

# **PRIMARY PETROLEUM CORPORATION**

## **Consolidated Financial Statements**

**For the Three and Six Months Ended November 30, 2009**

(Unaudited – Prepared by Management)

Q2/2010

# Primary Petroleum Corporation

## INTERIM CONSOLIDATED BALANCE SHEETS (Unaudited)

	November 30, 2009 <i>(Unaudited)</i>	May 31, 2009 <i>(Audited)</i>
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	\$ 110,509	\$ 41,407
Accounts receivable	47,127	94,310
Prepaid expenses and deposits	112,016	184,342
	<u>269,652</u>	<u>320,059</u>
Property and equipment (Note 4)	<u>2,738,124</u>	<u>5,864,314</u>
	<u>\$ 3,007,776</u>	<u>\$ 6,184,373</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities		
Accounts payable and accrued liabilities	\$ 908,265	\$ 1,081,222
Accrued interest	-	2,103
Demand loan (Note 5)	105,150	105,150
Credit facility (Note 6)	416,660	2,040,000
	<u>1,430,075</u>	<u>3,228,475</u>
Asset retirement obligation (Note 8)	<u>282,797</u>	<u>1,165,076</u>
	<u>1,712,872</u>	<u>4,393,551</u>
Shareholders' equity		
Common shares (Note 9)	18,962,812	18,462,812
Warrants (Note 9)	-	2,464,383
Contributed surplus (Note 9)	4,157,025	1,514,487
Convertible notes equity component	-	-
Deficit	(21,824,933)	(20,650,860)
	<u>1,294,904</u>	<u>1,790,822</u>
	<u>\$ 3,007,776</u>	<u>\$ 6,184,373</u>
Nature of operations and going concern (Note 1)		
Related party transactions (Note 12)		
Commitments (Note 13)		
Subsequent events (Note 16)		

### On behalf of the board:

“Rob Geisthardt”      Director

“Alan Blair”      Director

See accompanying notes to the consolidated financial statements.

# Primary Petroleum Corporation

## INTERIM CONSOLIDATED STATEMENTS OF LOSS, COMPREHENSIVE LOSS AND DEFICIT (Unaudited)

	Three Months ended November 30,		Six Months ended November 30,	
	2009	2008	2009	2008
<b>Revenue</b>				
Oil and natural gas	\$ 27,874	\$ 374,193	\$ 85,893	\$ 915,648
Royalties	14,482	(50,587)	(19,646)	(147,765)
	<u>42,356</u>	<u>323,606</u>	<u>66,247</u>	<u>767,883</u>
Interest	3,784	1,562	3,784	8,383
	<u>46,140</u>	<u>325,168</u>	<u>70,031</u>	<u>776,266</u>
<b>Expenses</b>				
Operating	39,443	88,786	75,565	161,072
General and administrative	272,664	291,266	441,064	596,141
Interest and finance fees	47,346	63,486	77,465	124,061
Foreign currency translation (gain)	(1,960)	(58,229)	(6,801)	(68,317)
Stock based compensation	80,922	74,970	178,155	175,521
Depletion, depreciation and accretion	32,400	226,538	93,011	454,264
Write-down of property and equipment	97,045	-	387,000	-
	<u>567,860</u>	<u>686,817</u>	<u>1,245,459</u>	<u>1,442,742</u>
<b>Loss before other income and income taxes</b>	<b>(521,720)</b>	<b>(361,649)</b>	<b>(1,175,428)</b>	<b>(666,476)</b>
Gain on sale of property (Note 4)	-	-	1,355	-
Income taxes (recovery)	-	-	-	-
<b>Net loss and other comprehensive loss for the period</b>	<b>(521,720)</b>	<b>(361,649)</b>	<b>(1,174,073)</b>	<b>(666,476)</b>
<b>Deficit, beginning of period</b>	<b>(21,303,213)</b>	<b>(9,771,984)</b>	<b>(20,650,860)</b>	<b>(9,467,157)</b>
<b>Deficit, end of period</b>	<b>\$ (21,824,933)</b>	<b>\$ (10,133,633)</b>	<b>\$ (21,824,933)</b>	<b>\$ (10,133,633)</b>
<b>Net loss per share</b>				
Basic and diluted (note 9)	\$ (0.01)	\$ (0.01)	\$ (0.02)	\$ (0.02)
Weighted average common shares outstanding	<u>59,249,438</u>	<u>43,696,847</u>	<u>54,332,606</u>	<u>44,192,071</u>

See accompanying notes to the consolidated financial statements.

# Primary Petroleum Corporation

## INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Three Months ended November 30,		Six Months ended November 30,	
	2009	2008	2009	2008
<b>Cash Flows from Operating Activities</b>				
Net loss and comprehensive loss	\$ (521,720)	\$ (361,649)	\$ (1,174,073)	\$ (666,476)
Non-cash items				
Depletion, depreciation and accretion	32,400	226,538	93,011	454,264
Write-down of property and equipment	97,045	-	387,000	-
Stock-based compensation	80,922	74,970	178,155	175,521
Gain on sale of property	-	-	(1,355)	-
Unrealized foreign exchange	1,072	(7,445)	2,351	(1,123)
Asset retirement costs incurred	-	(66,826)	-	(66,826)
	<u>(310,281)</u>	<u>(134,412)</u>	<u>(514,911)</u>	<u>(104,640)</u>
Change in non-cash working capital (note 11)				
Accounts receivable	(384)	(14,133)	32,044	171,732
Inventory	-	(2,053)	-	(35,809)
Prepaid expenses	32,190	23,243	72,326	18,811
Accounts payable and accrued liabilities	113,711	(192,868)	201,762	(206,387)
Accrued interest	(8,700)	-	(2,103)	-
	<u>(173,464)</u>	<u>(320,223)</u>	<u>(210,882)</u>	<u>(156,293)</u>
<b>Cash Flows from Financing Activities</b>				
Issue of share capital, net of issue costs (Note 9)	500,000	516,074	500,000	2,958,095
Conversion of convertible notes to shares	-	-	-	(2,250,000)
Credit facility	(250,000)	-	(1,623,340)	-
	<u>250,000</u>	<u>516,074</u>	<u>(1,123,340)</u>	<u>708,095</u>
<b>Cash Flows from Investing Activities</b>				
Expenditures on property and equipment	(1,462)	(187,342)	(1,462)	(832,853)
Net proceeds from sale of asset	31,446	-	1,404,786	-
	<u>29,984</u>	<u>(187,342)</u>	<u>1,403,324</u>	<u>(832,853)</u>
<b>Increase (decrease) in cash and cash equivalents</b>	<b>106,520</b>	<b>8,509</b>	<b>69,102</b>	<b>(281,051)</b>
<b>Cash and cash equivalents, beginning of period</b>	<b>3,989</b>	<b>993,616</b>	<b>41,407</b>	<b>1,283,176</b>
<b>Cash and cash equivalents, end of period</b>	<b>\$ 110,509</b>	<b>\$ 1,002,125</b>	<b>\$ 110,509</b>	<b>\$ 1,002,125</b>

Supplemental disclosure with respect to cash flows  
(Note 10)

See accompanying notes to the consolidated financial statements.

# Primary Petroleum Corporation

## NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

For the three and six months ended November 30, 2009

*(Unaudited)*

### 1. Nature of operations and going concern

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.

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.

As at November 30, 2009, there is significant doubt about the Corporation's ability to continue to meet obligations as they come due as the Corporation has accumulated losses of \$21,824,933, a significant working capital deficiency of \$1,160,423, and has not been able to service its obligations for accounts payable, or meet the obligations of the 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 fulfill its flow-through obligation. The Corporation's working capital deficiency includes a demand loan of \$105,150 and a credit facility of \$416,660. The Corporation has negotiated an extension of the credit facility until March 31, 2010. 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 16 - 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.

### 2. Basis of presentation

These unaudited interim consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles on a basis consistent with those followed in the Corporation's most recent annual consolidated financial statements for the year ended May 31, 2009, except as described in Note 3.

These unaudited interim consolidated financial statements do not include all note disclosures required by Canadian generally accepted accounting principles for annual financial statements, and therefore should be read in conjunction with the annual consolidated financial statements for the year ended May 31, 2009. In the opinion of management, all adjustments considered necessary for fair presentation of the Corporation's financial position, results of operations and cash flows have been included. Operating results for the six-month period ended November 30, 2009 are not necessarily indicative of the results that may be expected for the year ending May 31, 2010.

# Primary Petroleum Corporation

## NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

For the three and six months ended November 30, 2009

*(Unaudited)*

### 3. Significant accounting policies

#### (a) Accounting policy developments in 2010

The following summarizes the accounting changes that were applied to the Corporation's consolidated financial statements for the six months ended November 30, 2009:

##### **Goodwill and Intangible Assets**

Effective June 1, 2009, the Corporation adopted the CICA 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. The adoption of this standard had no material impact on the Corporation's consolidated financial statements.

##### **Business Combinations**

Effective June 1, 2009, the Corporation adopted the CICA 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. The adoption of this guidance had no material impact on the Corporation's consolidated financial statements.

##### **Consolidated Financial Statements and Non-controlling Interests**

Effective June 1, 2009, the Corporation adopted the CICA 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. The adoption of the guidance had no material impact on the Corporation's consolidated financial statements.

##### **Credit Risk and the Fair Value of Financial Assets and Financial Liabilities**

In January 2009, the Emerging Issues Committee ("EIC") issued EIC-173 "Credit Risk and the Fair Value of Financial Assets and Financial Liabilities." This abstract requires companies to take counterparty credit risk into account when measuring the fair value of financial assets and liabilities, including derivatives. The Corporation has performed an assessment and believes that there is no material impact to the Corporation's financial statements as a result of EIC-173.

#### (b) Future accounting policy developments

##### **Transition to International Financial Reporting Standards**

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.

For the Corporation, the transition date will be effective June 1, 2011, and will require the restatement for comparative purposes of amounts reported by the Corporation for the year ended May 31, 2011. While the Corporation has begun assessing the adoption of IFRS for 2011, the financial reporting impact of the transition of IFRS cannot be reasonably estimated at this time.

# Primary Petroleum Corporation

## NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

For the three and six months ended November 30, 2009

(Unaudited)

### 4. Property and equipment

As at November 30, 2009

	Cost	Accumulated depletion, depreciation and Amortization	Net Book Value
Petroleum and natural gas properties	\$19,178,835	\$ (16,464,235)	\$ 2,714,600
Office equipment	101,066	(77,542)	23,524
Net book value	<u>\$ 19,279,901</u>	<u>\$ (16,541,777)</u>	<u>\$ 2,738,124</u>

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>

On July 8, 2009, the Corporation sold its right, title and interest in its principal producing properties located in Montana for total consideration of \$2,394,919 to Commercial Energy of Montana Inc. The consideration included \$1,373,340 in cash, \$781,697 in the assumption of the asset retirement obligation, and \$239,882 in the assumption of royalties payable. As a result of the disposition, the Corporation recorded a gain of \$1,355. The effective date for the purchase and sale of the assets was May 1, 2009. The Corporation maintains certain land in Montana, which is represented in the remaining balance on the accounts.

On September 1, 2009, the Corporation sold its right, title and interest in a portion of its principal producing properties located in Alberta for total consideration of \$134,836 to Husky Oil Operations Ltd. (Husky Oil). The consideration included the offsetting of the indebtedness of \$134,836 owing to Husky Oil. The Company recorded no gain or loss on this transaction.

On November 17, 2009, the Corporation sold its right, title and interest in a portion of its non-producing property located in Montana for total consideration of \$32,700 (USD\$30,000) to NFR Bear Pay Basin LLC (NFR). The consideration included \$32,700 in cash. The Company recorded no gain or loss on this transaction. The effective date for the purchase and sale of the assets was November 1, 2009.

During the six months ended November 30, 2009, the Corporation capitalized geological costs of \$1,462 (November 30, 2008 - \$187,634), which are included in property and equipment.

The cost of unproved properties and unevaluated seismic data excluded from the depletion base at November 30, 2009 was \$2.22 million, of which \$225,000 were in Canada and \$2.0 were in the USA (November 30, 2008 - \$7.54 million, Canada - \$258,000, USA \$7.28 million). Future development costs of \$350,000 (Canada - \$350,000, USA \$Nil) (November 30, 2008 - \$751,000, Canada - \$525,000, USA \$226,000) are included in the depletable base.

# Primary Petroleum Corporation

## NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

For the three and six months ended November 30, 2009

(Unaudited)

The Corporation performed ceiling test calculations at November 30, 2009 to assess whether the carrying value of the property and equipment were recoverable. During the period ended November 30, 2009, the Corporation recognized a reduction in the value of its proved plus probable reserves in Canada and the United States and a reduction in the value of its undeveloped properties, and as a result the Corporation recorded a write-down in the carrying value of its property and equipment for the six month period ended November 30, 2009 of \$387,000.

### 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 12 – 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.

### 6. Credit facility

On May 21, 2008, The Corporation entered into a \$2,000,000 credit facility agreement with a private company. During fiscal 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. The loan bears interest at 18% per annum compounded and payable monthly, and is secured by a general security agreement over all the Corporation's assets. 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. Upon full payment, the credit facility will expire

### 7. Convertible notes

The Corporation has no convertible notes outstanding at November 30, 2009.

The following table summarizes the changes in the liability component of the convertible notes during the year ended May 31, 2009:

	Year ended May 31, 2009
Balance, beginning of period	\$ 2,250,000
Accretion	-
Redeemed for common shares	(2,250,000)
Balance, end of period	\$ -

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 2008, 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.

# Primary Petroleum Corporation

## NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

For the three and six months ended November 30, 2009

(Unaudited)

### 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. As at November 30, 2009, the Corporation has estimated the net present value of its asset retirement obligation to be \$300,000 based on the total undiscounted future obligation of 322,000. 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:

	<b>Six months ended November 30, 2009</b>	Year ended May 31, 2008
Asset retirement obligation, beginning of period	\$ 1,165,076	\$ 1,031,707
Additions and revisions	(107,466)	70,728
Disposition of property	(781,697)	-
Accretion	6,884	78,697
Costs incurred during the period	-	(16,056)
Asset retirement obligation, end of period	<u>\$ 282,797</u>	<u>\$ 1,165,076</u>

### 9. Share capital

#### (a) Authorized

Unlimited number of common shares

#### (b) Issued

	Number of shares	Amount
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
Private placement financing for cash	10,000,000	500,000
Balance, November 30, 2009	<u>59,469,218</u>	<u>\$ 18,962,812</u>

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 November 30, 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 13(a) – Commitments).

On September 3, 2009, the Corporation completed a private placement financing and issued 10,000,000 common shares at a price of \$0.05 per common share, for gross proceeds of \$500,000.

# Primary Petroleum Corporation

## NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

For the three and six months ended November 30, 2009

(Unaudited)

There were no costs associated with share offering. 3,636,601 of these shares are held in escrow and are being released pursuant to exchange policies.

### (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 November 30, 2009, the Corporation had 6,317,500 stock options outstanding for which shares have been reserved.

	Quantity		Weighted average exercise price
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
Granted	500,000		0.10
Forfeited	(1,245,000)		0.06
Balance November 30, 2009	6,317,500	\$	0.37

The fair value of the 500,000 options granted in the six month period ended November 30, 2009 was \$28,563 based on the date of grant using the Black-Scholes option pricing model with the following assumptions: average risk-free rate of 1.12%, expected life of five (5) years, expected volatility of 100% and no expected dividends.

The fair value of the 1,037,500 options granted in the three month period ended November 30, 2008 was \$343,118 based on the date of grant using the Black-Scholes option pricing model with the following assumptions: average risk-free rate of 4.02%, expected life of five (5) years, expected volatility of 100% and no expected dividends.

Options outstanding at November 30, 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	3,867,500	\$ 0.06	2.3	1,348,333	2.1
\$0.40	25,000	\$ -	-	8,333	-
\$0.50	887,000	\$ 0.07	0.5	295,833	0.3
\$1.00	1,537,500	\$ 0.24	0.5	1,058,333	0.3
	6,562,500	\$ 0.37	3.3	3,264,165	3.2

# Primary Petroleum Corporation

## NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

For the three and six months ended November 30, 2009

(Unaudited)

### (d) Contributed surplus

	<u>Amount</u>
Balance, May 31, 2008	\$ 524,949
Fair value of expired warrants	925,000
Stock based compensation	64,338
Balance, May 31, 2009	<u>1,514,487</u>
Fair value of expired warrants	2,464,383
Stock based compensation	178,155
Balance, November 30, 2009	<u>\$ 4,157,025</u>

### (e) Warrants

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

	<u>Number of Warrants</u>	<u>Value</u>
Balance, May 31, 2008	18,742,420	\$ 3,389,583
Expired warrants	(5,445,049)	(925,000)
Balance, May 31, 2009	<u>13,287,371</u>	<u>\$ 2,464,383</u>
Expired warrants	(13,287,371)	(2,464,383)
Balance November 30, 2009	<u>-</u>	<u>\$ -</u>

All the remaining warrants expired during the period ended November 30, 2009.

### (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 November 30, 2009, 6,317,500 options and Nil warrants (November 30, 2008 – 4,400,000 and 16,492,420) were excluded from determining the dilutive effect of stock options and warrants as their impact would be anti-dilutive to this calculation.

### (g) Escrow shares

As at November 30, 2009, 5,448,801 of the issued common shares are held in escrow. These shares are subject to the escrow requirements of the TSX Venture Exchange and will be released from escrow in stages in accordance with securities regulatory requirements.

# Primary Petroleum Corporation

## NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

For the three and six months ended November 30, 2009

*(Unaudited)*

### 10. Supplemental disclosure with respect to cash flows

	<b>Six months ended November 30, 2009</b>	Six months ended November 30, 2008
Interest received	\$ 3,784	\$ 8,283
Interest paid	77,465	124,061

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

During the six months ended November 30, 2009, pursuant to a debt settlement agreement, the Corporation assigned a portion of its Canadian producing property to a third party in exchange for \$134,837 owed to that third party. Under the terms of the agreement, no further costs are to be attributed to the Corporation from that property.

During the six months ended November 30, 2009 as part of the sale of its principal producing property in Montana, the purchaser assumed \$239,882 of the royalties payable previously accrued.

During the six months ended November 30, 2009, the Corporation revised the asset retirement obligations value by \$107,466 for wells it no longer has interest in and made a corresponding adjustment to petroleum and natural gas properties.

# Primary Petroleum Corporation

## NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

For the three and six months ended November 30, 2009

(Unaudited)

### 11. 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:

	Three months ended November 30,			Three months ended November 30,		
	2009			2008		
	Canada	USA	Total	Canada	USA	Total
Oil and gas sales	26,195	1,679	27,874	97,167	277,026	374,196
Interest and finance fees	47,346	-	47,346	63,486	-	63,486
Depletion, depreciation and accretion	49,275	(16,875)	32,400	103,655	122,833	226,538
Write-down of property and equipment	33,891	63,154	97,045	-	-	-
Gain on sale of property	-	-	-	-	-	-
Net income (loss)	(445,329)	(76,391)	(521,720)	(441,866)	80,217	(361,649)
Capital expenditures	-	1,462	1,462	126,517	60,825	187,342
	Six months ended November 30,			Six months ended November 30,		
	2009			2008		
	Canada	USA	Total	Canada	USA	Total
Oil and gas sales	82,493	3,400	85,893	261,236	654,412	915,648
Interest and finance fees	77,465	-	77,465	124,061	-	124,061
Depletion, depreciation and accretion	60,266	32,745	93,011	195,009	295,255	454,264
Write-down of property and equipment	67,478	319,522	387,000	-	-	-
Gain on sale of property	-	1,355	1,355	-	-	-
Net income (loss)	(799,312)	(374,761)	(1,174,073)	(871,321)	204,845	(666,476)
Capital expenditures	1,462	-	1,462	212,821	620,032	832,853
	Balance as at November 30, 2009			Balance as at November 30, 2008		
	Canada	USA	Total	Canada	USA	Total
	Property and equipment	656,463	2,081,661	2,738,124	2,256,246	6,808,921
Total assets	828,375	2,179,401	3,007,776	3,124,028	13,678,067	16,802,095

### 12. Related party transactions

During the six months ended November 30, 2009, 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 \$132,350 (November 30, 2008 – \$206,832) were charged to the Corporation by companies controlled by certain directors and officers of the Corporation. At November 30, 2009, \$82,350 (November 30, 2008 - \$Nil) in relation to these services is included in accounts payable and accrued liabilities.

# Primary Petroleum Corporation

## NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

For the three and six months ended November 30, 2009

*(Unaudited)*

- (b) Legal fees of \$290 (November 30, 2008 – \$Nil) were charged to the Corporation by a legal firm of which a director of the Corporation is a member. At November 30, 2009 \$290 (November 30, 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
- (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 six months ended November 30, 2009.
- (e) In November 2009, an officer and director of the Corporation who is also a significant shareholder, advanced \$9,000 to satisfy certain accounts payable. The advance is without stated terms of repayment, bears no interest and is not secured. The advance was repaid subsequent to November 30, 2009.
- (f) Rent totaling \$6,000 (November 30, 2008 – \$6,000) was charged to the Corporation by a company controlled by an officer and director of the Corporation who is also a significant shareholder. At November 30, 2009, \$1,000 (November 30, 2008 - \$Nil) in relation to these services is included in accounts payable and accrued liabilities.

### 13. 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 November 30, 2009, 80,847 acres were acquired (May 31, 2009 – 80,847 acres). As at November 30, 2009, the Corporation accrued \$Nil (May 31, 2009 – \$Nil) 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 November 30, 2009, the Corporation has accrued a liability of \$Nil (May 31, 2009 – \$Nil) with respect to the issuance of the shares. No further obligation under this agreement is anticipated by the Corporation.
- (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 November 30, 2009, the Corporation had incurred \$399,000 (May 31, 2009 - \$260,000) of Canadian exploration expenditures and is required to incur a minimum of \$226,000 (May 31, 2009 - \$365,000) of Canadian exploration expenditures by December 31, 2009.

# Primary Petroleum Corporation

## NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

For the three and six months ended November 30, 2009

*(Unaudited)*

- (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 6 – Credit facility).
- (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.

### 14. Financial instruments

- (a) Fair value of financial instruments

The Corporation's financial instruments as at November 30, 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.

#### 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. 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.

# Primary Petroleum Corporation

## NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

For the three and six months ended November 30, 2009

*(Unaudited)*

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 November 30, 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 dependent 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 November 30, 2009, the Corporation had a working capital deficiency of \$1,160,423, including a credit facility of \$416,660 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 \$416,660 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. As the credit facility is repaid the amount of the facility is permanently reduced and is not subject to renewal.

### 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 70% of the Corporation's assets are located in the United States, which during the six month period ended November 30, 2009 generated an immaterial amount 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 November 30, 2009.

# Primary Petroleum Corporation

## NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

For the three and six months ended November 30, 2009

*(Unaudited)*

### 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 November 30, 2009.

## 15. 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 November 30, 2009, the Corporation had a demand loan of \$105,150 (See Note 5 – Demand Loan) and a credit facility of \$416,660 (See Note 6 – Credit Facility).

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.

## 16. Subsequent events

- (a) The Corporation announced a private placement of up to 5,000,000 units at \$0.08 per unit for gross proceeds of up to \$400,000. Each unit will comprise of one common share of the Corporation and one-half common share purchase warrant, with each full warrant entitling the holder to purchase one additional common share at a price of \$0.15 per full warrant for a period of one year from the closing of the private placement. The Corporation has closed the first tranche of \$395,000. The offering is subject to regulatory approval. The proceeds will be used for general corporate purposes.
- (b) The Corporation closed on a private placement of up to 1,000,000 common shares on a flow-through basis of the Corporation at \$0.10 per unit for gross proceeds of up to \$100,000. The offering is subject to regulatory approval.

# Primary Petroleum Corporation

## CORPORATE INFORMATION

### **CORPORATE OFFICES**

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Calgary, Alberta, Canada

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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

**Rob Geisthardt** <sup>(1)</sup>

Energy Broker

Powerex Corp.

Incorporated Partner

Quantum Advisory Partners 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

**Paul Plater**

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