



Canoel International Energy Ltd.

Annual Report 2010

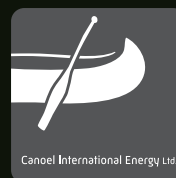




Canoel International Energy Ltd. is a fast growing Canadian based publicly traded international energy exploration company focusing on the acquisition of large acreage in oil producing countries that offer good protection of the ownership of petroleum assets by foreign investors. More specifically, the Company prefers to invest in areas where infrastructure already exists to transport crude oil and/or natural gas once a commercial discovery is achieved.

The Company's strength is due to experienced management and a board of directors composed of people having extensive international business and government exposure with a network of strong relationships in the energy industry dating back many years.

The strategy of the Company's management is to have the flexibility to act rapidly once an opportunity presents itself. On the other hand, this strategy does not suggest large unfunded commitments as the Company intends to properly perform the working program respecting its time schedule and matching the host country's energy development program.



### Executive management

Andrea Cattaneo, CEO & President  
Steve Austin, CFO

### Board of Directors

Jose Ramon Lopez Portillo  
James H. Grossman  
Emmanuel Olympitis  
Luigi Regis Milano  
Dario Sodero  
Francesco Zofrea

### Advisory Committee

Colin Russel  
Guglielmo Moscato

## LETTER TO SHAREHOLDERS

The Company's fiscal year ending the 31<sup>st</sup> of March 2010 was a very challenging year for our Company as it was for similarly situated small oil and gas exploration and production companies everywhere. We want you to know that despite the difficulties we (and others) face, we continue with our strategy and we believe that success will come to those who have a plan and continue to work toward a goal.

We want you to know that it is our intention to do the following:

A. Buying producing acreage of small dimensions in a steady way so to build a portfolio of producing properties of decent dimensions with revenues.

B. Buying large acreage with working programs presenting commitments of relatively small dimensions in the first two years. One aspect of this particular policy is that the focus shall be on the best opportunity readily available rather than- at first- a specific geographical area chosen in an abstract way. Our network of worldwide contacts permits us to gather a varied panorama of opportunities and among them we shall take the ones that match our risk profile.

We believe that once we have assembled a few solid opportunities we will have then automatically created a geographical identity, to carry forward in a coherent way.

Furthermore, Canoel is not interested in pure so called frontier situations; that is, target countries shall already present some crude oil or gas production in regions nearby the offered acreage; the countries in which we are open to take up opportunities are oil or gas producing countries, where large investigations have been made previously by majors or by some braver independent oil & gas companies and there exists a governmental structure for oil and gas development.

Additionally some forms of infrastructure shall exist in the proximities, from the better network of oil pipeline/gas ducts to the simpler availability of a railway line able to support a traffic of railway tankers.

Production and delivery of oil/gas to the market shall be technically possible, although perhaps not without some difficulties, shortly after the first commercial discovery is achieved; and without having the necessity of building a one billion dollar pipeline.

Canoel intends to prove to the market its ability to transact rapidly in a variety of countries. Canoel's focus shall be in transactions that offer a scenario of relative speed.

### **Practical Events**

This is the state of the Company after the 12 months of activity ending the 31<sup>st</sup> of March 2010.

#### **A. TUNISIA**

Our company so far has acquired 3 blocks in Tunisia, totaling 10,000 square kilometers: each block near others with existing production of oil or gas. Additionally, our blocks are crossed by pipelines and gas ducts. We have completed all the necessary 2D and 3D seismic works.

If we make a commercial discovery we can go on stream in few months. This refers to the working interest in Tunisia which has been clearly illustrated in last year's report; however, for the benefit of any new shareholder, in late 2008, the Company entered into a farm-out

arrangement under which the Company is entitled to earn an 11% working interest in three oil & gas exploration blocks (Bazma, Jorf, and Sud Touzer) in Tunisia.

#### **B. ARGENTINA**

We announced in February 2010 the acquisition of a producing property in Argentina. Thus, we will become a producer of oil with the consequent creation of cash-flow which we know to be an important element in our growth. There is still further due diligence being done on the properties, but we are hopeful of having this acquisition completed during the summer of 2010.

Certainly one of our greatest challenges has been as a result of the collapse of the worldwide equity markets in the second half of 2008 and the consequent and continuing disinterest of the investment community for small cap companies. The raising of funds to complete the projects we are looking at, has proven to be very difficult. However, we believe we have now sufficient funding to proceed with Argentina, subject of course to the due diligence referred to above.

#### **C. NORWAY**

We have announced and are now in the midst of completing a transaction in Norway whereby we will acquire a company, Oren Oil ASA, which will bring to Canoe some 700 shareholders (of which 200 promising large institutional investors) as well as the commitment of raising \$800,000 for Canoe. We look forward to reporting further on this deal over the next few weeks.

#### **D. MONGOLIA**

While the Company spent considerable time and effort to acquire a promising block in Mongolia (Block XXIII), we were quite disappointed that the Seller was, for whatever reason, unable to deliver on his obligations, which included the representation that no further government permissions were required. The Company has been reviewing the situation with legal counsel to determine the best way at least to regain its expenses if as it appears there will be no completion of this deal.

### **PROGRAMS FOR THE FISCAL YEAR 2011: OUR CONTINUING STRATEGY**

**Priority 1:** The Company continues to work with Cygam Energy Inc, the operator of the 3 blocks referred above, in making detailed geophysical and geological re-assessments in order to better pinpoint the drilling location within the Tunisian exploration blocks. Our objective for these prospects in 2009-2010 is to further define high-grade drillable structures and then to make presentations to industry participants with a view to finding additional partners for these projects.

In seeking new opportunities we feel that the radical change in our industry requires a different strategy. Instead of focusing, as we had earlier determined on securing minority positions in blocks around the world, we will look to take lead positions in large blocks in prolific countries, having high recognition for their oil reserves.

**Priority 2.** In addition in a parallel way, we will develop the revenues side of our accounts, by buying oil & gas production such as our Argentine venture. We believe that additional

production sites providing revenues will arise from owners who are forced to sell for whatever reasons. Canoel is actively looking for other opportunities around the world, focusing on its main forte, the ability to identify opportunities and to transact them in a speedy manner.

In closing, I would like to extend my sincere thanks to all the shareholders who have been with us since inception for their patience and continued confidence and the new shareholders who participated in the more recent financings for their continued support.

I also wish to thank the Company's Board, management and consultants for their dedication and hard work under challenging and often under-staffed and under-paid conditions.

We look forward to moving ahead during this new fiscal year, implementing our strategy and continuing to seek new opportunities elsewhere.

On behalf of the Board of Directors,

Andrea Cattaneo  
President & CEO.  
June 22, 2010

## CANOEL INTERNATIONAL ENERGY INC.

### MANAGEMENT'S DISCUSSION AND ANALYSIS

This Management's Discussion and Analysis ("**MD&A**") is provided by the management of Canoel Energy Inc. ("**Canoel**" or the "**Company**") and should be read in conjunction with the audited annual financial statements for the year ended March 31, 2010, including the notes thereon. This MD&A is dated as of June 15, 2010.

#### **Basis of Presentation**

All financial information is reported in Canadian dollars and is in accordance with Canadian generally accepted accounting principles ("**Canadian GAAP**") unless otherwise noted.

#### **Forward-Looking Information**

Certain information in this MD&A constitutes forward-looking statements or information (collectively referred to herein as "**forward-looking statements**") within the meaning of applicable securities legislation. Forward-looking statements are usually identified by the words "believe", "anticipate", "expect", "plan", "estimate", "target", "continue", "could", "intend", "may", "potential", "predict", "should", "will", "objective", "project", "forecast", "goal", "guidance", "outlook", "effort", "seeks", "schedule" or expressions of a similar nature suggesting future outcome or statements regarding an outlook. In particular, forward-looking statements include:

- management's belief that its option to increase its interest in the Tunisian exploration blocks will provide greater potential for financing or industry participation;
- management's belief that it will be able to exercise their option to increase its interest in the Tunisian exploration blocks to the full 45% if desired;
- management's belief that it will be able to raise the funds required to participate in the Tunisian exploration blocks, including the ability to participate beyond the 11% upon exercising their option to increase their working interest in the Tunisian exploration blocks up to 45%;
- management's belief that the expected commencement date according to the operator for drilling operations in the Bazma exploration block, located in Tunisia, and management's expectation that costs of drilling the well may be less than estimated;
- plans and timing for the drilling of exploratory wells on the Jorf and Sud Tozeur exploration blocks, located in Tunisia;
- management's expectation that there will be no significant monetary impact to the Company as a result of initiating and pursuing legal action against the Mongolian company to enforce the completion of their contractual requirements;
- management's expectation that permits from the Tunisian National Oil Company for the Bazma and Sud Tozeur exploration blocks can be extended if necessary; and
- all of the statements under the heading "Outlook"

These forward-looking statements are subject to certain assumptions, including the assumptions that: the opportunity to participate in the exploration and development of the Tunisian exploration blocks, whether directly, or through investment in the Company's shares, will be attractive to potential industry partners or investors; financing for the Company and other participants in proposed exploration activities will be available when required; the price of services and material required to carry-out exploration plans will be as expected; and that any required extensions of the exploration permits can be successfully negotiated with the Tunisian national oil company, ETAP. Forward-looking statements are not guarantees of future performance and the reader should not place undue reliance on these forward-looking statements as there can be no assurances that the assumptions, plans, initiatives or expectations upon which they are based will occur. In addition, forward-looking statements are subject to known and unknown risks, uncertainties and other factors that could cause the actual results, performance or achievements of the Company to be materially different from any future results, performance or achievements expressed or implied by forward-looking statements. Such factors include, among others: general economic and business conditions; the price of and demand for oil and natural gas and their effect on the economics of oil and gas exploration; fluctuations in currency and interest rates and their effect on projected profitability of the Company's operations; economic conditions in the countries and regions in which the Company will conduct its operations; political uncertainty; the ability of the Company to implement its business strategy, including exploration and development plans; the impact of competition; the availability and cost of seismic, drilling and other equipment; the Company's ability to secure adequate transportation and markets for any oil or gas discovered; drilling and operating hazards and other difficulties inherent in the exploration for and production and sale of oil and natural gas; the availability and cost of financing; the success of any exploration and development undertaken; actions by governmental authorities; changes government regulations and the expenditures required to comply with them (including but not limited to the changes in taxes or the royalty or other share of production taken by governmental authorities). Should one or more of these risks or uncertainties materialize, or should any of the Company's assumptions prove incorrect, actual results may vary in material respects from those projected in the forward-looking statements. Readers are cautioned that the foregoing list of risks, uncertainties and other factors is not exhaustive. Unpredictable or unknown factors not discussed could also have material adverse effects on forward-looking statements. The impact of any one factor on a particular forward-looking statement is not determinable with certainty as such factors are dependent upon other factors, and the Company's course of action would depend upon its assessment of the future considering all information then available. All forward-looking statements in this MD&A are expressly qualified in their entirety by these cautionary statements. Except as required by law, the Company assumes no obligation to update forward-looking statements should circumstances or Management's estimates or opinions change.

## **NATURE OF OPERATIONS**

The Company is involved in the exploration for, development of and production of petroleum and natural gas properties in western Canada. The Company was incorporated under the British Columbia Business Corporations Act on September 20, 2007. In March, 2008, the Company raised \$700,000 gross proceeds from an initial public offering of its common shares. The Company's common shares were subsequently listed on the TSX Venture Exchange ("TSXV" or "Exchange") as a Capital Pool Company. As a Capital Pool Company, the Company was subject to policies of the Exchange that restricted its business to identifying and evaluating assets or businesses that, if acquired, would constitute the Company's "Qualifying Transaction" under applicable Exchange policies.

In July 2008, the Company entered into a Farm-out and Participation Agreement (the "**Farmout and Participation Agreement**") with Cygam Energy Inc. ("**Cygam**"), a Calgary based public oil and gas exploration company listed on TSXV. Under the Farmout and Participation Agreement the Company has the right to earn an 11% interest in three onshore oil and gas exploration blocks (Bazma, Jorf and Sud Tozeur) in the south-western part of Tunisia by paying between 15.4% and 18.7% of the costs of certain seismic programs previously conducted by Cygam and by paying a share of the costs of drilling the first well on each of the blocks. In order to have the Farmout and Participation Agreement accepted as the Company's Qualifying Transaction, additional funds were required to provide capital for some of the expenditures required to be made by the Company under the Farmout and Participation Agreement and to provide unallocated working capital. In November 2008 the Company raised gross proceeds of \$2,305,400 through an offering of units by way of a Short Form Offering Document under Exchange policies and a Non Brokered Private Placement (collectively the "**Offerings**"). Each unit consisted of one common share of the Company and one common share purchase warrant. Each common share purchase warrant entitles the holder thereof to acquire one additional common share of the Company at a price of \$0.40 until November 21, 2010 (subject to acceleration in certain circumstances).

Entering into the Farmout and Participation Agreement was subsequently accepted by the Exchange as the Company's Qualifying Transaction and the Corporation is now listed on the Exchange as a Tier 2 Oil and Gas issuer and is no longer subject to the restrictions applicable to Capital Pool Companies.

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 March 31, 2010, IPRP exists solely as a shell with no assets and liabilities.

## **OPERATIONAL UPDATE**

### **TUNISIA**

During the year ended March 31, 2010, the Company incurred \$14,013 of expenditures in relation to the Farmout and Participation Agreement. An amount of \$490,000 is held by Cygam, as operator of each of the exploration blocks, as a cash call against expenses to be incurred while drilling a well on the Bazma block. The Company also has an option to increase its interest in two of its three exploration blocks, Bazma and Sud Touzer, up to 34%, from 11% to 45%. The Company remitted a payment of \$190,000 to the operator for this option during the year ended March 31, 2009, which pursuant to the Option Agreement, the payment is non-refundable and had an original expiry date of April 30, 2009 for Bazma and on June 30, 2009 for Sud Touzer. Such deadlines have been extended and will remain valid until the Authorization for Expenditure for the first well on each block is issued. If another party commits to Cygam 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. The Company will require additional financing or an industry partner to complete its earning obligations under the Farmout and Participation Agreement. Management believes that the option to increase the Company's interest to potentially 45% will provide greater potential for financing or industry participation because the opportunity



to earn a larger interest is more likely to satisfy the acquisition criteria of a broader spectrum of financiers and industry participants.

There has been no additional capital spending in Tunisia during the year ended March 31, 2010.

### ***Bazma***

The Bazma exploration permit, in the center of Tunisia, covers an area of 1,616 square kilometres and carries a drilling commitment over a period of four years. During the first quarter of 2008, Cygam completed a comprehensive geophysical interpretation of extensive seismic data on the Bazma permit. Several structures with similar characteristics as the nearby Tarfa and Bague I producing fields were mapped. One structure, initially called "W" and now renamed "Frida", less than 5 km from the Tarfa field, was selected as the first drilling location. In June of 2008, a new 2D seismic survey totalling 50 km was acquired in order to confirm the best drill location on the "Frida" structure and to further define additional structures. The Triassic Tagi, expected at a depth of approximately 2,500 metres, is the main target on the "Frida" structure. Drilling in Bazma was originally scheduled to occur in the final quarter of 2008; however, a hurricane, which struck the Houston area severely damaged the drilling rig scheduled to be moved to Tunisia and drilling operations had to be cancelled. Cygam, the operator, indicates that drilling operations at the Frida structure to test the Triassic Tagi formation are now planned for late 2010, subject to rig availability. Long delivery time items, such as wellhead and casing have been purchased and have been delivered or are in transit in anticipation of this drilling. Cygam has also signed a farm-out agreement with Timgad Energy, an Egyptian company, to participate as to a 10% working interest in Bazma and additional companies have expressed an interest in participating on a promoted basis.

On October 14, 2009, Cygam announced that it had signed an Option and Farm-in Agreement (the "Agreement") with a large U.S. independent oil and natural gas company (the "U.S. Company") for the Bazma permit. Under the terms of the Agreement, the U.S. Company has agreed to reprocess the existing 2D seismic data and acquire new 2D seismic data on the Bazma permit. The U.S. Company will also have the option to conduct a 3D seismic survey and the option of earning an interest by drilling a deep well on the Bazma permit. If, during the term of the Agreement, Cygam decides to drill a well to test the shallower Triassic Tagi formation, the U.S. Company also has the option to participate in the costs of drilling such a well. In the event the U.S. Company drills a deep well on the Bazma exploration block prior to Cygam drilling the Triassic TAJI test well, and the U.S. Company commits to also owning an interest in the Triassic TAJI well prior the Company exercising its option to increase its working interest to 45%, then the option of the Company will be decreased proportionately by the interest assumed by the U.S. Company. As of this date, management does not believe that the U.S. Company is likely to exercise any option which would decrease the Company's option rights.

Management's intention are to utilize the option to increase their interest in the Tunisian exploration blocks and believes it will be able to raise the necessary capital to satisfy the additional spending required with an increased interest.

## ***Jorf***

The Jorf exploration permit, located in the center of Tunisia covers an area of 3,768 square kilometres. ETAP has agreed to extend the Jorf permit until August 6, 2011, by committing to drill a new well. The Company concurs with the operator's geophysical interpretation which indicates that two middle Permian pinnacle reef prospects and one Triassic target are present in the northern portion of the permit. During August 2007, drilling of the shallow Bhayra Rigo 1 well at a location south east of the current Jorf permit confirmed the presence of good seal rocks and of an excellent dolomitized and porous Permian reef, as interpreted through seismic. Burial of potential pinnacle reefs at greater depth (over 3,500 metres) in the northern portion of the Jorf permit should improve the probability that such reefs may have trapped hydrocarbons generated by overlaying and underlying source rocks. An exploratory well is planned for the second quarter of 2011, subject to rig availability. The timing of drilling is subject to change with the arrival of a new operator, Timgad, our current partner in the above described Bazma block.

## ***Sud Tozeur***

Cygam completed a preliminary geophysical interpretation of the majority of seismic data on the Sud Tozeur permit in early 2008, inclusive of the 61 km 2-D delineation seismic acquired on the permit in 2007. Several structures have now been outlined, inclusive of two separate anomalies close to a well with Triassic and Ordovician reservoir potential which was drilled in late 1997 by a previous operator. Several additional undrilled structures have also been identified on the permit but they will require further evaluation.

The Sud Tozeur exploration permit, located near the Algerian border and in close proximity to the Sabria and El Franig producing fields, covers an area of 4,380 square kilometres (1,082,283 acres) and carries a drilling commitment over a period of four years. The operator is considering drilling a well within this block in 2011 pending final seismic evaluation and availability of a rig capable to drill a deep Ordovician test to approximately 4,500 metres.

## **MONGOLIA**

During May 2009, and updated in August 2009, the Company entered into an agreement to become the operator of a large oil exploration block in Mongolia. Pending successful completion of negotiations, due diligence and additional capital being raised, the Company would acquire all of the shares of a Mongolian Company, a subsidiary of the Seller, which is the holder of the exploration license of Block XXIII (as such block is designated by the Mongolian Petroleum Authority), in exchange for US \$1.1 million and the grant to the Seller of a 6% carried interest in the Block. Block XXIII, which is located in the Mongolian part of the Gobi desert, immediately north of the border with China, covers 13,575 square kilometres and includes a structural feature that separates the highly prospective Erlian Basin in China from the East Gobi Basin in Mongolia. The biggest field in that basin, the Ershan field, produces 60,000 bopd. No intensive exploration activities have been carried out in Block XXIII. The Soviets conducted seismic surveys in the 1970s, which have subsequently been reprocessed; but no wells have been drilled in Block XXIII. The Mongolian Petroleum Authority imposes certain minimum work commitments to licenses granted, which are spread over 5 years, with this license anticipating approximately US \$46 million over the next 5 years. The Company is not committed to any spending under the work commitment. Under the agreement, a due diligence period existed until December 31, 2009

allowing for clarification of legislative and contractual terms with the Seller and local authorities, and for the Company to raise the required financing.

As part of its closing due diligence, the Company requested that the Seller provide evidence that the Mongolian government and regulatory authorities have consented to or approved the transaction, specifically regarding potential issues surrounding the change in the Mongolian Company's shareholder, interest, name, and nationality that would occur if and when the Company acquired the Mongolian Company. The Company was not provided with such evidence prior to December 31, 2009, and has not subsequently been provided with any such evidence. The Company has delivered a Notice of Default with the intention of initiating legal proceedings to enforce the agreement if the Seller is not able to meet these commitments. At this time, management does not believe that there will be any significant monetary impact to the Company as a result of pursuing legal proceedings.

## **ARGENTINA**

On February 12, 2009, the Company signed a Share Purchase Agreement (the "Agreement") with a U.S. based privately held company for the purchase of two adjacent oil producing properties in Argentina. The transaction was previously announced during September 2009 with the signing of a Memorandum of Understanding. The properties are located in the San Jorge basin in the Patagonia region in southern Argentina, licensed by authorities to produce oil, and according to the Seller the properties are able to produce 55,000 barrels per annum of sweet oil having an API gravity of 18.5 and being non paraffinic. The acquisition contemplated the acquisition would be completed through the acquisition of the shares of certain U.S. subsidiary companies which in turn own the Argentine entity which directly owns the properties. The purchase price is anticipated to be U.S. \$2.4 million in exchange for the acquisition of the shares of the U.S. subsidiary companies and their ongoing businesses, the two concessions and the existing production equipment to ensure the Company will be able to continue the existing income stream immediately upon closing. Pursuant to the Agreement, for a period of three years from the closing date, the Company will provide the Seller 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. Subsequent to March 31, 2010, after completion of due diligence procedures, the Company has terminated the agreement to allow for additional time to study certain technical aspects of the production numbers and to complete additional financings. Accordingly, there is no certainty that the Company will proceed to close this transaction or receive necessary regulatory approval from the TSX or any other approvals which may be required.

## **OTHER ACTIVITIES**

In addition to its activities discussed, the Company is actively pursuing the acquisition of other oil and gas producing properties in North America, Italy and Argentina in order to provide cash flow to fund its operations, exploration prospects elsewhere in the world and financing for future acquisitions.

**SELECTED ANNUAL INFORMATION**

	March 31, 2010	March 31, 2009	March 31, 2008
	\$	\$	\$
Revenue	1,220	7,394	-
Net Loss	(1,055,388)	(467,158)	(12,000)
Per share – basic and diluted	(0.06)	(0.05)	(0.012)
Total assets	2,538,288	2,508,481	898,530
Capital expenditures	91,573	881,144	-
Total long-term liabilities	-	-	-

**Income and Net Loss**

The Company is an "exploration stage" oil and gas company and does not have any properties that produce revenue. During the year, the Company's only income was interest on funds held on deposit. General and administrative expenses ("G&A") for the year increased significantly to \$994,797 from \$399,977 during 2009. This increase is primarily due to the expanding activities of the Company and the need for technical and financial personnel to undertake and oversee those activities. During the prior year, G&A was primarily due to costs related to the completion of the Company's Qualifying Transaction and the growth of the Company, most of which were incurred during the three months ended March 31, 2009. There were minimal costs incurred during the nine months of 2009, whereas during 2010, the Company was operational throughout the twelve months. During 2010, G&A was primarily due to travel costs, including sustenance, of \$188,897 (2009 - \$116,532) and professional fees of \$418,644 (2009- \$182,286) related to seeking and initiating potential international business opportunities. Office expenses of \$210,218 (2009 - \$18,810) related to the Calgary and London offices; and accounting, audit fees and advertising expenses of \$108,383.

**Total assets**

Total assets at year end were \$2,538,288 (2009 - \$2,508,481). The small increase was the result of the cash proceeds raised during the year, which were largely offset by the G&A expenditures.

**Capital expenditures**

Capital expenditures for the year ended March 31, 2010 decreased to \$91,573 compared to \$881,144 during the year ended March 31, 2009. During the prior year, the Company completed the Qualifying Transaction and thus incurred capital expenditures related to the Farmout and Participation Agreement to acquire the Tunisian interest. During the year ended March 31, 2010, the Company incurred an additional Finder's Fee (the "Fee") of \$77,560 related to the Qualifying Transaction; and \$14,013 in seismic spending on the Bazma permit. The Fee, which was pursuant to the Engagement Agreement and approved for payment during the current year, was made in connection the acquisition of the Sud Touzer exploration block in Tunisia. The Fee was paid to a current director and officer of the Company for his consulting efforts prior to his becoming a director or an officer of the Company, and the agreement to pay the Fee was established prior to his becoming a director and officer. The Fee is considered a component of the cost of the acquisition of the exploration block.

## **SELECTED QUARTERLY FINANCIAL INFORMATION**

	Three Months Ended							
	March 31, 2010	December 31, 2009	September 30 2009	June 30 2009	March 31, 2009	December 31, 2008	September 30, 2008	June 30, 2008
	\$	\$	\$	\$	\$	\$	\$	\$
Revenue	183	153	331	553	1,267	469	1,652	4,006
Net loss	397,607	252,099	209,148	196,534	298,305	62,948	26,463	79,442
Per share *	(0.02)	(0.02)	(0.01)	(0.01)	(0.03)	(0.008)	(0.004)	(0.012)

\*per share amounts are basic and diluted

G&A expenses have remained relatively consistent quarter over quarter during the year ended March 31, 2010. There was an increase during the fourth quarter compared to the first three quarters primarily due to auditing and accounting fees. The net loss substantially consists of G&A expenditures incurred to seek and initiate potential international business opportunities, primarily within Mongolia and Argentina. G&A expenses are comprised mainly of consulting services, legal fees, travel expenditures and office expenses.

Net loss for the three months ended March 31, 2010 increased to \$397,607 (\$0.02/share), compared to \$298,305 (\$0.03/share) for the three months ended March 31, 2009. During the fourth quarter ending March 31, 2010, the costs were primarily incurred to develop the Company through potential international business, whereas during the fourth quarter ending March 31, 2009, the costs incurred were primarily related to the Qualifying Transaction.

During the year ended March 31, 2010, there was a steady increase in the loss across each quarter reflecting the escalating activities of the Company throughout the year. During the fourth quarter ending March 31, 2009, there was a significant increase in net loss compared to the first three quarters primarily due to the costs incurred to complete the Qualifying Transaction and the expanding activities of the Company, which occurred during the fourth quarter.

## **LIQUIDITY AND CAPITAL RESOURCES**

The Company had a net working capital balance of \$1,290,302 at March 31, 2010 consisting primarily of cash on deposit of \$992,599 and accounts receivable of \$547,542, net of liabilities of \$261,566. Cash balances in excess of planned requirements were held in banks and highly liquid savings accounts. During the three months ended March 31, 2010, this excess cash generated \$183 in interest income.

On August 11, 2009, the Company completed a non-brokered private placement, issuing 657,615 common shares for total gross proceeds of \$170,980 (\$0.26 per share).

On December 18, 2009 and February 3, 2010, the Company completed a non-brokered private placement, issuing 1,260,000 units and 3,545,000, respectively, for total gross proceeds of \$816,850 (\$0.17 per unit). Each unit consists of one common share, one-half of one common share purchase warrant ("Year 1 Warrant") and one-half of one common share purchase warrant ("Year 2 Warrant"). Each whole Year 1 Warrant entitles the holder to purchase one additional common share of the Company at \$0.30 per share, exercisable for 1 year from the date of each respective placement. Each whole Year 2 Warrant entitles the holder to purchase one additional common share of the Company at \$0.40 per share, exercisable for 2 years from the date of each respective placement. If at any time following four months and one day from the grant of the Year 1 Warrants and Year 2 Warrants, the closing price of the Company's listed shares exceeds \$0.40 and \$0.50, respectively, 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 been an exploration stage oil and gas Company that engages principally in the acquisition, exploration and development of oil and gas properties. The Company continues to seek producing oil and gas properties but none has been purchased as of this date. Since none of the Company's properties currently produce revenue, the Company is currently unable to self finance all of its proposed operations. Current cash resources will not be sufficient to continue the exploration and development activities. These matters raise doubt about the ability of the Company to continue to meet its obligations as they become due. Continuing operations are dependent on the ability to obtain adequate new funding to finance existing operations, attain commercial production from its oil and gas properties, finding an industry partner to participate in exploration activities 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 repricing of credit risk and 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.

The Company and the operator have received expressions of interest from third parties to participate in an exploration program on some of the Tunisian permits, however there can be no assurance that an industry partner will be found or that additional equity financing will be available on reasonable terms, or at all.

#### **RELATED PARTY TRANSACTIONS**

Related party transactions are as follows:

- a) Aggregate consulting fees of \$178,326 (March 31, 2009 - \$21,740) were charged by directors and officers of the Company and recorded in the statement of loss, comprehensive loss and deficit.
- b) Aggregate legal fees of \$18,334 (March 31, 2009 - \$10,023) were charged by a director of the Company.
- c) An aggregate of \$14,013 (March 31, 2009 - \$921,212) was paid by the Company to the operator of the Tunisian oil and gas assets for capital spending. Of this amount \$14,013, has been capitalized to property, plant and equipment (2009 - \$490,000 was included in accounts receivable as a cash call receivable and the remaining \$431,212 was included in property plant and equipment). The Chief Executive Officer of the operator is a current director of the Company.
- d) Included in accounts payable and accrued liabilities at March 31, 2010 was \$23,284 (March 31, 2009 - \$nil) payable to related parties. These amounts are non-interest bearing and have no specific terms of repayment.

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

The Company's compensation arrangements with directors and officers are limited to the following, and are for services performed in the capacity as directors and officers:

- a) The President and CEO is paid annual consulting fees of \$64,800, issued in monthly instalments.
- b) The former Chairman received \$2,583 per month for services as counsel to the Company. This payment continued for the nine months ended in September 2009 and resumed for the months beginning March 2010.
- c) A corporation of which the CFO is shareholder is paid an hourly fee for accounting services provided to the Company. The CFO does not receive compensation for his services as such.

The following compensation was paid to directors and officers during the periods indicated:

	Three month period ended March 31, 2010 (\$)	Twelve month period ended March 31, 2010 (\$)
Andrea Cattaneo (President and CEO)*	16,200	64,800
James Grossman (Chairman & Counsel)	2,528	18,334
Stephen Austin (CFO)**	17,002	34,193

Notes:

\*In addition to the 64,800 annual compensation, \$26,700 and \$79,296 for the three and twelve months ended March 31, 2010 were paid to a company owned by the CEO to reimburse it for actual expenses of the Company's London office. These amounts were recorded as consulting fees paid during the period.

\*\*For the three and twelve months ended March 31, 2010, compensation of \$17,002 and \$34,193, respectively, were paid to a company of which the CFO is a shareholder as fees for accounting services provided to the Company. Mr. Austin does not receive any additional fees for acting as CFO.

## **COMMITMENTS**

The Company has entered into a farm-out and participation agreement giving it the right to participate in production sharing contracts 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 case by case 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.

## **ADOPTION OF NEW ACCOUNTING STANDARDS**

### **Goodwill and Intangible Assets – CICA Handbook Section 3064**

The CICA issued the new Handbook Section 3064, Goodwill and Intangible Assets, which replaced Section 3062, Goodwill and Other Intangible Assets. The new standard establishes revised standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. The new standard also provides guidance for the treatment of pre-production and start-up costs and requires that these costs be expensed as incurred. Upon adoption at April 1 2009, there has been no impact upon adoption in the consolidated financial statements.

### **Credit risk and fair value of financial assets and financial liabilities – EIC-173**

The CICA issued EIC-173 “Credit Risk and the Fair Value of Financial Assets and Financial Liabilities” in January 2009 which concludes that an entity’s own credit and the credit risk of the counterparty should be taken into account in determining the fair value of financial assets and financial liabilities, including derivative instruments. The adoption of this new standard has no material impact on the Company’s consolidated financial statements.

### **Financial Instruments – Disclosures – CICA Handbook Section 3862**

The CICA amended Handbook Section 3862 to include additional disclosure requirements about fair value measurement for financial instruments and liquidity risk disclosures. These amendments require a three-level hierarchy that reflects the significance of the inputs used in making the fair value measurement. Fair values of assets and liabilities 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. The amendments were adopted on March 31, 2010 and result in increased note disclosures for financial instruments.

## **FUTURE ACCOUNTING AND REPORTING CHANGES**

### **International Financial Reporting Standards (“IFRS”)**

In 2006, the Canadian Accounting Standards Board (“AcSB”) published a new strategic plan that will significantly affect financial reporting requirements for Canadian companies. The AcSB strategic plan outlines the convergence of Canadian GAAP with IFRS for publicly accountable enterprises over an expected five year transitional period. In February 2008 the AcSB announced that 2011 is the changeover date for publicly-listed companies to use IFRS, replacing Canada’s own GAAP. The date is for interim and annual consolidated financial statements relating to fiscal years beginning on or after January 1, 2011. The transition date of January 1, 2011 will require the restatement for comparative purposes of amounts reported by the Company for the year ended December 31, 2010. The Company is currently assessing the impact of the conversion from Canadian GAAP to IFRS on its results of operations, financial position, and disclosures and is in the process of developing an IFRS changeover plan. The plan will include an assessment of differences between Canadian GAAP and IFRS, accounting policy choices under IFRS, internal controls over financial reporting, potential system changes required, potential corporate governance changes and effects on internal controls and processes including resources and training required for

employees. Initial activities include: training sessions for key financial reporting and operation staff; updating the accounting software to include a module to track assets by cash generating unit ("CGU"); and acquisition of written standards and examples of IFRS disclosure. The Company will provide disclosures of the key elements of its plan and progress on the project as the information becomes available during the transition period. The Company does not anticipate that the adoption of IFRS to be a material project given the early stage nature and the current lack of complexity of the Company, and we do not expect that the adoption of IFRS to materially impact the Company's reporting of the underlying cash flows and operating performance.

Below is a summary of significant standards under IFRS that may impact the financial statements of the Company. It is intended to highlight those areas the Company believes to be the most significant. The future impacts of IFRS will also depend on the particular circumstances prevailing in future years. The differences as described below, which include, but are not limited to, those existing based on Canadian GAAP and IFRS today.

IFRS 1 - First-Time Adoption of International Financial Reporting Standards provides the framework for the first time adoption of IFRS and specifies in general that an entity will apply IFRS principles retrospectively. IFRS 1 also specifies that the adjustments that arise on retrospective conversion to IFRS should be recognized directly in retained earnings. Certain optional exemptions and mandatory exceptions to retrospective application are provided under IFRS 1. Analysis of the various accounting policy choices is ongoing and will be undertaken in 2010.

Under IFRS, the accounting for activities of the extractive industry (including oil and gas exploration) is governed by IFRS 6 (for the exploration and evaluation phase) and IAS 16 (for development and production phase). Given the early stage of the Company, the transition is not expected to significantly impact the Company.

Under IFRS, the underlying asset retirement obligation ("ARO") liability may vary from Canadian GAAP given potential variances in the rates used to present value such liabilities. In addition, the unwinding of any present value discount generally will be reflected as a cost of financing under IFRS versus accretion expense under Canadian GAAP. Such differences are not anticipated to materially impact the Company upon transition as currently there is no obligation recorded.

Under IFRS, the asset impairment test is carried out by comparing the asset's carrying amount with its recoverable amount – being the higher of the asset's or CGU fair value less costs to sell and its value in use (generally, using discounted cash flows), with the excess of carrying value being recorded as an impairment loss. The sole use of discounted cash flows may result in more frequent write-downs than under Canadian GAAP.

Under IAS 37 – Provisions, Contingent Liabilities and Contingent Assets - the threshold for recognition of these items are generally lower under IFRS than under Canadian GAAP. Accordingly, there may be some contingent liabilities that may require recognition that otherwise may not have been required under GAAP.

The Company has not determined the full accounting effects of adopting IFRS, since key accounting policy alternatives and implementation decisions are currently being evaluated. As the review of accounting policies is completed, appropriate changes to ensure the integrity of internal control over financial reporting and disclosure controls and procedures

will be made. Changes in accounting policies may result in additional controls or procedures being required to address first time adoption issues and ongoing IFRS requirements.

### **Business Combinations, Consolidated Financial Statements and Non-controlling Interest**

In January 2009, the CICA issued CICA Handbook Sections 1582: Business Combinations, Section 1601: Consolidations, and Section 1602: Non-controlling Interest. These sections replace the former CICA Handbook Section 1581: Business Combinations and Section 1600: Consolidated Financial Statements and establish a new section for accounting for a non-controlling interest in a subsidiary. CICA Handbook Section 1582 establishes standards for the accounting for a business combination, and states that all assets and liabilities of an acquired business will be recorded at fair value. Obligations for contingent considerations and contingencies will also be recorded at fair value at the acquisition date. The standard also states that acquisition-related costs will be expensed as incurred and that restructuring charges will be expensed in the periods after the acquisition date. It provides the Canadian equivalent to IFRS 3, Business Combinations (January 2008). The section applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2011.

CICA Handbook Section 1601 establishes standards for the preparation of consolidated financial statements.

CICA Handbook Section 1602 establishes standards for accounting for a non-controlling interest in a subsidiary in the preparation of consolidated financial statements subsequent to a business combination. It is equivalent to the corresponding provisions of IFRS IAS 27, Consolidated and Separate Financial Statements (January 2008).

CICA Handbook Sections 1601 and 1602 apply to interim and annual consolidated financial statements relating to fiscal years beginning on or after January 1, 2011. Earlier adoption of these sections is permitted as of the beginning of a fiscal year.

All three sections must be adopted concurrently.

### **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.

## **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 and accounts payable and accrued liabilities. 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.

As at March 31, 2010 the Company's receivables consisted of \$490,000 (2009 - \$490,000) from joint venture partners, \$39,444 (2009 - \$24,981) of good and service taxes from the Government of Canada, and \$18,098 (2009 -\$nil) of other trade receivables.

Virtually all of the Company's accounts receivable is with the operator of the Tunsian permits, thus exposing the Company to concentration risk. Management believes the risk is mitigated by the size and reputation of the companies to which they extend credit. The Company's maximum credit risk exposure is limited to the carrying value of its accounts receivable of \$547,542 and cash and cash equivalents of \$992,599.

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. The international nature of the Company's operations will result in exposure to fluctuations in commodity prices as the Company continues to develop.

**(i) 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 March 31, 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.

As at March 31, 2010, the Company's financial liabilities totalled \$261,566, and are comprised of accounts payable and accrued liabilities and amounts due to related parties. As at March 31, 2010, the Company's cash and cash equivalent balance is sufficient to meet the Company's obligations. \$23,284 of the financial liabilities are owed to related individuals and these amounts are subject to the forbearance of the related individuals.

The Company's financial liabilities at March 31, 2010 are aged as follows:

Current (less than 90 days)	\$	211,004
Past due (more than 90 days)		50,562
Total	\$	<u>261,566</u>

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 year would not have a significant impact on the Company's earnings for the year.

**SUBSEQUENT EVENTS**

The Company entered into the following transactions subsequent to March 31, 2010:

- a) On June 4, 2010, the Company announced that it has entered into an acquisition agreement (the "Agreement") with Oren Oil ASA ("Oren"). Oren has represented that through the acquisition, the Company will be introduced to opportunities to acquire oil and gas leases within the republic of Russia, which will be assessed through due diligence procedures. Under the Agreement, the Company will make an offer (the "Offer") to the shareholders of Oren to purchase all of their shares of Oren ("Oren Shares") on the basis of one common share in the capital of the Company ("Canoel Share") for every 1,000 Oren Shares tendered under the Offer. The Company paid a non-refundable deposit of 20,000 Norwegian Kroner ("NOK"), approximately CAD \$3,000, upon execution of the Agreement.

In connection with the Offer, the Company intends to offer to all of the Oren shareholders the opportunity to participate in a private placement of Canoel Shares (the "Private Placement") for total gross proceeds of a minimum of NOK 5,000,000 (approximately CAD \$800,000). The price per Canoel Share for the Private Placement will be set at a later date and announced in the future.

Completion of the foregoing transactions is subject to approval by the Exchange, and is conditional upon: (i) the receipt by the Company of binding commitments from at least 50.01% of the Oren Shareholders to accept the Offer; and (ii) binding commitments from Oren Shareholders to subscribe for a minimum of NOK 5,000,000 (approximately CAD

\$800,000) in Canoel Shares pursuant to the Private Placement. Accordingly, this offer is subject to the above requirements and there can be no certainty that this agreement with the Oren shareholders will be completed.

- b) On February 12, 2009, the Company signed a Share Purchase Agreement (the "Agreement") with a U.S. based company for the purchase of two adjacent oil producing properties in Argentina. The transaction was previously announced during September 2009 with the signing of a Memorandum of Understanding. Upon completion of the due diligence procedures subsequent to March 31, 2010, certain conditions were not met and the Agreement was terminated.

### **SHARES AND CONVERTIBLE, EXERCISABLE AND EXCHANGEABLE SECURITIES**

The Company is authorized to issue an unlimited number of common shares and an unlimited number of preferred shares issuable in series. As of the date hereof, the Company's issued share capital and the outstanding securities that are convertible into or exercisable or exchangeable for any voting or equity securities of the Company is as follows

Common Shares	21,618,715
Preferred Shares	Nil
Warrants	14,308,361
Stock Options	1,565,000

#### **Notes:**

1. 9,221,600 of the Warrants entitle the holder to acquire one additional common share at \$0.40 per share until November 21, 2010 (subject to acceleration in certain events). 177,730 of the Warrants entitle the holder to acquire one common share at \$0.25 per share until November 21, 2010 (subject to acceleration in certain events). 59,031 of the Warrants entitle the holder to acquire one common share at \$0.26 per share until August 11, 2011. 675,000 of the Warrants entitle the holder to acquire one common share at \$0.30 per share until December 18, 2010. 630,000 of the Warrants entitle the holder to acquire one common share at \$0.40 per share until December 18, 2011. 1,772,500 of the Warrants entitle the holder to acquire one common share at \$0.30 per share until February 3, 2011. 1,772,500 of the Warrants entitle the holder to acquire one common share at \$0.40 per share until February 3, 2012.
2. 125,000 of the Stock Options entitle the holders to acquire an equal number of common shares at \$0.20 per share until April 8, 2013. 950,000 of the Stock Options entitle the holders to acquire an equal number of common shares at \$0.10 per share, which expire between March 13, 2014 and March 20, 2014. 145,000 of the Stock Options entitle the holders to acquire an equal number of common shares at \$0.23 per share until September 11, 2014. 105,000 of the Stock Options entitle the holders to acquire an equal number of common shares at \$0.125 per share until September 25, 2014. 70,000 of the Stock Options entitle the holders to acquire an equal number of common shares at \$0.15 per share until October 27, 2014. 170,000 of the Stock Options entitle the holders to acquire an equal number of common shares at \$0.17 per share until February 8, 2015. In each case, the expiration is subject to earlier termination in certain events.

### **OUTLOOK**

The Company plans to continue to focus on both international oil and natural gas exploration opportunities as well as continuing its search for smaller producing assets in North America, Italy and Argentina. Management intends to focus its efforts toward

acquiring large exploration permits, which offer high exploration potential and the opportunity to act as operator at least for the initial exploration period; and on acquiring the producing assets in North America and internationally.

In Tunisia, the Company intends to conduct a two phase, success based, initial exploration program. The first phase will involve seismic acquisition and interpretation plus the drilling, testing and potential completion of one well on each of the exploration blocks. The second phase will involve the drilling, testing and potential completion of additional wells if and when the Company determines it is warranted.

The Company's plans for 2011 include:

- (a) **Bazma Permit:** Drilling of an initial well is expected in the fall of 2010. Drilling is subject to the Company obtaining additional financing or finding an industry partner and rig availability. Exercise the option to increase working interest beyond 11%.
- (b) **Jorf Permit:** Drilling one initial well is expected to occur in 2011 on a target identified by interpretation of approximately 200 kilometres of new 2-D seismic on the northern portion of the block.
- (c) **Sud Tozeur Permit:** Continue the geophysical interpretation of seismic data. Drilling is likely to commence in 2011.
- (d) **Mongolia:** Continue with legal proceedings, with the intention to complete the acquisition or to obtain compensation expenses incurred.
- (e) **Argentina:** Continue with the due diligence period and efforts to obtain the required financing for the acquisition of the companies controlling the two Argentina properties.
- (f) **Norway:** complete the acquisition of Oren and then work on the benefit of having a large institutional shareholders list.

#### **OTHER**

Additional information related to the Company's business and activities can be found on SEDAR at [www.sedar.com](http://www.sedar.com)

# **Canoel International Energy Ltd.**

**(A Development Stage Company)**

Consolidated Financial Statements  
March 31, 2010 and 2009  
(expressed in Canadian dollars)



## **Management's Responsibility for Financial Reporting**

The accompanying consolidated financial statements of Canoe International Energy Ltd. (the "Company") have been prepared by and are the responsibility of the management of the Company. The consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles and reflect management's best estimates and judgment based on currently available information.

The Audit Committee of the Board of Directors meets periodically with management and the independent auditors to review the scope and results of the annual audit, and to review the consolidated financial statements and related financial reporting matters prior to submitting the consolidated financial statements to the Board for approval.

The Company's independent auditors, KPMG LLP, who are appointed by the shareholders, conducted an audit in accordance with Canadian generally accepted auditing standards. Their report outlines the scope of their audit and gives their opinion on the consolidated financial statements.

Management has developed and maintains a system of internal controls to provide reasonable assurance that the Company's assets are safeguarded, transactions are authorized and financial information is accurate and reliable.

(Signed) "*Andrea Cattaneo*"  
President and Chief Executive Officer

(Signed) "*Stephen Austin*"  
Chief Financial Officer

June 15, 2010  
Calgary, Alberta



**KPMG** LLP  
**Chartered Accountants**  
2700-205 5 Avenue SW  
Calgary AB T2P 4B9

Telephone (403) 691-8000  
Telefax (403) 691-8008  
Internet [www.kpmg.ca](http://www.kpmg.ca)

## **AUDITORS' REPORT TO THE SHAREHOLDERS**

We have audited the consolidated balance sheets of Canoe International Energy Ltd. (the "Company") as at March 31, 2010 and 2009 and the consolidated statements of loss, comprehensive loss and deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at March 31, 2010 and 2009 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

A handwritten signature in black ink that reads 'KPMG LLP.' The signature is written in a cursive, stylized font.

Chartered Accountants  
Calgary, Canada  
June 15, 2010

# Canoel International Energy Ltd.

## (a Development Stage Company)

Consolidated Balance Sheets

As at March 31, 2010 and 2009

(Expressed in Canadian dollars)

	2010	2009
	\$	\$
<b>Assets</b>		
<b>Current Assets</b>		
Cash and cash equivalents	992,599	1,094,065
Accounts receivable	547,542	514,981
Prepaid expenditures	11,727	4,588
	<b>1,551,868</b>	1,613,634
Property, plant and equipment (note 6)	<b>986,420</b>	894,847
	<b>2,538,288</b>	2,508,481
<b>Liabilities</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities	261,566	121,627
<b>Shareholders' equity</b>		
Share capital (note 8b)	3,136,450	2,331,344
Warrants (note 8c)	479,283	382,567
Contributed surplus (note 8e)	195,535	152,101
Deficit	(1,534,546)	(479,158)
	<b>2,276,722</b>	2,386,854
	<b>2,538,288</b>	2,508,481
<b>Going concern</b> (note 2)		
<b>Commitments</b> (note 12)		
<b>Subsequent events</b> (note 13)		

### Approved by the Board of Directors

(Signed) "Emanuel Olympitis"  
Director

(Signed) "Andrea Cattaneo"  
Director

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

# Canoel International Energy Ltd.

## (a Development Stage Company)

Consolidated Statements of Loss, Comprehensive Loss and Deficit

For the years ended March 31, 2010 and March 31, 2009

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(Expressed in Canadian dollars)

	2010	2009
	\$	\$
<b>Revenue</b>		
Interest income	1,220	7,394
<b>Expenses</b>		
General and administrative	994,797	399,977
Foreign exchange	18,377	-
Stock-based compensation (note 8d)	43,434	74,575
	<b>1,056,608</b>	<b>474,552</b>
<b>Net loss and comprehensive loss</b>	<b>(1,055,388)</b>	<b>(467,158)</b>
<b>Deficit, beginning of year</b>	<b>(479,158)</b>	<b>(12,000)</b>
<b>Deficit, end of year</b>	<b>(1,534,546)</b>	<b>(479,158)</b>
<b>Basic and diluted loss per share</b> (note 8f)	<b>(0.06)</b>	<b>(0.05)</b>
<b>Weighted average shares outstanding during the year - basic and diluted</b>	<b>17,173,432</b>	<b>9,864,405</b>

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

# Canoel International Energy Ltd.

## (a Development Stage Company)

Consolidated Statement of Cash Flows

For the years ended March 31, 2010 and March 31, 2009

(Expressed in Canadian dollars)

	2010 \$	2009 \$
<b>Cash flows used in operating activities:</b>		
Net loss for the year	(1,055,388)	(467,158)
Items not affecting cash:		
Stock-based compensation	43,434	74,575
	(1,011,954)	(392,583)
Changes in non-cash working capital	100,239	12,848
	(911,715)	(379,735)
<b>Cash flows used in investing activities</b>		
Investment in property, plant and equipment	(91,573)	(881,144)
Change in non-cash working capital	-	(490,000)
	(91,573)	(1,371,144)
<b>Cash flows provided by financing activities</b>		
Proceeds from issuance of common shares, net of issue costs	805,106	1,950,165
Proceeds from issuance of warrants	96,716	-
	901,822	1,950,165
<b>Change in cash and cash equivalents</b>	(101,466)	199,286
<b>Cash and cash equivalents, beginning of year</b>	1,094,065	894,779
<b>Cash and cash equivalents, end of year</b>	992,599	1,094,065
<b>Supplemental cash flow disclosure</b>		
Interest received	1,220	7,394

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

# **Canoel International Energy Ltd.**

## **(a Development Stage Company)**

Notes to the Consolidated Financial Statements

**For the years ended March 31, 2010 and March 31, 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 was listed on the TSX Venture Exchange Inc ("TSXV") as a capital pool company on April 10, 2008. On November 21, 2008, the Company completed a Short Form Offering to the public and a non-brokered Private Placement, which allowed the Company to complete its Qualifying Transaction in accordance with the applicable policies of the TSXV on December 8, 2008. The Company is a Tier 2 listed Issuer on the TSXV. The Company is a development stage entity as defined by the Canadian Institute of Chartered Accountants ("CICA") Accounting Guideline 11.

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 March 31, 2010, IPRP exists solely as a shell with no assets and liabilities.

### **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 March 31, 2010, the Company had not yet achieved profitable operations, has accumulated a deficit of \$1,534,546 (2009 - \$479,158) since its inception, and expects to incur further losses in the development of its business, which is typical of an oil and gas exploration company in the developmental stage. Current oil and gas activities are in the exploration stage and have not identified oil and gas reserves. Current cash resources will not be sufficient to continue the exploration and development activities. These matters raise doubt about the ability of the Company to continue to meet its obligations as they become due. Continuing

# **Canoel International Energy Ltd.**

## **(a Development Stage Company)**

Notes to the Consolidated Financial Statements

**For the years ended March 31, 2010 and March 31, 2009**

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(Expressed in Canadian dollars)

operations are dependent on the ability to obtain adequate funding to finance existing operations, attain commercial production from its 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 repricing of credit risk and 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**

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("Canadian GAAP") and reflect the following significant accounting policies:

#### **Measurement uncertainty**

The Company calculates depreciation, depletion and accretion expense and assesses impairment in long-lived assets and unproven properties in the development stage using management estimates of oil and gas reserves remaining in oil and gas properties, commodity prices and capital costs required to develop those reserves. Estimates of volumes and the related future cash flows are subject to measurement uncertainty. Such reserve estimates are subject to change as additional information becomes available.

Numerous assumptions and judgments are required in the fair value calculation of the asset retirement obligation ("ARO") including the ultimate settlement amounts, inflation factors, credit adjusted discount rates, timing of settlement, and changes in the legal, regulatory, environment and political environments. To the extent future revisions to these assumptions impact the fair value of any existing ARO liability, a corresponding adjustment is made to the oil and gas property.

The Company uses the Black-Scholes option valuation model to value the stock options granted. The Black-Scholes model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable and takes into account on the date of grant: the exercise price and expected life of the option; the price of the underlying security; the expected volatility and dividends (if any) on the underlying security; and the risk-free interest rate. The model requires management to make estimates which are subjective and may not be

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representative of actual results. Changes in assumptions can materially affect estimates of fair values.

Future income taxes are based on estimates as to the timing of the reversal of temporary differences and tax rates currently substantively enacted.

By their nature, these estimates are subject to measurement uncertainty, and the impact of differences between actual and estimated amounts on the consolidated financial statements of future periods could be material.

### **Cash and cash equivalents**

Cash and cash equivalents include cash and highly liquid investments held in the form of high quality commercial paper, treasury bills, bankers' acceptances, money market investments and certificates of deposit with investment terms that are less than three months at the time of acquisition. These investments are stated at fair value, which approximates cost plus accrued interest.

### **Joint interests**

The Company's oil and gas operations are conducted jointly with other parties and accordingly, the consolidated financial statements reflect only the Company's proportionate interest in these assets and operations.

### **Property, plant and equipment**

#### **(i) Petroleum and natural gas properties**

The Company follows the full cost method of accounting whereby all costs related to the acquisition are initially capitalized on a country by country cost centre basis. Costs capitalized include land acquisition costs, geological and geophysical expenditures, lease rentals, costs of drilling productive and non-productive wells, together with overhead and interest directly related to exploration and development activities, and lease and well equipment. As the Company's oil and gas activities are in the development stage, any incidental revenues are netted against costs until commercial production begins. These costs are evaluated in each reporting period to determine if the costs recorded



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are recoverable. When commercial production begins, these capitalized costs will be depleted following the unit-of-production method based on proved reserves.

Gains or losses are not recognized upon disposition of petroleum and natural gas properties unless such a disposition would alter the rate of depletion and depreciation by more than 20%.

(ii) Depletion

Costs capitalized are depleted and amortized on a cost centre basis using the unit-of-production method based on estimated proved petroleum and natural gas reserves before royalties as determined by independent engineers. For purposes of this calculation, petroleum and natural gas reserves before royalties are converted to a common unit of measure on the basis of their relative energy content where one barrel of oil or liquids equals six thousand cubic feet of gas.

In determining its depletion base, the Company includes estimated future capital costs to be incurred in developing proved reserves and excludes the cost of significant unproved properties until it is determined whether proved reserves are attributable to the unproved properties or impairment has occurred. Unproved properties are evaluated separately for impairment based on management's assessment of future drilling.

During the year there has been no production, and as such a depletion expense was not recognized.

(iii) Ceiling test

Under the full cost method of accounting, a limit is placed on the carrying amount of petroleum and natural gas properties. A ceiling test is performed on a country by country cost centre basis to recognize and measure impairment, if any.

The carrying value of oil and gas properties may not reflect their fair value. In particular, the future value of the oil and gas properties depends on the start-up of commercial production, the ability of the Company to obtain adequate financing and the future profitability of the oil and gas properties. A limit is placed on the carrying value of the net capitalized assets in order to test impairment. Impairment is recognized if the carrying amount of petroleum and natural gas properties, less the cost of unproved properties not subject to depletion (the "adjusted carrying amount"), exceeds the

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estimated undiscounted future cash flows from the Company's proved reserves. The future cash flows are based on forecast prices and costs, as provided by an independent third party. If recognized, the magnitude of the impairment, if any, is measured by comparing the adjusted carrying amount to the estimated, discounted future cash flows of the Company's proved plus probable reserves. The cash flows are discounted at a risk-free interest rate. Any recognized impairment is recorded as additional depletion and amortization expense.

(iv) Other assets

Other assets are carried at cost and amortized over the estimated useful lives of the assets at various rates per annum calculated on a declining balance basis. Amortization is charged at half rates in the year of acquisition.

### **Asset retirement obligations**

The Company recognizes the fair value of an ARO in the period in which a well or related asset is drilled, constructed or acquired and when a reasonable estimate of the fair value can be made. The fair value of the estimated ARO is recorded as a long-term liability, and equals the present value of estimated future cash flows, discounted using a risk-free interest rate adjusted for the Company's credit standing. The liability accretes until the date of expected settlement of the retirement obligations or the asset is sold and is recorded as an accretion expense. The associated asset retirement costs are capitalized as part of the carrying value of the related assets. The capitalized amount is amortized to earnings on a basis consistent with depreciation and depletion of the underlying assets. Actual restoration expenditures are charged to the accumulated obligation as incurred.

On a periodic basis, management will review these estimates and if changes to the estimate are required, these changes will be applied on a prospective basis, and will result in an increase or decrease to the ARO.

During the year the Company did not record an ARO liability as environmental disturbances which would result in a future restoration liability had not occurred.

### **Income taxes**

The Company follows the asset and liability method of accounting for income taxes. Under this method, income tax assets and liabilities are recognized for the estimated tax consequences attributable to differences between the amounts reported in the financial statements and their

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respective tax bases, using income tax rate that are substantively enacted and expected to apply in the periods when the temporary differences are expected to reverse. The effect of a change in rates on future income tax assets and liabilities is recognized in the period that the change occurs. A valuation allowance is recorded against any future tax assets, if it is more likely than not that the asset will not be realized.

### **Revenue recognition**

Revenue from the sale of petroleum and natural gas is recorded on a gross basis when title passes to an external party and is recognized based on volumes delivered to customers at contractual delivery points and rates and when the significant risks and rewards of ownership have been transferred to the buyer and collectability is reasonably assured.

### **Stock-based compensation**

Under the fair value method, compensation cost attributable to all stock options granted are measured at fair value at the date of grant and expensed over the vesting period with a corresponding increase to contributed surplus. Upon the exercise of the stock options, the consideration received together with the amount previously recognized in contributed surplus is recorded as an increase to share capital and the contributed surplus balance is reduced.

The Company has not incorporated an estimated forfeiture rate for stock options that will not vest, rather, the Company accounts for actual forfeitures as they occur.

### **Per share amounts**

Basic per share amounts are calculated using the weighted average number of common shares outstanding during the period. Diluted per share amounts reflect the potential dilution that could occur if securities or other contracts to issue common shares were exercised or converted to common shares. The treasury stock method is used to determine the dilutive effect of stock options and other dilutive instruments. Under the treasury stock method, only options for which the exercise price is less than the market value impact the dilution calculations.

### **Foreign currency translation**

Transactions in foreign currencies are translated to Canadian dollars at the rates in effect on the transaction date. Exchange gains or losses arising on translation or settlement of foreign currency denominated monetary items are charged to earnings in the period they arise.

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### **Financial instruments**

Financial instruments are classified into one of the following five categories: held-for-trading, held-to-maturity investments, loans and receivables, available for sale financial assets or other financial liabilities. All financial instruments and derivatives are measured on the balance sheet date at fair value upon initial recognition except for certain related party transactions. Subsequent measurement depends on the initial classification of the instrument. Held-for-trading financial assets and liabilities are measured at fair value, with changes in fair value recognized in net earnings (loss). Available for sale financial instruments are measured at fair value, with changes in fair value recorded in OCI until the instrument is derecognized or impaired. Loans and receivables, held-to-maturity investments and other financial liabilities are recognized at fair value and subsequently measured at amortized cost.

The Company has designated its cash and cash equivalents as held for trading, which are measured at fair value. Accounts receivable are designated as loans and receivables, which are measured at amortized cost. Accounts payable and accrued liabilities are designated as other financial liabilities, which are measured at amortized cost.

The Company expenses all transaction costs as incurred in relation to the acquisition of a financial assets or liability.

## **4 Adoption of new accounting standards**

### **Goodwill and Intangible Assets – CICA Handbook Section 3064**

The CICA issued the new Handbook Section 3064, Goodwill and Intangible Assets, which replaced Section 3062, Goodwill and Other Intangible Assets. The new standard establishes revised standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. The new standard also provides guidance for the treatment of pre-production and start-up costs and requires that these costs be expensed as incurred. Upon adoption at April 1, 2009, there has been no impact to the consolidated financial statements.

### **Credit risk and fair value of financial assets and financial liabilities – EIC-173**

The CICA issued EIC-173 “Credit Risk and the Fair Value of Financial Assets and Financial Liabilities” in January 2009 which concludes that an entity’s own credit and the credit risk of the counterparty should be taken into account in determining the fair value of financial assets and financial liabilities, including derivative instruments. The adoption of this new standard has no material impact on the Company’s consolidated financial statements.

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### **Financial Instruments – Disclosures – CICA Handbook Section 3862**

The CICA amended Handbook Section 3862 to include additional disclosure requirements about fair value measurement for financial instruments and liquidity risk disclosures. These amendments require a three-level hierarchy that reflects the significance of the inputs used in making the fair value measurement. Fair values of assets and liabilities 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. The amendments were adopted on March 31, 2010 and result in increased note disclosures for financial instruments.

## **5 Future accounting and reporting changes**

### **Business Combinations, Consolidated Financial Statements and Non-controlling Interest**

In January 2009, the CICA issued CICA Handbook Sections 1582: Business Combinations, Section 1601: Consolidations, and Section 1602: Non-controlling Interest. These sections replace the former CICA Handbook Section 1581: Business Combinations and Section 1600: Consolidated Financial Statements and establish a new section for accounting for a non-controlling interest in a subsidiary. CICA Handbook Section 1582 establishes standards for the accounting for a business combination, and states that all assets and liabilities of an acquired business will be recorded at fair value. Obligations for contingent considerations and contingencies will also be recorded at fair value at the acquisition date. The standard also states that acquisition-related costs will be expensed as incurred and that restructuring charges will be expensed in the periods after the acquisition date. It provides the Canadian equivalent to IFRS 3, Business Combinations (January 2008). The section applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2011.

CICA Handbook Section 1601 establishes standards for the preparation of consolidated financial statements.

CICA Handbook Section 1602 establishes standards for accounting for a non-controlling interest in a subsidiary in the preparation of consolidated financial statements subsequent to a business combination. It is equivalent to the corresponding provisions of IFRS IAS 27, Consolidated and Separate Financial Statements (January 2008).

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CICA Handbook Sections 1601 and 1602 apply to interim and annual consolidated financial statements relating to fiscal years beginning on or after January 1, 2011. Earlier adoption of these sections is permitted as of the beginning of a fiscal year.

All three sections must be adopted concurrently.

### 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.

## 6 Property, plant and equipment

			2010
	Cost	Accumulated depletion & depreciation	Net book value
	\$	\$	\$
Oil and gas properties	986,420	-	986,420
	986,420	-	986,420

			2009
	Cost	Accumulated depletion & depreciation	Net book value
	\$	\$	\$
Oil and gas properties	894,847	-	894,847
	894,847	-	894,847

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. At March 31, 2010 there has been no

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production and accordingly there has been no depletion or depreciation recorded against the assets.

During the year ended March 31, 2010, the Company capitalized \$77,560 in a Finder's Fee payment (the "Fee"), pursuant to the Engagement Agreement. This Fee, which was approved for payment during the current year, was made in connection with the acquisition of the Sud Touzer exploration block in Tunisia. The Fee was paid to a current director and officer of the Company for his consulting efforts prior to his becoming a director or an officer of the Company, and the agreement to pay the Fee was established prior to his becoming a director and officer. The Fee is considered a component of the cost of the acquisition of the exploration block.

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, subsequent to the receipt of an AFE by the Company, another party commits to earn an interest prior to the Company exercising their option, then the option will be decreased 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.

## 7 Future Income Taxes

a) The significant components of the Company's future tax assets and liabilities are as follows:

	2010	2009
	\$	\$
Property, plant and equipment	(44,795)	(22,371)
Non-capital loss	465,884	154,899
Share issuance costs	118,069	118,362
Valuation allowance	(539,158)	(250,890)
	-	-

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- b) The provision for income taxes is different from the amount computed by applying the combined Federal and Provincial tax rates to the loss before income taxes. The reasons for the difference follows:

	2010	2009
	\$	\$
Expected income tax provision (reduction) at 28.75% (2009 – 30%)	(303,400)	(140,147)
Non-deductible items	15,500	26,592
Change in tax rate and other	37,500	25,068
Valuation allowance	250,400	88,487
	-	-

- c) The Company has non-capital losses carried forward totaling \$1,863,537, which expire as follows:

2022	\$ 33,232
2028	586,365
2029	1,243,940
<b>Total</b>	<b>1,863,537</b>



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### 8 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, 2008 (i)</b>	6,580,000	806,186
Short-form offering (ii)	4,373,600	1,093,400
Non-brokered private placement (ii)	4,848,000	1,212,000
Fair value of share purchase warrants (ii)	-	(368,864)
Share issue costs	-	(411,378)
<b>Outstanding, March 31, 2009</b>	<b>15,801,600</b>	<b>2,331,344</b>
Non-brokered private placement (iii)	657,615	170,980
Non-brokered private placement (iv)	4,805,000	816,850
Fair value of share purchase warrants (iv)	-	(91,115)
Share issue costs (iii and iv)	-	(145,454)
Common shares issued to Finder (iv)	354,500	53,845
<b>Outstanding, March 31, 2010</b>	<b>21,618,715</b>	<b>3,136,450</b>

- (i) During the year ended March 31, 2008, the Company closed a private placement to issue 3,080,000 common shares at a price of \$0.10 per share for gross proceeds of \$308,000. At the time of issuance, 3,080,000 common shares were held in escrow pursuant to the requirements of the TSXV. Subsequent to the completion of the Qualifying Transaction on December 8, 2008, 10% of the common shares were released from escrow. As at March 31, 2010, there were 1,872,000 common shares remaining in escrow with the balance to be released at 15% of the original on each of the 6<sup>th</sup>, 12<sup>th</sup>, 18<sup>th</sup>, 24<sup>th</sup>, 30<sup>th</sup>, and 36<sup>th</sup> month following the Qualifying Transaction.

The Company also completed its initial public offering raising gross proceeds of \$700,000, pursuant to a Prospectus dated March 5, 2008. A total of 3,500,000 common shares in the capital of the Company were subscribed for at a price of \$0.20 per common share.

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- (ii) On November 21, 2008, the Company completed a short-form offering ("SFO") and the non-brokered private placement issuing 9,221,600 units for total proceeds of \$2,305,400 (\$0.25 per unit). Each unit consists of one common share and one share purchase warrant. Each share purchase warrant is exercisable into one common share at a price of \$0.40 per share, exercisable for 2 years. There is a forced exercise provision following the expiry of four months plus one day from the date of Closing ("Special Hold Period"). If at any time after the Special Hold Period the closing price of the Company's listed shares exceeds \$0.60 for 15 consecutive trading days the exercise period for the share purchase warrant will be shortened to a period of 30 days following notice. The Company has allocated \$368,864 of the unit value to the warrant.
- (iii) On August 11, 2009 the Company completed a non-brokered private placement, issuing 657,615 common shares for total proceeds of \$170,980 (\$0.26 per share). The Company incurred share issue costs to an unrelated Finder of \$37,475 related to this private placement.
- (iv) On December 18, 2009 and February 3, 2010, the Company completed a non-brokered private placement, issuing 1,260,000 units and 3,545,000, respectively, for total proceeds of \$816,850 (\$0.17 per unit). Each unit consists of one common share, one-half of one common share purchase warrant ("Year 1 Warrant") and one-half of one common share purchase warrant ("Year 2 Warrant"). Each whole Year 1 Warrant entitles the holder to purchase one additional common share of the Company at \$0.30 per share, exercisable for 1 year from the date of each respective placement. Each whole Year 2 Warrant entitles the holder to purchase one additional common share of the Company at \$0.40 per share, exercisable for 2 years from the date of each respective placement. If at any time following four months and one day from the grant of the Year 1 Warrants and Year 2 Warrants, the closing price of the Company's listed shares exceeds \$0.40 and \$0.50, respectively, 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 \$91,115 of the unit value to warrants.

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The fair value of the share purchase warrants 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:

	2010	2009
Risk-free rate	1.22%	1.86%
Expected life	1.5 years	2 years
Expected volatility	60%	54%
Fair value per warrant	\$0.02	\$0.04

The Company incurred share issue costs to an unrelated Finder of \$107,979 related to this placement. This includes the value of 354,500 common shares issued to Finders.

### c) Warrants

The schedule of warrant activity for the year ended March 31, 2010 is as follows:

	Number of warrants issued and exercisable	Amount \$	Weighted average exercise price \$
<b>Balance, March 31, 2008</b>	-	-	-
Share purchase warrants (note 8b(ii))	9,221,600	368,864	0.40
Engagement Agreement share purchase warrants	177,730	13,703	0.25
<b>Balance, March 31, 2009</b>	9,399,330	382,567	0.39
Share purchase warrants (8b(iv))	4,805,000	91,115	0.35
Finders' share purchase warrants (i ), (ii)	104,031	5,601	0.28
<b>Balance, March 31, 2010</b>	14,308,361	479,283	0.38

- (i) In relation to the non-brokered private placement on August 11, 2009, Finder's Warrants totaling 59,031 were issued to two unrelated Finder's for introducing to the Company subscribers of the private placement. Each Finder's Warrant is exercisable for one common share at a price of \$0.26 per share, exercisable for 2 years.
- (ii) In relation to the non-brokered private placement on December 18, 2009, Finder's Warrants totaling 45,000 were issued to an unrelated Finder for introducing to the Company subscribers to the private placement. Each Finder's Warrant is exercisable for one common share at a price of \$0.30 per share, exercisable for 1 year.

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The fair value of the Finder's Warrants issued is estimated at the grant date using the Black-Scholes option pricing model. A weighted average of the assumptions used in the calculation for the Finder's Warrants granted during the year ended March 31, 2010 is noted below:

	2010	2009
Risk-free rate	1.26%	1.86%
Expected life	1.57 years	2 years
Expected volatility	60%	54%
Fair value per warrant	\$0.05	\$0.08

### 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.

The following table summarizes information about the Company's stock options outstanding at March 31, 2010:

	Number of options Outstanding and exercisable	Weighted average exercise price \$
<b>Balance, March 31, 2008</b>	-	-
Granted	1,775,000	0.13
Cancelled	(225,000)	0.20
<b>Balance, March 31, 2009</b>	1,550,000	0.12
Granted	490,000	0.18
Cancelled	(475,000)	0.14
<b>Balance, March 31, 2010</b>	1,565,000	0.13

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During the year, the Company granted 490,000 options to employees and directors (2009 – 1,775,000). The terms of the grant are consistent with the Plan. 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:

	2010	2009
Risk-free rate	2.12%	2.00%
Expected life	5 years	5 years
Expected volatility	60%	54%
Fair value per warrant	\$0.089	\$0.04

Stock based compensation expense for the year ended March 31, 2010 was \$43,434 (2009 - \$74,575), 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 March 31, 2010:

Range of exercise prices (\$)	Number of options outstanding	Option outstanding and exercisable	
		Weighted average remaining contractual life (years)	Weighted average exercise price \$
0.10 - 0.20	1,420,000	4.05	0.12
0.21 – 0.30	145,000	4.45	0.23

### e) Contributed Surplus

	2010	2009
	\$	\$
Balance, Beginning of year	152,101	21,383
Stock-based compensation (note 8(d))	43,434	74,575
Agent options (i)	-	56,143
Balance, End of year	195,535	152,101

- (i) Pursuant to the Agency Agreement and the closing of the SFO and the non-broker private placement on November 21, 2008, the Agent was granted 728,161 Agent Unit Options ("Agent Option"). Each Agent Option is exercisable into one common share and

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one common share purchase warrant ("Agent Warrant") of the Company for a period of 24 months at \$0.25. Each Agent Warrant is exercisable into one common share of the Company at \$0.40 per common share until November 21, 2010, with a forced exercise provision following the Special Hold Period (8b(ii)).

The charge to contributed surplus was based on the fair value of the Agent Option estimated at the grant date using the Black-Scholes option pricing model. The assumptions used in the calculation are noted below:

Risk-free rate	1.86%
Expected life	2 years
Expected volatility	54%
Fair value per agent option	\$0.077

### f) Per share data

Basic earnings per share are calculated based on the weighted average number of shares outstanding during the period of 17,173,432 (2009 – 9,864,405). 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.

## 9 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. As the Company is in the development stage its principal source of funds is from 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

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ratio of current assets divided by current liabilities. At March 31, 2010, the working capital ratio was 5.9:1.

### **10 Related Parties**

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

- a) Aggregate consulting fees of \$178,326 (March 31, 2009 - \$21,740) were charged by directors and officers of the Company and recorded in the statement of loss, comprehensive loss and deficit.
- b) Aggregate legal fees of \$18,334 (March 31, 2009 - \$10,023) were charged by a director of the Company.
- c) An aggregate of \$14,013 (March 31, 2009 - \$921,212) was paid by the Company to the operator of the Tunisian oil and gas assets for capital spending. Of this amount \$14,013, has been capitalized to property, plant and equipment (2009 - \$490,000 was included in accounts receivable as a cash call receivable and the remaining \$431,212 was included in property plant and equipment). The Chief Executive Officer of the operator is a current director of the Company.
- d) Included in accounts payable and accrued liabilities at March 31, 2010 was \$23,284 (March 31, 2009 - \$nil) payable to related parties. These amounts are non-interest bearing and have no specific terms of repayment.

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

### **11 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**

# **Canoel International Energy Ltd.**

## **(a Development Stage Company)**

Notes to the Consolidated Financial Statements

**For the years ended March 31, 2010 and March 31, 2009**

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(Expressed in Canadian dollars)

The Company's financial instruments consist of cash and cash equivalents, accounts receivable and accounts payable and accrued liabilities. 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.

As at March 31, 2010 the Company's receivables consisted of \$490,000 (2009 - \$490,000) from the operator of the Tunisian permits, \$39,444 (2009 - \$24,981) of good and service taxes from the Government of Canada, and \$18,098 (2009 - \$nil) of other trade receivables.

Virtually all 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 \$547,542 and cash and cash equivalents of \$992,599.

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.



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(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. The international nature of the Company's operations will result in exposure to fluctuations in commodity prices as the Company continues to develop.

(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 March 31, 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.

As at March 31, 2010, the Company's financial liabilities totaled \$261,566, and are comprised of accounts payable and accrued liabilities and amounts due to related parties. As at March 31, 2010, the Company's cash and cash equivalent balance is sufficient to meet the Company's obligations. \$23,284 of the financial liabilities are owed to related individuals and these amounts are subject to the forbearance of the related individuals.

The Company's financial liabilities at March 31, 2010 are aged as follows:

Current (less than 90 days)	\$	211,004
Past due (more than 90 days)		50,562
Total	\$	<u>261,566</u>

# **Canoel International Energy Ltd.**

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**For the years ended March 31, 2010 and March 31, 2009**

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### **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 year would not have a significant impact on the Company's earnings for the year.

## **12 Commitments**

The Company has entered into a farm-out and participation agreement giving it the right to participate in production sharing contracts 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 case by case 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.

## **13 Subsequent events**

The Company entered into the following transactions subsequent to March 31, 2010:

- a) On June 4, 2010, the Company announced that it has entered into an acquisition agreement (the "Agreement") with Oren Oil ASA ("Oren"). Oren has represented that through the acquisition, the Company will be introduced to opportunities to acquire oil and gas leases within the republic of Russia, which will be assessed through due diligence procedures. Under the Agreement, the Company will make an offer (the "Offer") to the shareholders of Oren to purchase all of their shares of Oren ("Oren Shares") on the basis of one common share in the capital of the Company ("Canoel Share") for every 1,000 Oren Shares tendered

# **Canoel International Energy Ltd.**

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**For the years ended March 31, 2010 and March 31, 2009**

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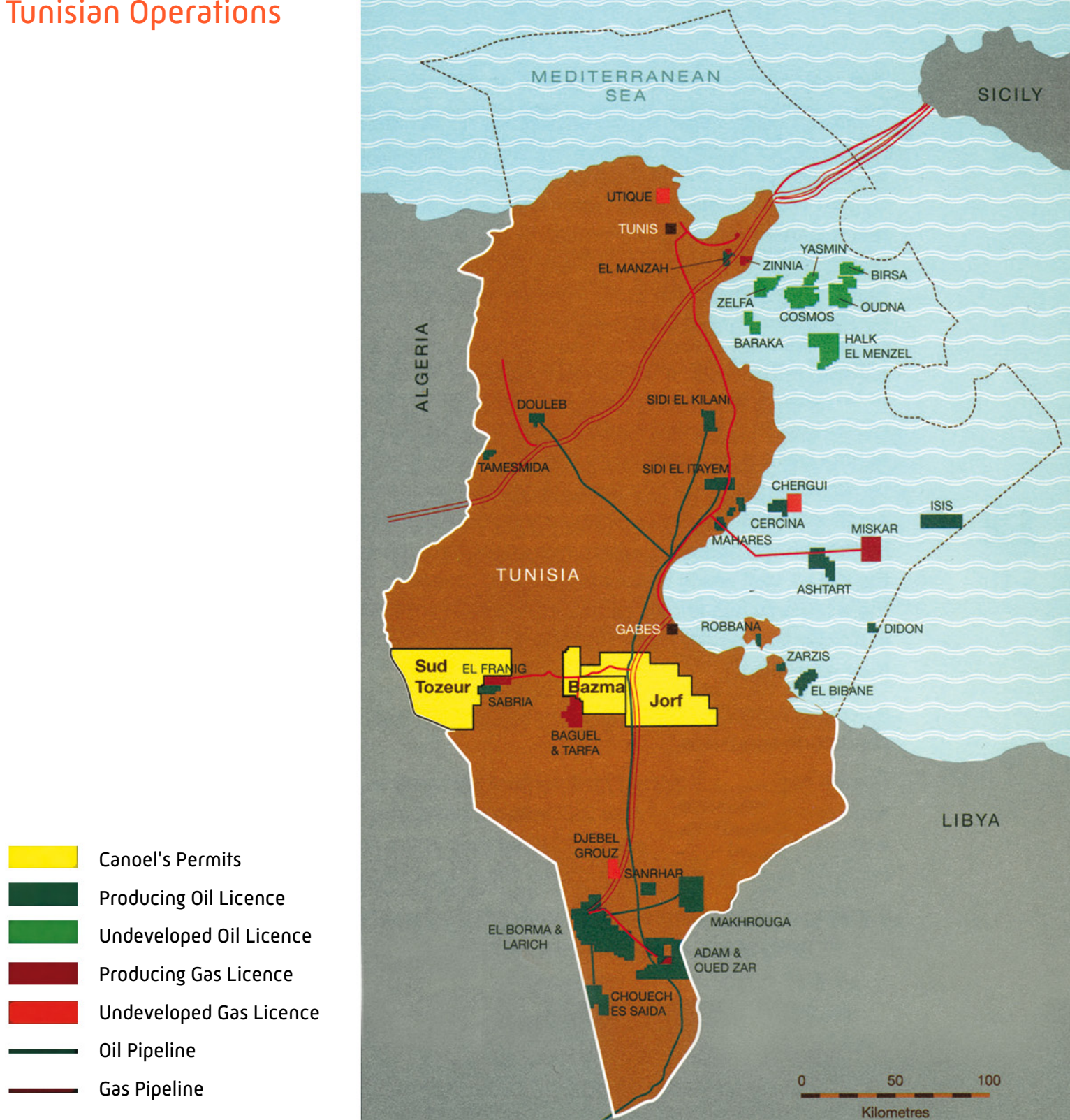
(Expressed in Canadian dollars)

under the Offer. The Company paid a non-refundable deposit of 20,000 Norwegian Kroner ("NOK"), approximately CAD \$3,000, upon execution of the Agreement.

In connection with the Offer, the Company intends to offer to all of the Oren shareholders the opportunity to participate in a private placement of Canoel Shares (the "Private Placement") for total gross proceeds of a minimum of NOK 5,000,000 (approximately CAD \$800,000). The price per Canoel Share for the Private Placement will be set at a later date and announced in the future.

Completion of the foregoing transactions is subject to approval by the Exchange, and is conditional upon: (i) the receipt by the Company of binding commitments from at least 50.01% of the Oren Shareholders to accept the Offer; and (ii) binding commitments from Oren Shareholders to subscribe for a minimum of NOK 5,000,000 (approximately CAD \$800,000) in Canoel Shares pursuant to the Private Placement. Accordingly, this offer is subject to the above requirements and there can be no certainty that this agreement with the Oren shareholders will be completed.

- b) On February 12, 2009, the Company signed a Share Purchase Agreement (the "Agreement") with a U.S. based company for the purchase of two adjacent oil producing properties in Argentina. The transaction was previously announced during September 2009 with the signing of a Memorandum of Understanding. Upon completion of the due diligence procedures subsequent to March 31, 2010, certain conditions were not met and the Agreement was terminated.





# Canoel International Energy Ltd.

## Calgary

Suite 207  
525, 11th Avenue SW  
Calgary Alberta T2R 0C9  
Canada  
telephone : +1 (403) 2629596

## London

Suite 97  
95, Wilton Road  
London SW1V 1BZ  
United Kingdom  
telephone : +44 (20) 76306591  
fax: +44 (20) 72336277

[info@canoelenergy.com](mailto:info@canoelenergy.com)  
[www.canoelenergy.com](http://www.canoelenergy.com)

