

# Primary Petroleum Corporation

## President's Message to Shareholders

The past year has been a difficult year for the Corporation due to the economic downturn. The ability to raise capital in the financial markets has been limited and together with falling natural gas prices forced the Corporation to focus on the elimination of its debt obligations.

The Corporation has successfully reduced its secured debt obligation from \$2.14 million to a current amount of approximately \$400,000 and its general and administrative costs. The reduction of the secured debt obligation was accomplished by the sale of its Prairie Dell Gas field in Montana, which closed on July 13, 2009, and a private placement equity issue of \$500,000, which closed on September 3, 2009. Management is continuing to pursue additional alternatives to eliminate the remaining portion of its secured debt obligation and its unsecured debts.

The Corporation was successful in the elimination of both of its statements of claims that were brought against Primary. The first statement of claim in the amount of \$100,000 was settled and dismissed by the Corporation issuing to the claimant 20,000 shares in the Corporation. The second statement of claim in the amount of US\$400,000 was won by the Corporation in which courts not only dismissed the claim but also eliminated its further obligation to lease a further 19,000 acres at a cost of US\$12.50 per acre and the issuance of 28,500 shares of Primary.

In the fiscal year 2010, Primary will focus on the following:

1. Continue to work towards the elimination of its debt.
2. Seek oil prospect opportunities that will enhance the Corporation's cash flow.
3. Seek equity and/or joint venture opportunities to complete a 3D seismic program on its Saturn prospect in Montana.
4. Seek a joint venture funding partner to drill a minimum of 3 exploration wells on our Saturn Prospect.
5. Seek a joint venture partner to drill a minimum of four development wells on its Pondera Teton prospect in Montana.

Mike Marrandino  
President and  
Chief Executive Officer

# Primary Petroleum Corporation

## Operations Review

### Montana, USA

#### *Pondera and Teton Areas*

Primary currently has approximately 110,000 net acres in the Teton and Pondera Counties in Western, Montana. These lands are prospective for oil in the Mississippian Madison Formation and for oil and natural gas in the lower Cretaceous Sunburst Formation. The Gypsy Basin field in the area has produced over 500,000 bbls of oil.

Primary has 25 square miles 3D seismic over the Teton prospect. Eleven drilling locations have been identified and we are currently looking for an industry partner to further develop this property.

#### *Saturn Area*

The Corporation's Saturn prospect is located along the western margin of the Williston basin in Daniel's County. Primary has approximately 22,000 net acres in Daniel's County. Primary's land adjoins the Cabaret Coulee field, which has produced in excess of 450,000 bbls of oil to date from the Mississippian McGowan and Mission Canyon Formations.

Primary has acquired approximately 50 miles of 2D seismic data and the interpreted results indicate several Mississippian structures. The Corporation anticipates shooting a 3D seismic program of approximately 14 square miles and is in the process of seeking out an industry partner to accomplish this.

#### *Prairie Dell Area*

Primary completed the disposition of the Prairie Dell property which closed July 13, 2009.

#### *Woodrow Area*

The Corporation has a 100% working interest in over 20,000 net acres in the Woodrow area, which is on-trend with the Teton prospect.

Geological mapping and 2D seismic have identified several Mississippian 'highs' on the lands. These structures are prospective for oil in the Madison Formation and for oil and or natural gas in the Sunburst and Bow Island Formations.

The Corporation is currently seeking an industry partner to further evaluate the lands and determine the optimum drilling locations.

#### *Tiber Area*

The Tiber prospect is in Toole and Liberty Counties and is situated on the eastern flank of the Sweetgrass Arch. Primary has a 100% interest in over 53,000 net acres in an area that has multi zone potential in the Carlile, Mowry and Bow Island Formations. Several off setting pools to the Corporation's acreage have produced 2 to 3 bcf of natural gas from these sands.

#### *Powder River Area*

In southeastern Montana Primary has acquired over 60,000 net acres in the Powder River and Carter Counties. The area is prospective for natural gas in the Upper Cretaceous Eagle – Shannon Formation. Drilling depths range from 1,500 to 3,000 feet.

### Alberta, Canada

#### *Swimming Area*

Primary currently has an interest in 2,720 net acres in the Swimming area of east central Alberta, with one producing natural gas well; two shut-in wells and one suspended well. An offset well at 13-33 was drilled during the fiscal year and is currently shut-in, pending more favorable gas prices. Primary's working interest is 50% in this well.

Natural gas production in the Swimming area comes from a series of Colony channels, which look prospective on other Primary lands in this area.

#### *Twin Lakes Area*

The Corporation re-completed and tested a Glauconite natural gas well (7-35) in the Twin Lakes area. The well was tied in during the fiscal year and is on production. Primary has an interest in 1,280 gross acres, 704 net acres in this area. Evaluation of the Corporation's seismic data and geological analysis has identified additional drilling locations on the Twin Lakes lands.

# Primary Petroleum Corporation

## Ashmont Area

Primary has a 100% interest in 5,120 net acres in the Ashmont area, which is prospective for natural gas in the Colony Formation. The Corporation has currently identified 4 prospective drilling locations and is seeking a JV Partner to further develop this prospect.

## Reserves

Trimble Engineering Associates Ltd. have evaluated Primary's Canadian reserves as at May 31, 2009. The reserves presented below include Primary's working interests before royalty interests and before royalty costs. The reserves as at May 31, 2009 represent only the reserves in Canada whereas the reserves as at May 31, 2008 represent the reserves located in Canada and the United States.

	May 31, 2009				May 31, 2008			
	Oil (mbbls)		Gas (mmcf)		Oil (mbbls)		Gas (mmcf)	
	Gross	Net	Gross	Net	Gross	Net	Gross	Net
<b>Proved developed producing</b>	-	-	<b>383</b>	<b>252</b>	-		1,113	940
<b>Non producing</b>	-	-	<b>344</b>	<b>265</b>	7	6	460	328
<b>Total proved</b>	-	-	<b>727</b>	<b>517</b>	7	6	1,573	1,268
<b>Probable</b>	-	-	<b>710</b>	<b>386</b>	7	6	781	650
<b>Proved + probable</b>	-	-	<b>1,437</b>	<b>903</b>	14	12	2,354	1,918

The following table presents the net present values of future net revenues of Primary's Canadian reserves as at May 31, 2009, before income taxes:

Discount rate (\$000)	0%	5%	10%	15%	20%
<b>Proved developed producing</b>	<b>915</b>	<b>831</b>	<b>763</b>	<b>706</b>	<b>658</b>
<b>Non producing</b>	<b>766</b>	<b>587</b>	<b>456</b>	<b>468</b>	<b>284</b>
<b>Total Proved</b>	<b>1,681</b>	<b>1,418</b>	<b>1,219</b>	<b>1,064</b>	<b>942</b>
<b>Probable</b>	<b>2,159</b>	<b>1,420</b>	<b>1,002</b>	<b>746</b>	<b>580</b>
<b>Proved + probable</b>	<b>3,840</b>	<b>2,838</b>	<b>2,221</b>	<b>1,810</b>	<b>1,522</b>

# Primary Petroleum Corporation

## FINANCIAL REPORT

### AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the consolidated financial statements of Primary Petroleum Corporation as at May 31, 2009 and 2008 and the consolidated statements of loss, comprehensive loss and deficit and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated 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 May 31, 2009 and 2008 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP  
Chartered Accountants

Calgary, Alberta  
September 25, 2009

# Primary Petroleum Corporation

## CONSOLIDATED BALANCE SHEETS

	May 31, 2009	May 31, 2008
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	\$ 41,407	\$ 1,283,176
Accounts receivable	94,310	355,958
Inventory	-	6,696
Prepaid expenses and deposits	184,342	222,174
	<u>320,059</u>	<u>1,868,004</u>
Property and equipment (note 3)	<u>5,864,314</u>	<u>14,977,178</u>
	<u>\$ 6,184,373</u>	<u>\$ 16,845,182</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities		
Accounts payable and accrued liabilities	\$ 1,081,222	\$ 1,246,777
Accrued interest	2,103	184,069
Demand loan (note 5)	105,150	-
Credit facility (note 6)	2,040,000	2,000,000
Convertible notes (note 7)	-	2,250,000
	<u>3,228,475</u>	<u>5,680,846</u>
Other liabilities	-	92,703
Asset retirement obligation (note 8)	<u>1,165,076</u>	<u>1,031,707</u>
	<u>4,393,551</u>	<u>6,805,256</u>
Shareholders' equity		
Common shares (note 9)	18,462,812	15,224,834
Warrants (note 9)	2,464,383	3,389,583
Contributed surplus (note 9)	1,514,487	524,949
Convertible notes equity component	-	367,717
Deficit	<u>(20,650,860)</u>	<u>(9,467,157)</u>
	<u>1,790,822</u>	<u>10,039,926</u>
	<u>\$ 6,184,373</u>	<u>\$ 16,845,182</u>
Going concern (note 2)		
Commitments (note 14)		
Subsequent events (note 17)		

See accompanying notes to the consolidated financial statements.

# Primary Petroleum Corporation

## CONSOLIDATED STATEMENTS OF LOSS, COMPREHENSIVE LOSS AND DEFICIT

	Years ended May 31,	
	2009	2008
<b>Revenue</b>		
Oil and natural gas	\$ 1,423,450	\$ 1,327,277
Royalties	(228,728)	(387,822)
	<u>1,194,722</u>	<u>939,455</u>
Interest	10,377	94,168
	<u>1,205,099</u>	<u>1,033,623</u>
<b>Expenses</b>		
Operating	389,794	157,158
General and administrative	1,177,267	1,904,356
Stock-based compensation	64,338	324,105
Foreign currency translation (gain)	(31,799)	129,056
Interest and finance fees	506,641	409,822
Accretion on convertible notes	-	116,341
Depletion, depreciation and accretion	1,215,811	925,317
Write-down of property and equipment	9,223,000	249,230
	<u>12,545,052</u>	<u>4,215,385</u>
<b>Loss before income taxes</b>	(11,339,953)	(3,181,762)
Income taxes (reduction) (note 10)	(156,250)	-
<b>Net loss and other comprehensive loss for the year</b>	(11,183,703)	(3,181,762)
<b>Deficit, beginning of year</b>	(9,467,157)	(6,285,395)
<b>Deficit, end of year</b>	<u>\$ (20,650,860)</u>	<u>\$ (9,467,157)</u>
<b>Net loss per share</b>		
Basic and diluted (note 9)	<u>\$ (0.25)</u>	<u>\$ (0.09)</u>
Weighted average common shares outstanding	<u>44,949,747</u>	<u>33,632,848</u>

See accompanying notes to the consolidated financial statements.

# Primary Petroleum Corporation

## CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years ended May 31,	
	2009	2008
<b>Operating</b>		
Net loss and comprehensive loss	\$ (11,183,703)	\$ (3,181,762)
Non-cash items		
Stock-based compensation	64,338	324,105
Accretion on convertible notes	-	116,341
Finance charges	-	128,499
Unrealized foreign exchange gain (loss)	(31,799)	(11,499)
Depletion, depreciation and accretion	1,215,811	925,317
Income tax reduction	(156,250)	-
Write-down of property and equipment	9,223,000	249,230
Asset retirement costs incurred	(16,056)	(173,002)
	<u>(884,659)</u>	<u>(1,622,771)</u>
Change in non-cash working capital (note 11)	532,869	131,089
	<u>(351,790)</u>	<u>(1,491,682)</u>
<b>Financing</b>		
Issue of share capital, net of issue costs (note 9)	601,998	7,325,473
Credit facility	40,000	2,000,000
Demand loan	105,150	-
Change in non-cash working capital (note 11)	-	105,889
	<u>747,148</u>	<u>9,431,362</u>
<b>Investing</b>		
Expenditures on property and equipment	(1,241,064)	(5,752,354)
Cash paid for corporate acquisition	-	(2,543,746)
Loan receivable	-	181,379
Change in non-cash working capital (note 11)	(396,063)	138,876
	<u>(1,637,127)</u>	<u>(7,975,845)</u>
<b>Decrease in cash and cash equivalents</b>	<b>(1,241,769)</b>	<b>(36,165)</b>
<b>Cash and cash equivalents, beginning of year</b>	<b>1,283,176</b>	<b>1,319,341</b>
<b>Cash and cash equivalents, end of year</b>	<b>\$ 41,407</b>	<b>\$ 1,283,176</b>
<b>Supplemental information</b>		
Interest received	\$ 10,377	\$ 95,425
Interest paid	\$ 461,132	\$ 161,160

See accompanying notes to the consolidated financial statements.

# Primary Petroleum Corporation

## NOTES TO CONSOLIDATED STATEMENTS

### 1. Nature of operations and basis of presentation

Primary Petroleum Corporation (the "Corporation") was incorporated under the laws of the Province of British Columbia and is a public corporation listed on the Toronto Venture Exchange. Primary is engaged in the exploration and development of petroleum and natural gas reserves in the Province of Alberta and the State of Montana. The consolidated financial statements of Primary Petroleum Corporation (the "Corporation") have been prepared in accordance with generally accepted accounting principles ("GAAP") in Canada and include the accounts of the Corporation and its subsidiaries. The financial statements are stated in Canadian dollars.

### 2. Significant Accounting Policies

#### (a) Going concern

These consolidated financial statements have been prepared on the going concern basis, which presumes that the Corporation will be able to discharge its obligations and realize its assets in the normal course of business at the values at which they are carried in these financial statements, and that the Corporation will be able to continue its business activities.

There is significant doubt about the Corporation's ability to continue to meet obligations as they come due as the Corporation has a significant working capital deficiency of \$2,908,416 as at May 31, 2009, and has not been able to pay all of its accounts payable, demand loan and credit facility on a timely basis.

The future of the Corporation is dependant on the Corporation's success in obtaining the necessary funds to repay its debts as they come due and to fund the development of its properties and fulfil its flow-through obligation. The Corporation's working capital deficiency includes a demand loan of \$105,150 and a credit facility of \$2,040,000. The Corporation has negotiated an extension of the credit facility until March 31, 2010. The Corporation expects to reduce the credit facility with proceeds from the disposition of properties during the fiscal year 2010. (See Note 17 - Subsequent Events). In addition, the Corporation has taken steps to reduce its overhead including reducing salaries and the termination of employees.

Management has been and continues to be active in seeking alternative sources of funding and disposition of assets (See Note 17 - Subsequent Events) to repay the credit facility and other obligations and to continue with its planned capital expenditure program.

These financial statements do not reflect any adjustments to the carrying value of assets, liabilities and reported revenues and expenses that might be necessary should the Corporation be unable to secure the necessary funds and continue as a going concern. Such adjustments may be material.

#### (b) Full cost accounting

The Corporation follows the full cost method of accounting for petroleum and natural gas properties whereby all costs related to the acquisition, exploration and development of petroleum and natural gas reserves are capitalized. Such costs include lease acquisition costs, geological and geophysical costs, carrying charges of non-producing properties, costs of drilling both productive and non-productive wells, the cost of petroleum and natural gas production equipment and overhead charges related to exploration and development activities. Such costs are accumulated in two cost centres, Canada and the United States

The carrying value of the Corporation's property and equipment is reviewed each reporting period to determine that the carrying value is recoverable and does not exceed the fair value of the properties. Costs of acquiring and evaluating unproved properties are initially excluded from the depletion calculations. Properties are considered unproved until they have established commercial production for a sustained period of time. The unevaluated properties are assessed periodically to ascertain whether impairment has occurred. The assessment includes consideration of the following factors: land relinquishment; intent to drill; remaining lease term; geological and geophysical evaluations; drilling results and activities; assessment of proved reserves; and the economic viability of

# Primary Petroleum Corporation

## NOTES TO CONSOLIDATED STATEMENTS

development if reserves are assigned. When proved reserves are assigned or the property is impaired, the associated costs are added to the costs subject to depletion calculations. Under Canadian accounting standards, the ceiling test calculation is a two part process. The first part, the recognition of impairment, is determined by comparing the carrying amount of the petroleum and natural gas properties and equipment to the sum of the undiscounted cash flows expected to result from the Corporation's proved reserves and the lower of cost and market of unproved properties. Cash flows are calculated based on third party quoted forward prices, adjusted for the Corporation's quality differentials. If there is impairment, the second part of the calculation would measure the magnitude of the impairment by comparing the carrying amount of the petroleum and natural gas properties and equipment to the estimated net present value of future cash flows from proved plus probable reserves and the lower of cost and market of unproved properties. A risk free interest rate is used to arrive at the net present value of the future cash flows. Any excess carrying value above the net present value of the future cash flows would be recorded as a permanent impairment and charged as a write-down of property and equipment in the statement of operations. Proceeds from the disposition of petroleum and natural gas properties are applied against capitalized costs except for dispositions that would change the rate of depletion and depreciation of 20 percent or more, in which case a gain or loss would be recorded.

Capitalized costs, together with estimated future capital costs associated with proven reserves, are depleted and depreciated using the unit-of-production method based on estimated gross proven reserves before royalties of petroleum and natural gas as determined by independent reservoir engineers. For purposes of the calculation, natural gas reserves and production are converted to equivalent units of oil based on relative energy content of 6,000 cubic feet of natural gas to one barrel of oil. Costs of significant unproved properties, net of impairments, are excluded from the depletion and depreciation calculation.

Other assets, which are comprised of office equipment and furniture and fixtures, are recorded at cost and depreciated over their useful life on a straight line basis ranging from 20 percent to 50 percent.

### **(c) Asset retirement obligation**

The Corporation recognizes the fair value of an asset retirement obligation in the period it is incurred and a corresponding increase in the carrying amount of the related long lived asset. The fair value is determined through a review of engineering studies, industry guidelines, and management's estimate on an area by area basis. The liability is subsequently adjusted due to the passage of time, and is recognized as accretion expense in the statement of operations. The liability is subsequently adjusted for revisions in either the timing or the amount of the original estimated cash flows associated with the liability. Actual restoration expenditures are charged to the accumulated obligation to the extent of the liability recorded.

### **(d) Stock based compensation**

The Corporation has a stock-based compensation plan enabling officers, directors, employees and certain consultants to purchase common shares at exercise prices equal to the market price on the date the stock option is granted. Stock option awards are accounted for based on the fair value method of accounting (Note 9(c)). Under this method stock based compensation expense for employees is based on the estimated fair value of the related stock option at the time of the grant and is expensed over the vesting period of the option, with a corresponding increase in contributed surplus. Stock-based compensation expense for consultants is based on the estimated fair value of the related stock option at the end of each reporting period and the appropriate amount is expensed in that period, with a corresponding increase in contributed surplus. For both employees and consultants, stock based compensation expense is based on the estimated fair value of the related stock option using the Black-Scholes option model. When stock options are exercised, the consideration paid to the Corporation along with amounts previously credited to contributed surplus,

# Primary Petroleum Corporation

## NOTES TO CONSOLIDATED STATEMENTS

is credited to share capital. Forfeitures are accounted as they occur and result in a reduction of compensation expense if the options have not vested.

### **(e) Measurement uncertainty**

The preparation of the financial statements are in conformity with Canadian generally accepted accounting principles which requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the year. Actual results could differ from these estimates.

The amounts recorded for depletion and depreciation of petroleum and natural gas assets, the asset retirement obligation and stock based compensation are based on estimates. The cost recovery ceiling test is based on estimates of reserves, production rates, oil and gas prices, future costs and other relevant assumptions. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statement of changes in such estimates in future periods could be significant.

### **(f) Per share amounts**

Basic per share amounts are calculated using the weighted average number of shares outstanding during the year. Weighted average number of shares is determined by relating the portion of time within the reporting period that common shares have been outstanding to the total time in the period. Diluted per share amounts are calculated based on the treasury-stock method, which assumes that any proceeds obtained on the exercise of in-the-money options and warrants plus the related unamortized stock based compensation cost would be used to purchase common shares at the average market price during the period. The weighted average number of shares outstanding is then adjusted by the net change.

### **(g) Flow-through shares**

The resource expenditure deductions for income tax purposes related to exploratory and development activities funded by flow-through share arrangements are renounced to investors in accordance with tax legislation. Future tax liabilities and share capital are adjusted by the estimated cost of the renounced tax deductions when the tax pools are renounced.

### **(h) Cash and cash equivalents**

The Corporation considers deposits in banks, certificates of deposit and short-term investments with original maturities of three months or less as cash and cash equivalents.

### **(i) Interest in joint operations**

Substantially all of the Corporation's oil and gas exploration and development activities are conducted jointly with others, and accordingly, the financial statements reflect only the Corporation's proportionate interest in such activities.

### **(j) Revenue recognition**

Crude oil and natural gas revenues are recognized in earnings when title passes from the Corporation to its customer.

### **(k) Accounting policy developments in 2009**

The following summarizes the accounting changes that were applied to the Corporation's consolidated financial statements for the year ended May 31, 2009:

The CICA issued Section 3031 "Inventories" which requires inventory to be measured at lower of cost and net realizable value. The standard also provides guidance on costs that can be capitalized. In addition, previous inventory write-downs must be reversed if the economic circumstances have changed to support an increase in the previously impaired inventory value. The standard became

# Primary Petroleum Corporation

## NOTES TO CONSOLIDATED STATEMENTS

effective for fiscal years beginning on or after January 1, 2008. The adoption of this standard on June 1, 2008 had no material impact on the Corporation's consolidated financial statements.

Effective June 1, 2008, the Corporation adopted the CICA Section 3862 "Financial Instruments – Disclosures" and Section 3863 "Financial Instruments – Presentation" replaced existing Section 3861. These standards provide additional guidance on disclosing risks related to recognized and unrecognized financial instruments and how those risks are managed. The adoption of this standard had no material impact on the Corporation's consolidated financial statements. The new disclosures are included in note 15.

Effective June 1, 2008, the Corporation adopted the CICA Section 1535 "Capital Disclosures" which establishes additional reporting of objectives, policies and processes of how the Corporation manages its capital as well as its compliance with externally imposed capital requirement.

Effective June 1, 2008 the Corporation was required to adopt the additional requirements of CICA Section 1400 – General Standards of Financial Statements. Management is required to assess the Corporation's ability to continue as a going concern and to disclose any material uncertainties related to events or conditions that may cast significant doubt upon its ability to continue as a going concern. The Corporation's discussion of going concern is summarized in note 2(a).

### **(I) Future accounting policy developments**

The AcSB has adopted a strategic plan for the direction of accounting standards in Canada. Accounting standards for public companies in Canada will converge with the International Financial Reporting Standards ("IFRS") by 2011. IFRS will replace Canadian GAAP with the official change over to IFRS to occur for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The Corporation is engaged in preparing for this transition and will be reading to prepared financial statements under IFRS for comparative purposes in 2011.

The CICA issued section 3064, Goodwill and Intangible Assets, replacing Section 3062, Goodwill and Other Intangible Assets, and Section 3450, Research and Development Costs. New Section 3064 addresses when an internally developed intangible asset meets the criteria for recognition as an asset. The CICA also issued amendments to Section 1000, Financial Statement Concepts. These changes are effective for fiscal years beginning on after October 1, 2008 with earlier adoption permitted, and will be adopted by the Corporation June 1, 2009. The Corporation is currently evaluating the effects of adopting these changes.

In January, 2009, the AcSB issued Section 1582, Business Combinations, which replaces former guidance on business combinations. Section 1582 establishes principles and requirements of the acquisition method for business combinations and related disclosures. This statement 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, 2011 with earlier application permitted. Primary plans to adopt this standard prospectively effectively June 1, 2009 and does not expect the adoption of this statement to have a material impact on our results of operations or financial position.

In January, 2009, the AcSB issued Sections 1601, Consolidated Financial Statements, and 1602, Non-controlling Interests, which replaces existing guidance. Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 provides guidance on accounting for a non-controlling in a subsidiary in consolidated financial statements subsequent to a business combination. These standards are effective on or after the beginning of the first annual reporting period beginning on or after January 2011 with earlier application permitted. Primary plans to adopt these standards effective June 1, 2009 and does not expect the adoption will have a material impact on our results of operations of financial position.

# Primary Petroleum Corporation

## NOTES TO CONSOLIDATED STATEMENTS

### 3. Property and equipment

As at May 31, 2009

	Cost	Accumulated depletion, depreciation and Amortization	Net Book Value
Petroleum and natural gas properties	\$ 23,126,195	\$ (17,295,897)	\$ 5,830,298
Office equipment	101,066	(67,050)	34,016
Net book value	<u>\$ 23,227,261</u>	<u>\$ (17,362,947)</u>	<u>\$ 5,864,314</u>

As at May 31, 2008

	Cost	Accumulated depletion, depreciation and Amortization	Net Book Value
Petroleum and natural gas properties	\$ 21,879,958	\$ (6,959,978)	\$ 14,919,980
Office equipment	100,177	(42,979)	57,198
Net book value	<u>\$ 21,980,135</u>	<u>\$ (7,002,957)</u>	<u>\$ 14,977,178</u>

During the year ended May 31, 2009, the Corporation capitalized general and administrative costs of \$351,772 (February 29, 2008 - \$nil), which are included in property and equipment.

The cost of unproved properties and unevaluated seismic data excluded from the depletion base at May 31, 2009 was \$2,711,028 (Canada - \$308,093, USA - \$2,402,935) (May 31, 2008 - \$10,153,552 of which \$495,020 were in Canada and \$9,658,532 were in the USA). Future development costs of \$350,661 (Canada - \$350,661, USA - \$nil) (May 31, 2008 - \$751,700, Canada - \$525,000, USA - \$226,000) are included in the depletable base.

At February 28, 2009, the Corporation performed ceiling test calculations in its Canadian and United States cost centres based on internal estimates of future net revenues from proved and probable reserves and the lower of cost and market of unproved properties. As a result the Corporation recognized a write-down in its Canadian cost centre of \$1,300,000 and write-down in its United States cost centre of \$5,000,000. The future net revenues were based on estimated future commodity prices ranging from \$3.49/Mcf and \$3.72/Mcf.

At May 31, 2009, the Corporation performed a ceiling test calculation in its United States cost centre. As a result, the Corporation recorded an additional impairment in the United States of \$2,923,000 based on the subsequent sale of its remaining United States proved properties (See Note 17 – Subsequent Events) and the estimated recoverable amount of its United States unproved properties. The total write-down of the Corporation's United States cost centre for the year ended May 31, 2009 was \$7,923,000.

At May 31, 2009, the Corporation performed a ceiling test calculation in its Canadian cost centre based on an external reserve estimate of future net revenues from proved and probable reserves and the lower of cost and market value of unproved properties. The ceiling test calculation indicated no additional impairment of the Corporation's Canadian cost centre was required at May 31, 2009.

# Primary Petroleum Corporation

## NOTES TO CONSOLIDATED STATEMENTS

The following table summarizes the future benchmark prices used in the Canadian ceiling test at May 31, 2009:

Year	\$US/\$Cdn Exchange Rate	WTI Cushing Oklahoma (US/Bbl)	Edmonton Par Price 40° API (\$Cdn/Bbl)	AECO Gas Price (\$Cdn/MMBTU)	Edmonton Butane (\$Cdn/Bbl)	Edmonton Propane (\$Cdn/Bbl)	Edmonton Condensate (\$Cdn/Bbl)
Forecast							
2009(9 mo)	0.80	52.75	65.00	4.50	52.00	39.00	65.00
2010	0.80	60.75	75.00	6.00	60.00	45.00	75.00
2011	.085	68.75	80.00	6.75	64.00	48.00	80.00
2012	.090	77.25	85.00	7.50	68.00	51.00	85.00
2013	.095	86.25	90.00	8.25	72.00	54.00	90.00
Thereafter		+2%/yr	+2%/yr	+2%/yr	+2%/yr	+2%/yr	+2%/yr

#### 4. Acquisition:

On December 14, 2007, the Corporation acquired all of the issued and outstanding units of AP Petroleum Corporation LLC (“AP”), a Montana limited liability company involved in the production of natural gas in the state of Montana. The acquisition is accounted for by the purchase method. The following table summarizes the estimated fair value of the assets acquired and liabilities assumed at the date of the acquisition.

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Net assets acquired:	
Working capital	\$ 29,984
Petroleum and natural gas properties	4,191,267
Asset retirement obligation	(690,847)
	\$ 3,530,404

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#### Consideration:

Cash (net of cash acquired)	\$ 2,543,746
Issuance of 1,205,049 common shares	641,524
Issuance of 1,205,049 warrants	117,657
Issuance of 269,529 common shares as a finder’s fee	169,803
Cash transaction costs	57,674
	\$ 3,530,404

The Corporation issued 1,205,049 units to the sellers. Each unit was comprised of one common share plus a one-year warrant exercisable into one common share at a price of \$1.10 per share. The common shares were valued at \$0.63 per share (the average trading price before and after the announcement date of November 29, 2007). The Corporation used the Black-Scholes option pricing to estimate the fair value of the warrants assuming a share price of \$0.63 per share, volatility of 80% and risk free interest rate of 4%. In addition, the Corporation incurred a finder’s fee which was settled with the issuance of 269,529 common shares valued at \$0.63 per share.

#### 5. Demand Loan

The Corporation entered into a secured demand loan agreement on May 26, 2009 with a syndicate of individuals, including related parties (see Note 13 – Related Party Transactions) resulting in borrowings of \$105,150. The loan bears interest at 12% per annum, compounded and payable semi-annually. The demand loan is repayable by the Corporation at any time without penalty.

# Primary Petroleum Corporation

## NOTES TO CONSOLIDATED STATEMENTS

### 6. Credit facility

On May 21, 2008, The Corporation entered into a \$2,000,000 credit facility agreement with a private company. During 2009 the repayment date was extended to March 31, 2010 and the facility limit increased to \$2,140,000, including a fee of \$140,000 which has been expensed. The loan bears interest at 18% per annum compounded and payable monthly. Pursuant to the credit facility amending agreement dated May 27, 2009, the Corporation is required to pay the private company the net sale proceeds from the sale of any of its properties. (See Subsequent Events – Note 17). The loan is secured by a general security agreement over all the Corporation's assets.

### 7. Convertible notes

The following table summarizes the changes in the liability component of the convertible notes:

	May 31, 2009	May 31, 2008
Balance, beginning of year	\$ 2,250,000	\$ 2,133,659
Accretion	-	116,341
Redeemed for common shares	(2,250,000)	-
Balance, end of year	\$ -	\$ 2,250,000

The convertible notes matured on various dates between September 27, 2007 and October 23, 2007. The convertible notes were extended to June 27, 2008 and July 23, 2008. The extension of the terms of the convertible notes resulted in an additional financing charge of \$30,793 in 2008. In August the holders of the convertible notes agreed to 6,105,051 common shares (\$0.40 per share being the fair value of the shares on settlement date) as full settlement of the notes and accrued interest.

### 8. Asset retirement obligation

The Corporation's management estimated the total future asset retirement obligation based on the expected cost to abandon and restore well and facility sites and the estimated timing of the costs to be incurred. The Corporation has estimated the net present value of its asset retirement obligation to be \$1.2 million as at May 31, 2009, based on the total undiscounted future obligation of \$1.9 million. These costs are expected to be incurred between 2012 and 2019. The Corporation used a credit adjusted risk free rate of 8% to 10% and an inflation rate of 2% to calculate the present value of the asset retirement obligation.

The following table summarizes the changes in the asset retirement obligation:

	Years ended May 31,	
	2009	2008
Asset retirement obligation, beginning of year	\$ 1,031,707	\$ 389,573
Additions and revisions	70,728	80,262
Acquired on corporate acquisition	-	690,847
Accretion	78,697	44,027
Costs incurred during the year	(16,056)	(173,002)
Asset retirement obligation, end of year	\$ 1,165,076	\$ 1,031,707

# Primary Petroleum Corporation

## NOTES TO CONSOLIDATED STATEMENTS

### 9. Share capital

#### (a) Authorized

Unlimited number of common shares

#### (b) Issued

	Number of shares	Amount
Balance, May 31, 2007	26,918,317	\$ 8,835,739
Issued for cash on initial public offering	8,500,000	7,325,473
Fair value of warrants issued on initial public offering	-	(1,847,705)
Issued as corporate finance fee	100,000	100,000
Issued for corporate acquisition	1,205,049	641,524
Issued for finders fee related to acquisition	269,529	169,803
Balance, May 31, 2008	36,992,895	15,224,834
Issued on redemption of convertible note and accrued interest (note 7)	6,105,051	2,809,738
Private placement of flow-through shares for cash	6,250,000	625,000
Shares issued on acquisition of lands	121,272	3,638
Share issue costs	-	(44,148)
Tax effect of flow-through shares	-	(156,250)
Balance, May 31, 2009	49,469,218	\$ 18,462,812

During November and December 2008 the Corporation issued 6,250,000 common shares on a flow-through basis at a price of \$0.10 per common share. To May 31, 2009, the Corporation had incurred \$260,000 of Canadian exploration expenditures and is required to incur a minimum of \$365,000 of Canadian exploration expenditures by December 31, 2009.

In May 27, 2009, the Corporation issued 121,272 common shares to satisfy its obligation to issue shares upon the acquisition of land in certain areas of Montana. (See Note 14(a) – Commitments).

#### (c) Stock options

The Corporation has a stock option plan under which it may grant options to purchase common shares to its directors, officers, employees and consultants. Pursuant to a shareholder approved new stock option plan on November 19, 2008, the Corporation may grant up to a maximum of 8,619,589 options to eligible participants. The options generally vest over a two year period and have a maximum term of five years.

At May 31, 2009, the Corporation had 7,062,500 stock options outstanding for which shares have been reserved.

	Quantity	Weighted average exercise price
Balance, May 31, 2007	3,012,500	\$ 1.00
Granted	1,850,000	0.59
Forfeited	(50,000)	1.00
Balance, May 31, 2008	4,812,500	0.84
Granted	4,025,000	0.20
Forfeited	(1,775,000)	0.60
Balance, May 31, 2009	7,062,500	\$ 0.41

On January 20, 2009, the Board of Directors approved a change in the exercise price of 1,025,000 options to \$0.10 per share with no other changes in terms and conditions. These options were

# Primary Petroleum Corporation

## NOTES TO CONSOLIDATED STATEMENTS

previously granted at exercise prices ranging from \$0.50 per share to \$1.00 per share. The modification resulted in an incremental fair value increase of \$39,681 which was recorded as stock based compensation for the year ended May 31, 2009.

The fair value of the 4,025,000 options granted in the year ended May 31, 2009 is \$506,436 based on the date of grant using the Black-Scholes option pricing model with the following assumptions: average risk-free rate of 1.66%, expected life of five (5) years, expected volatility of 100% and no expected dividends. The fair value of the 1,850,000 options granted in the year ended May 31, 2008 is \$471,454 based on the date of grant using the Black-Scholes option pricing model with the following assumptions: average risk-free rate of 4.00%, expected life of five (5) years, expected volatility of 80% and no expected dividends.

Options outstanding at May 31, 2009:

Exercise Price (\$)	Options Outstanding			Options Exercisable	
	Number of options	Weighted average exercise price	Weighted average remaining contractual life (years)	Number of Options	Weighted average remaining contractual life (years)
\$0.10	3,987,500	\$ 0.10	4.0	1,109,425	4.0
\$0.40	25,000	\$ 0.40	4.3	-	-
\$0.50	1,062,500	\$ 0.50	4.1	-	4.1
\$0.75	100,000	\$ 0.75	3.4	33,300	3.4
\$1.00	1,887,500	\$ 1.00	2.9	1,375,513	2.9
	7,062,500	\$ 0.41	3.8	2,518,238	3.8

### (d) Contributed surplus

	Amount
Balance, May 31, 2007	\$ 200,843
Stock based compensation	324,106
Balance, May 31, 2008	524,949
Fair value of expired warrants	925,200
Stock based compensation	64,338
Balance, May 31, 2009	\$ 1,514,487

### (e) Warrants

The following is a summary of the fair value of the warrants outstanding:

	Number of Warrants	Value
Balance, May 31, 2007	12,767,371	\$ 1,326,917
Fair value of warrants issued on initial public offering	5,045,000	1,847,706
Fair value of warrants issued for corporate acquisition (note 4)	1,205,049	117,657
Fair value of warrants revalued	-	97,303
Expired warrants	(275,000)	-
Balance, May 31, 2008	18,742,420	3,389,583
Expired warrants	(5,455,049)	(925,200)
Balance, May 31, 2009	13,287,371	\$ 2,464,383

# Primary Petroleum Corporation

## NOTES TO CONSOLIDATED STATEMENTS

The Corporation used the Black-Scholes valuation model to estimate the fair value of the warrants issued in 2008 with the following assumptions: average risk-free interest rate of 4.00%, expected life of two years, and expected volatility of 80% and no expected dividends.

The following table summarizes the warrants outstanding at May 31, 2009.

	Number of warrants	Weighted average exercise price	Weighted average remaining life (years)
Consultants warrants	126,000	\$ 0.75	0.29
Share purchase warrants	8,116,371	\$ 0.75	0.29
Warrants issued for corporate finance fee	50,000	\$ 1.35	0.29
Tradable warrants	4,250,000	\$ 1.35	0.29
Agent's warrants	745,000	\$ 1.35	0.29
	<b>13,287,371</b>	<b>\$ 0.98</b>	<b>0.29</b>

2,000,000 private placement warrants issued May 11, 2006 were due to expire August 11, 2007. The warrants were extended to December 31, 2008 and the conversion price of the warrants was increased from \$1.25 to \$1.35 per share. The modification of the warrants resulted in a finance charge of \$97,303.

Subsequent to May 31, 2008, the Corporation revised its previously determined fair value assigned to certain issued and outstanding warrants. Using the Black-Scholes valuation model and using an estimated volatility of 50%, the value assigned to the warrants was \$1,326,917. The Corporation's balances at May 31, 2007 have been restated to increase the stated value of warrants by \$1,326,917 with the corresponding reduction to share capital.

### (f) Per share amounts

Basic loss per share is computed by dividing the net loss available to common shareholders by the weighted average number of common shares outstanding. Diluted loss per share is calculated using the treasury stock method to determine the dilutive effect of stock options and warrants. The treasury stock method assumes that the proceeds received from the exercise of "in the money" stock options and warrants are used to repurchase common shares at the average market price during the period. At May 31, 2009, 7,062,500 options and 13,287,371 warrants (2008 – 4,812,500 and 18,742,420) were excluded from determining the dilutive effect of stock options and warrants as their impact would be anti-dilutive to this calculation.

## 10. Income taxes

The provision for current income taxes recorded in the financial statements differs from the amount which would be obtained by applying the combined Canadian federal and Alberta provincial statutory rate of 29.3% (May 31, 2008 – 31%) to the loss before taxes for the following periods:

	Years ended May 31,	
	2009	2008
Loss before income taxes	<b>\$(11,339,953)</b>	\$(3,181,762)
Expected income tax provision (reduction)	<b>(3,322,606)</b>	(986,982)
Non-deductible stock based compensation	<b>18,851</b>	100,537
Accretion on convertible notes	-	75,949
Change in tax rates and other	<b>(1,083,576)</b>	519,388
Valuation changes	<b>4,231,081</b>	291,108
<b>Income tax provision (recovery)</b>	<b>\$ (156,250)</b>	\$ -

The Corporation has an unrecorded future income tax asset that has not been recognized in prior years.

# Primary Petroleum Corporation

## NOTES TO CONSOLIDATED STATEMENTS

The issuance of flow-through common shares and the subsequent renunciation of flow-through expenditures as at December 31, 2008 gave rise to a reduction of the unrecorded future tax asset which has been recognized in the consolidated statement of loss as a recovery of income taxes in the current fiscal period in the amount of \$156,250.

The future income tax asset is comprised of the following:

	2009	2008
Future Income Tax Benefits:		
Properties and equipment	\$ 5,212,989	\$ 729,732
Non-capital losses	1,131,521	1,078,354
Share issue costs	165,273	386,176
Asset retirement obligation	404,536	269,789
Valuation allowance	(6,914,319)	(2,464,051)
	<u>\$ -</u>	<u>\$ -</u>

The Corporation has loss carryforwards in Canada of \$4,891,000, which expire between 2024 and 2029. The Corporation has no loss carryforwards in the United States.

### 11. Change in non-cash working capital

Changes in non-cash working capital were comprised of the following:

	Years ended May 31,	
	2009	2008
Accounts receivable	\$ 261,648	\$ 125,200
Inventory	6,696	23,897
Prepaid expenses	37,832	60,856
Accounts payable and accrued liabilities	(165,555)	(48,152)
Accrued interest	(3,815)	184,069
Working capital acquired	-	29,984
<b>Net change</b>	<u>\$ 136,806</u>	<u>\$ 375,854</u>
<b>Net change by activity:</b>		
Operating	\$ 532,869	\$ 131,089
Financing	-	105,889
Investing	(396,063)	138,876
<b>Net change</b>	<u>\$ 136,806</u>	<u>\$ 375,854</u>

The following non-cash transactions were not included in the cash flow statement:

In August the holders of the convertible notes agreed to 6,105,051 common shares (\$0.40 per share being the fair value of the shares on settlement date) as full settlement of the notes and accrued interest.

Pursuant to an agreement dated August 30, 2006, finder's fees are payable by the Corporation upon the completion of certain Powder River prospect land acquisitions in Montana. The fees are payable on the basis of the issuance of one common share of the Corporation for each acre acquired. A total of 61,802 acres were acquired and on May 27, 2009, 61,802 common shares of the Corporation were issued to settle the obligation.

# Primary Petroleum Corporation

## NOTES TO CONSOLIDATED STATEMENTS

On December 14, 2007 in conjunction with the acquisition of AP Petroleum Company LLC, the Corporation incurred a finder's fee which was settled with the issuance of 269,529 common shares valued at \$0.63 per common share (\$169,803).

### 12. Segmented information

The Corporation operates in one reportable operating segment, being exploration and development of resource property interests. Segmented information relative to this activity on a geographic basis is as follows:

(Cdn dollars)	Year ended May 31,			Year ended May 31,		
	2009			2008		
	Canada	USA	Total	Canada	USA	Total
Oil and gas sales	\$ 492,893	\$ 930,557	\$ 1,423,450	\$ 807,957	\$ 519,320	\$ 1,327,277
Depletion, depreciation and accretion	372,715	843,096	1,215,811	621,730	303,587	925,317
Write-down of property and equipment	1,300,000	7,923,000	9,223,000	-	249,230	249,230
Net loss	(2,908,246)	(8,237,957)	(11,146,203)	(2,940,324)	(241,438)	(3,181,762)
Capital expenditures	406,633	834,431	1,241,064	902,737	4,849,616	5,752,354
	<b>Balance as at May 31, 2009</b>			<b>Balance as at May 31, 2008</b>		
	<b>Canada</b>	<b>USA</b>	<b>Total</b>	<b>Canada</b>	<b>USA</b>	<b>Total</b>
Property and equipment	\$ 1,009,703	\$ 4,854,611	\$ 5,864,314	\$ 1,735,911	\$ 13,241,267	\$ 14,977,178
Total assets	\$ 1,207,239	\$ 4,977,134	\$ 6,184,376	\$ 3,153,362	\$ 13,691,821	\$ 16,845,182

### 13. Related party transactions

During the year ended May 31, 2009, the Corporation the following related party transactions occurred in the normal course of operations and were recorded at the exchange amount, which is the amount of consideration established and agreed to by the related parties:

- (a) Management fees totaling \$455,830 (2008 – \$252,000) were charged to the Corporation by companies controlled by certain directors and officers of the Corporation. At May 31, 2009, \$10,500 (May 31, 2008 - \$nil) payable in relation to these services is included in accounts payable and accrued liabilities.
- (b) Legal fees of \$7,599 (2008 – \$1,884) were charged to the Corporation by a legal firm of which a director of the Corporation is a member. At May 31, 2009 \$536 (May 31, 2008 – \$nil) was payable in relation to these services and included in accounts payable and accrued liabilities.
- (c) Pursuant to an agreement dated May 31, 2005 an officer and director of the Corporation is to receive a gross overriding royalty of 1% on certain oil and gas revenue produced from the Pondera and Teton prospect areas in Montana. The Corporation has the right to purchase two-thirds of the gross overriding royalty for cash or common shares of the Corporation as determined by an independent valuation. No royalties have been paid to date.
- (d) On May 26, 2009, the Corporation entered into a demand loan agreement with a syndicate of individuals in the amount of \$105,150. Included in the syndicate are three directors of the Corporation whose share of the loan proceeds was \$65,150. The loan bears interest at 12% per annum, compounded and payable semi-annually. The loan is repayable by the Corporation at any time without penalty. No interest was paid during the year ended May 31, 2009.

# Primary Petroleum Corporation

## NOTES TO CONSOLIDATED STATEMENTS

### 14. Commitments

- (a) Pursuant to an agreement dated July 26, 2006, the Corporation committed to purchase a minimum of 100,000 and up to 300,000 net mineral acres in Montana, with a net revenue interest of not less than 85% to the Corporation, at a cost of US \$12.50 per acre plus the issue of one-half of a common share of the Corporation for each acre acquired. As at May 31, 2009, 80,847 acres were acquired (May 31, 2008 – 80,847 acres). As at May 31, 2009, the Corporation accrued \$nil (May 31, 2008 – \$30,901) with respect to the issuance of the shares. The commitment was eliminated upon the issuance of 121,272 shares on May 27, 2009. The Corporation received a ruling from the Montana courts that it has been relieved of any further commitment under this agreement.
- (b) Pursuant to an agreement dated August 31, 2006, a finder's fees is payable by the Corporation upon the completion of certain Powder River prospect land acquisitions in Montana. The fees are payable on the basis of the issuance of one common share of the Corporation for each of the 61,802 acres acquired. As at May 31, 2009, the Corporation has accrued a liability of \$nil (May 31, 2008 – \$61,802) with respect to the issuance of the shares. The amount of the final obligation is not determinable at this time.
- (c) Prior to the end of calendar year 2008, the Corporation issued 6,250,000 shares on a flow-through basis for gross proceeds of \$625,000. Effective December 31, 2008, the Corporation renounced \$625,000 of Canadian exploration expenditures to the subscribers of the flow-through shares. At May 31, 2009, the Corporation had incurred \$260,000 of Canadian exploration expenditures and is required to incur a minimum of \$365,000 of Canadian exploration expenditures by December 31, 2009.
- (d) Pursuant to the credit facility amending agreement dated May 27, 2009, the Corporation is required to pay to a private company the net sale proceeds from the sale of any of its properties. (See Note 17 - Subsequent Events).
- (e) The Corporation has a five year lease agreement expiring March 1, 2012 with a minimum obligation of \$123,172 per annum, excluding operating costs.

### 15. Financial Instruments

#### (a) Fair value of financial instruments

The Corporation's financial instruments as at May 31, 2009, include cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, demand loan and the credit facility. The fair value of the cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, demand loan and the credit facility approximates their carrying amounts due to their short-terms to maturity.

#### (b) The Corporation has exposure to the following risks from its use of financial instruments;

- credit risk
- liquidity risk
- market risk

This note presents information about the Corporation's exposure to each of the above risks, the Corporation's objectives, policies and processes for measuring and managing risk, and the Corporation's management of capital.

The Board of Directors has overall responsibility for the establishment and oversight of the Corporation's risk management framework. The Board of Directors has implemented and monitors compliance with risk management policies. The Corporation's risk management policies are established to identify and analyze the risks faced by the Corporation, to set appropriate risk limits and controls, and to monitor risks and adherence to market conditions and the Corporation's activities.

# Primary Petroleum Corporation

## NOTES TO CONSOLIDATED STATEMENTS

### i. Credit risk

Credit risk is the risk of financial loss to the Corporation if a customer or counterparty to a financial instrument fails to meet its contractual obligation, and arises principally from the Corporation's receivables from joint venture partners and natural gas marketers. As at May 31, 2009, the Corporation's receivables consisted of \$13,759 (2008 - \$8,000) of receivables from joint venture partners and \$67,835 (\$2008 - \$173,841) of receivables from natural gas marketers. Receivables from petroleum and natural gas marketers are normally collected on the 25<sup>th</sup> day of the month following production. The Corporation's policy to mitigate credit risk associated with these balances is to establish marketing relationships with reputable marketers. Joint venture receivables are typically collected within one to three months of the joint venture bill being issued to the partner. The Corporation attempts to mitigate the risk from joint venture partner receivables by obtaining partner approval for significant capital expenditures prior to the expenditure. However, the receivables are from participants in the petroleum and natural gas sector, and collection of the outstanding balances is dependent on industry factors such as commodity price fluctuations, escalating costs and the risk of unsuccessful drilling. In addition, further risk exists with joint venture partners as disagreements occasionally arise that increases the potential for non-collection. The Corporation does not typically obtain collateral from petroleum and natural gas marketers or joint venture partners; however the Corporation does have the ability to withhold production from joint venture partners in the event of non-payment.

Cash consists of cash bank balances and cash equivalents such as short term deposits maturing in less than 90 days. The carrying amount of cash, cash equivalents and accounts receivables represent the maximum credit exposure. The Corporation has provided for an allowance for doubtful accounts as at May 31, 2009 in the amount of \$16,659.

### ii. Liquidity risk

Liquidity risk is the risk that the Corporation will not be able to meet its financial obligations as they are due. The Corporation's approach to managing liquidity is to ensure, as far as possible, that it will have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions without incurring unacceptable losses or risking harm to the Corporation's reputation. The Corporation monitors its capital expenditures and utilizes authorizations for expenditures on both operated and non-operated capital expenditures. The Corporation also attempts to match its payment cycle with collection of oil and natural gas revenues on the 25<sup>th</sup> of each month.

The future of the Corporation is dependant on the Corporation's success in obtaining the necessary funds to repay its debts as they come due and to fund the development of its properties, obtain positive cash flow and attain profitable operations. As at May 31, 2009, the Corporation had a working capital deficiency of \$2,908,416, including a credit facility of \$2,040,000 and demand loan of \$105,150. Management has been actively working to raise funds through alternative arrangements and/or sell properties to be able to repay the \$2,040,000 credit facility and to continue operations. On May 27, 2009, the Corporation negotiated an extension of the credit facility subject to the net proceeds from the sale of a properties being applied to the credit facility. Subsequent to May 31, 2009, the Corporation disposed of certain producing properties and undeveloped lands for net proceeds of \$1,373,340 which were applied to the credit facility. As the credit facility is repaid the amount of the facility is permanently reduced and is not subject to renewal.

# Primary Petroleum Corporation

## NOTES TO CONSOLIDATED STATEMENTS

### iii. Market risk

Market risk is the risk of changes in market prices, such as foreign exchange rates, commodity prices, and interest rates that will affect the Corporation's net earnings and 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 and meeting shareholder objectives.

### iv. Foreign currency exchange rate risk

Foreign currency exchange rate risk is the risk that the fair value of assets in foreign countries and future cash flows will fluctuate as a result of changes in foreign currency exchange rates. Approximately 82% of the Corporation's assets are located in the United States, which during 2009 generated approximately 65% of the Corporation's cash flow. The underlying market prices in Canada for petroleum and natural gas and the translation of operating results from United States subsidiaries are impacted by changes in the exchange rate between the Canadian and United States dollar. The Corporation had no forward exchange contracts in place as at or during the period ended May 31, 2009.

### v. 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. Commodity prices for petroleum and natural gas are impacted by not only the relationship between the Canadian and United States dollar, as outlined above, but also world economic events that dictate the levels of supply and demand. The Corporation had no hedging contracts in place as at or during the period ended May 31, 2009.

## 16. Capital Structure and Management

The Corporation uses equity to fund its operations. The Corporation considers its capital structure to include common shares, its credit facility and demand loan. In order to maintain and adjust the capital structure, the Corporation will from time to time issue shares and adjust its capital spending to manage current and projected debt levels. At May 31, 2009, the Corporation had a credit facility of \$2,040,000 (See Note 6 – Credit Facility) and demand loan of \$105,150 (See Note 5 – Demand Loan).

The Corporation's share structure is not subject to external restriction. The Corporation has not paid or declared any dividends since the date of incorporation, nor are any contemplated in the foreseeable future.

## 17. Subsequent Events

- (a) Subsequent to year end the Corporation disposed of its principal producing property in Montana for net proceeds of \$1,373,340. This disposition eliminated \$239,882 of working capital deficiency and asset retirement obligations of \$781,697. The net proceeds were used to permanently reduce the Corporation's credit facility to \$666,660. Upon full payment of the credit facility will expire.
- (b) Subsequent to year end the Corporation completed the private placement of 10,000,000 common shares for gross proceeds of \$500,000. The proceeds will be used to further reduce the Corporation's credit facility and for general corporate purposes.
- (c) On September 18, 2009, all outstanding warrants expired unexercised.

# Primary Petroleum Corporation

## CORPORATE INFORMATION

### **CORPORATE OFFICES**

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Calgary, Alberta, Canada  
Phone: 403-262-3132  
Fax: 403-262-3175

Website: [www.primarypetroleum.com](http://www.primarypetroleum.com)  
Inquiries: [mike@primarypetroleum.com](mailto:mike@primarypetroleum.com)

### **BOARD OF DIRECTORS**

**Michele Marrandino** <sup>(1)</sup>  
Chairman  
President and Chief Executive Officer  
Primary Petroleum Corporation

**Alan Blair** <sup>(1)</sup>  
Partner  
Gowlings Lafleur Henderson LLP

**Rod Haverslew**  
Vice President Exploration  
Primary Petroleum Corporation  
(1) Member of the Audit Committee.

### **OFFICERS**

**Michele Marrandino**  
President and Chief Executive Officer

**Rod Haverslew**  
Vice President Exploration

**Rick Jaggard**  
Interim Chief Financial Officer

### **LEGAL COUNSEL**

Davis LLP

### **AUDITORS**

KPMG LLP, Calgary

### **BANKERS**

HSBC

### **INDEPENDENT RESERVES ENGINEERS**

Trimble Engineering Associates Ltd.

### **TRANSFER AGENT**

Computershare Trust Company of Canada

### **STOCK EXCHANGE LISTING**

TSX Venture Exchange  
Symbol: PIE

### **SUBSIDIARIES**

Primary Petroleum Canada Corporation  
Primary Petroleum Company USA Inc.  
Primary Petroleum Company LLC  
AP Petroleum Company LLC