Finder Warrant") of the Company at $0.05 per unit. Each Finder Warrant is exercisable into one common share of the Company at $0.10 per common share. The Finders Options expire one year from the original grant date. The Finders Options were valued at $16,818 (note 11(b)(v)).

The fair value of the Finders Options granted is estimated as at the grant date using the Black-Scholes option pricing model. The assumptions used in the calculation are noted below:

	2013	**2012**
Risk-free interest rate	1.01%	1.14%
Expected life	1 year	1 year
Expected volatility	140.95%	168.16%
Fair value per option	$0.03	$0.03

Volatility was determined based on the Company's historical share prices.

f) **Contributed surplus**

	June 30, 2013	December 31, 2012
	$	$
Balance, beginning of period	**1,135,960**	1,048,656
Finders options (note 11(b)(iv) and (v))	**16,818**	93,657
Finders options exercised (note 11(b))	-	(6,353)
Balance, end of period	**1,152,778**	1,135,960

g) **Per share data**

Basic earnings per share are calculated based on the weighted average number of shares outstanding during the period. The treasury stock method is used for the calculation of diluted loss per share. Under this method, it is assumed that proceeds from the exercise of dilutive securities are used by the Company to repurchase Company shares at the average price during the period. All warrants, finders options and stock options have been excluded from the calculation of diluted shares outstanding as they would be anti-dilutive due to the loss position of the Company.

12 Restatement

During the preparation of the December 31, 2012 financial statements, it was determined that the Company's prior year financial statements required correction for the following reasons:

Previously, the Company had not made provisions for shareholder indemnity liability and Part XII.6 taxes payable relative to flow through shares issued in 2009 and 2010. The summary of the adjustments to the June 30, 2012 financial statements is as follows:

December 31, 2011	As previously reported	Adjustments	As restated
	$	$	$
Accounts payable and accrued liabilities	2,333,903	20,839	2,354,742
Shareholder indemnity	-	181,020	181,020
General and administrative expense	1,229,864	125,579	1,355,443
Opening deficit	9,786,167	76,280	9,862,447
Deficit	11,763,223	201,859	11,965,082

13 Income tax

Significant components of the deferred tax liability are as follows:

	June 30, 2013	December 31, 2012
	$	$
Property and equipment	**(397,699)**	(401,270)
Non-capital loss carried forward	**(1,464,882)**	(1,361,009)
Decommissioning liabilities	**(44,743)**	(45,570)
Share issue costs	**(40,908)**	(51,334)
Equity investments	**11,008**	16,680
Flow-through share indemnity liability	**(80,373)**	(80,373)
Scientific research and experimental development	**(150,663)**	(150,663)
Financing fees	**(27,520)**	(45,867)
Attributed Canadian royalty income	**(110,080)**	(110,080)
Investment tax credits	**(195,000)**	(195,000)
Deferred tax asset not recognized	**2,500,860**	2,424,486
	-	-

The Company has estimated tax pools totaling:

	Rate of Claim	June 30, 2013 $
Canadian exploration expenditures	100%	**1,204,141**
Canadian oil and gas property expenditures	10%	**5,991**
Foreign development expenditures	Various	**898,782**
Undepreciated capital cost	Various	**1,287,287**
Share issue costs	20%	**163,632**
Financing fee	20%	**110,080**
Scientific research and experimental development		**602,650**
Attributed Canadian royalty income		**1,100,800**
Non-capital loss carry forward		**5,859,530**
		11,232,893

14 Related party transactions

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

a) The following amounts are due from related parties:

	June 30, 2013 $	December 31, 2012 $
Note receivable from officer (i)	**241,415**	238,164
Fair value allowance (ii)	**(216,515)**	(216,515)
Net note receivable	**24,900**	21,649
Advance fees (iii)	**6,529**	6,529
	31,429	28,178

(i) A promissory note was issued to an officer of the Company bearing interest at 3% per annum and there is no fixed maturity date, unless the officer's employment is terminated or he is petitioned into bankruptcy wherein the note and accrued interest becomes immediately payable. The note is secured by 393,000 common shares of the Company which had a fair value of $23,580 at June 30, 2013 (December 31, 2012 - $23,580).

(ii) The fair value allowance was initially determined on December 31, 2008 based on the market value of the secured shares. During the three and six months ended June 30, 2013, there was no additional allowance provided to the estimated fair value of the 393,000 common shares held as security as fair value did not exceed the carrying amount (December 31, 2012 - $nil).

(iii) During the year ended December 31, 2008, a director was advanced $59,473 in relation to efforts to finance and advance the Company's drilling technology. At June 30, 2013 $6,529 (December 31, 2012 - $6,529) remains outstanding. There is no guarantee that such efforts will be successful and if such efforts are not successful, the full balance will be repaid. The original repayment date of December 31, 2010 has been extended to December 31, 2013.

b) Additional related party transactions not disclosed elsewhere in these financial statements are as follows:

During the three months ended June 30, 2013:

(i) Aggregate fees of $nil (June 30, 2012 - $57,300) were charged by directors of the Company. Of this amount $nil (June 30, 2012 - $57,300) was recorded in the statement of comprehensive loss.

(ii) Aggregate fees of $12,000 (June 30, 2012 - $nil) were charged by a U.S. corporation, which is owned and controlled by an officer and a director of the Company for costs it incurred for operation of the Company's U.S. properties. Of this amount $12,000 (June 30, 2012 - $nil) was recorded in the statement of comprehensive loss.

(iii) Aggregate fees of $8,718 (June 30, 2012 - $35,334) were charged by corporations, which are owned and controlled by other equity investors in PRI, and were all recorded as general and administrative costs.

During the six months ended June 30, 2013:

(iv) Aggregate fees of $3,150 (June 30, 2012 - $127,125) were charged by directors of the Company. Of this amount $3,150 (June 30, 2012 - $127,125) was recorded in the statement of comprehensive loss.

(v) Aggregate fees of $24,000 (June 30, 2012 - $12,000) were charged by a U.S. corporation, which is owned and controlled by an officer and a director of the Company for costs it incurred for operation of the Company's U.S. properties. Of this amount $24,000 (June 30, 2012 - $12,000) was recorded in the statement of comprehensive loss.

(vi) Aggregate fees of $17,232 (June 30, 2012 - $50,098) were charged by corporations, which are owned and controlled by other equity investors in PRI, and were all recorded as general and administrative costs.

(vii) Included in accounts payable at June 30, 2013 was $3,490 owing to related parties of the Company (December 31, 2012 - $87,943).

15 Commitments

a) On January 15, 2012, the Company entered into a lease agreement with a related party for the lease of office space. Under a lease agreement, the Company has committed to monthly payments of $2,771 for the lease of its office space until January 31, 2015.

b) The Company has entered into various vehicle loan agreements with total annual principal repayments for fiscal years 2013 through to 2015 as follows: $24,688, $26,110 and $15,868.

c) The Company raised capital through the issuance of flow through shares in 2009, 2010 and 2011 which provided indemnity to the subscriber for additional taxes payable if the Company was unable to, or failed to, renounce the qualifying expenditures as agreed. The Company was not able to spend $824,338 of the flow through funds raised. The Company is exposed to costs for the indemnification of the subscribers. The Company has estimated a potential liability on the amount of $321,497 at June 30, 2013 (December 31, 2012 - $321,497). The Company has also estimated a potential liability for penalties and taxes on the amounts of $39,320 in 2012 (December 31, 2011 - $35,348, January 1, 2011 - $ 20,839) included in accounts payable and accrued liabilities. The accrued amount is subject to measurement uncertainty due to the tax filing positions of the subscribers, their tax rates and the amount of personal taxes that may be payable and the interpretation of the indemnity agreement, which will not be known until potentially affected subscribers are reassessed for their tax positions by the Canada Revenue Agency and these amounts become known to the Company.

16 Supplemental cash flow information

	June 30, 2013	June 30, 2012
	$	$
The Company had the following non-cash transactions.		
Shares issued to reduce related party loan	-	301,157
Fair value of finders options (note 11(e))	**16,818**	20,272
Cash interest paid	**61,763**	78,218

17 Financial risk management

The Board of Directors oversees managements' establishment and execution of the Company's risk management framework. Management has implemented and monitors compliance with risk management policies. The Company's risk management policies are established 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 activities.

(a) Fair values

The Company's financial instruments consist of cash and cash equivalents, long-term investments, trade and other receivables, share subscription receivable, due from related parties, accounts payable and accrued liabilities, the shareholder indemnity, the related party loan, the convertible related party debt, the current portion of long-term debt and the long-term debt.

Financial Instrument	**Classification**	**Carrying Value $**	**Fair Value $**
Cash and cash equivalents	Fair value through profit and loss	237,164	237,164
Long-term investments	Fair value through profit and loss	52,590	52,590
Trade and other receivables	Loans and receivables	575,720	575,720
Share subscription receivable	Loans and receivables	20,000	20,000
Due from related parties	Loans and receivables	31,429	31,429
Accounts payable and accrued liabilities	Other financial liabilities	3,313,096	3,313,096
Shareholder indemnity	Other financial liabilities	321,497	321,497
Related party loan	Other financial liabilities	1,184,105	1,184,105
Convertible related party debt	Other financial liabilities	89,403	89,403
Current portion of long-term debt	Other financial liabilities	25,389	25,389
Long-term debt	Other financial liabilities	29,117	29,117

The significance of inputs used in making fair value measurements are examined and classified according to a fair value hierarchy. Fair values of assets and liabilities included in Level 1 are determined by reference to quoted prices in active markets for identical assets and liabilities. Assets and liabilities in Level 2 include valuations using inputs other than quoted prices for which all significant outputs are observable, either directly or indirectly. Level 3 valuations are based on inputs that are unobservable and significant to the overall fair value measurement.

At June 30, 2013, the Company's cash and cash equivalents and long-term investments have been subject to Level 1 valuation.

(b) Credit risk:

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Company's receivables from joint venture partners and oil and natural gas marketers.

Virtually all of the Company's trade and other receivables are from companies in the oil and gas industry and are subject to normal industry credit risks. Credit risks arise principally from the amounts owing to the Company from oil and natural gas marketers and joint venture partners. Management does not believe that any significant concentration of trade and other receivables exists that will result in any loss to the Company based on past payment experience. Receivables from petroleum and natural gas marketers are normally collected on the 25th day of the month following production. The Company's policy to mitigate credit risk associated with these balances is to establish relationships with large marketers. However, the receivables are from participants in the petroleum and natural gas sector and collection of the outstanding balances is dependent on industry factors such as commodity price fluctuations and escalating costs. The Company does not typically obtain collateral from petroleum and natural gas marketers or others in the event of non-payment.

A provision for doubtful accounts of $nil has been recorded at June 30, 2013 (June 30, 2012 – recovery of bad debt expense of $15,000).

Cash and cash equivalents consist of cash bank balances held in both interest and non-interest bearing accounts. The Company manages credit exposure of cash by selecting financial institutions with high credit ratings.

(c) Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due. At June 30, 2013, the Company's maximum exposure to liquidity risk is the total current liabilities of $5,019,212 (December 31, 2012 - $4,345,082).

The current liabilities and commitments are due as follows:

Accounts payable and accrued liabilities	3,313,096	Due within 90 days
Related party loan (note 9)	1,184,105	Maturity date of August 15, 2013
Convertible related party debt (note 10)	89,403	Maturity date of December 31, 2013
Current portion of long-term debt (note 15(b))	25,389	Due within 12 months
Long-term debt (note 15(b))	29,117	Due within 36 months
Shareholder indemnities (note 15(c))	321,497	Due on demand

The Company's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Company's reputation.

To achieve this objective, the Company prepares annual capital expenditure budgets, which are regularly monitored and updated as considered necessary. Further, the Company utilizes authorizations for expenditures on both operated and non operated projects to further manage capital expenditures. The Company also attempts to match its payment cycle with collection of oil and natural gas revenue on the 25th of each month.

(d) Market risk

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

(i) Commodity price risk:

Commodity price risk is the risk that the fair value or future cash flows will fluctuate as a result of changes in commodity prices. Commodity prices for oil and natural gas are impacted by not only the relationship between the Canadian and United States dollar but also world economic events that dictate the levels of supply and demand. All of the Company's oil and gas production is sold at spot rates exposing the Company to the risk of price movements.

During 2010, the Company entered into a commodity call option effective from January 1, 2012 to December 31, 2012 at a strike price of USD $90.00 per BBL. On February 2, 2012, the Company terminated the commodity call option for consideration of $116,114 and recognized an unrealized gain of $161,770 to reverse the financial contract liability recorded at December 31, 2011.

A 10% increase or decrease in the commodity price throughout the period would result in approximately a $7,100 increase or decrease in net operating loss for the period ended June 30, 2013, after holding operating expenses constant and increasing or decreasing royalties accordingly.

(ii) Currency risk:

The Company is exposed to the financial risk related to the fluctuation of foreign exchange rates. The Company operates in Canada and the United States and a portion of its expenses are incurred in US dollars. The Company does not hedge its exposure to fluctuations in the exchange rate. Future changes in exchange rates could have a material effect on the Company's business including its intended capital plans, its financial condition and results of operations.

Certain of the Company's financial instruments are exposed to fluctuations in the US dollar, including cash and cash equivalents, trade and other receivables and accounts payable and accrued liabilities. As at June 30, 2013, an increase or decrease 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 would have had approximately a $24,643 impact on the Company's comprehensive loss for the period.

(iii) 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 June 30, 2013, all of the Company's debt, including the related party loan and the convertible related party debt, bears fixed interest rates and accordingly, is not subject to market interest rate fluctuations.

The Company has no interest rate swaps or financial contracts in place as at or during the three and six months ended June 30, 2013.

(e) Capital management

The Company's capital consists of shareholders' deficit, the related party loan, the convertible related party debt and working capital. The Company will adjust its capital structure to manage its current and future debt, drilling programs and potential corporate acquisitions through the issuance of shares, sourcing additional debt financing and adjustments to capital spending. The Company's objective for managing capital is to maximize long-term shareholder value by ensuring adequate capital to achieve the Company's objectives. The Company is not subject to any external capital requirements.

Management reviews its capital management approach on an ongoing basis and believes its current approach is reasonable given the size of the Company. There has been no change in management's approach to capital management during the period.

18 Segmented information

The Company's primary operations are limited to a single industry being the acquisition, exploration for, and development of petroleum and natural gas. Geographical segmentation is as follows:

	Three months ended June 30, 2013 ($)		
	Canada	**United States**	**Total**
Petroleum and natural gas sales	21,312	33,436	54,748
Other income and expenses	32,136	-	32,136
Depletion, depreciation and impairment	17,368	10,440	27,808
Net loss	325,001	37,241	362,242
Property and equipment	661,975	81,665	743,640
Exploration and evaluation assets	-	1,061,766	1,061,766
Total liabilities	3,631,479	1,595,821	5,227,300

	Three months ended June 30, 2012 ($)		
	Canada	**United States**	**Total**
Petroleum and natural gas sales	10,341	16,186	26,527
Other income and (expenses)	(55,440)	-	(55,440)
Depletion, depreciation and impairment	9,448	12,533	21,981
Net loss	429,209	65,018	494,227
Property and equipment	867,986	317,000	1,184,986
Total liabilities	3,865,410	330,844	4,196,254

	Six months ended June 30, 2013 ($)		
	Canada	**United States**	**Total**
Petroleum and natural gas sales	31,872	45,512	77,384
Other income and expenses	88,064	-	88,064
Depletion, depreciation and impairment	33,264	13,517	46,781
Net loss	509,991	74,915	584,906
Property and equipment	661,975	81,665	743,640
Exploration and evaluation assets	-	1,061,766	1,061,766
Total liabilities	3,631,479	1,595,821	5,227,300

	Six months ended June 30, 2012 ($)		
	Canada	**United States**	**Total**
Petroleum and natural gas sales	42,427	46,029	88,456
Other income and expenses	22,780	-	22,780
Depletion, depreciation and impairment	33,216	27,705	60,921
Net loss	646,955	117,664	764,619
Property and equipment	867,986	317,000	1,184,986
Total liabilities	3,865,410	330,844	4,196,254