PetroFrontier

Consolidated Financial Statements for the years ended December 31, 2010 and 2009

MANAGEMENT'S REPORT

To the Shareholders of PetroFrontier Corp.:

Management is responsible for the preparation of the accompanying consolidated financial statements. Management maintains a system of internal controls to provide reasonable assurance that all assets are safeguarded and to facilitate the preparation of relevant, reliable and timely financial information.

PetroFrontier's external auditors, KPMG LLP, Chartered Accountants, who are appointed by the shareholders, have audited the consolidated financial statements. The Audit Committee has reviewed the consolidated financial statements with management and the auditors and has recommended their approval to the Board of Directors. The Board of Directors has subsequently approved the consolidated financial statements.

"signed"

Paul J. Bennett, H.BSc., MSc., P. Geol.
Chief Executive Officer

"signed"

Shane J. Kozak, CA
Vice President Finance and Chief Financial

Calgary, Canada
April 28, 2011

INDEPENDENT AUDITORS' REPORT

To the Shareholders of PetroFrontier Corp.:

We have audited the accompanying consolidated financial statements of PetroFrontier Corp. ("the Company"), which comprise the consolidated balance sheets as at December 31, 2010 and 2009, the consolidated statements of operations, comprehensive loss and deficit, and cash flows for the year ended December 31, 2010 and the period from February 6, 2009 (date of incorporation) to December 31, 2009, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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 comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

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

"signed"

KPMG LLP
Chartered Accountants

Calgary, Canada
April 27, 2011

CONSOLIDATED BALANCE SHEETS

PetroFrontier Corp.

(Canadian Dollars)

(Audited)

As at	December 31, 2010	December 31, 2009
Assets		
Current		
Cash and cash equivalents	55,710,522	8,279,000
Restricted cash (Note 3)	58,467	-
Accounts receivable	1,675,441	10,919
Prepaid expenses and deposits	321,411	-
	57,765,841	8,289,919
Property, plant and equipment (Note 5)	10,215,976	2,129,008
	67,981,817	**10,418,927**
Liabilities		
Current		
Accounts payable and accrued liabilities	2,764,508	78,347
Shareholders' equity		
Share capital (Note 6)	67,238,959	10,411,608
Contributed surplus (Note 6)	2,088,326	172,421
Accumulated other comprehensive income (Note 6)	789,146	285,608
Deficit	(4,899,122)	(529,057)
	65,217,309	10,340,580
	67,981,817	**10,418,927**

See accompanying notes to the consolidated financial statements
Commitments (Note 11)
Subsequent Events (Note 12)

Approved on behalf of the Board

"signed"	"signed"
Martin P. McGoldrick Director	Robert J. Iverach, Q.C., ICD.D Director

CONSOLIDATED STATEMENTS OF OPERATIONS, COMPREHENSIVE LOSS AND DEFICIT

PetroFrontier Corp.

(Canadian Dollars)

(Audited)

	For the year ended December 31, 2010	**For the period from February 6, 2009 (date of incorporation) to December 31, 2009**
Revenues		
Interest revenue	99,881	-
Expenses		
General and administrative	2,425,504	355,805
Stock based compensation (Note 6)	2,035,328	172,421
Interest and banking	8,601	831
Depreciation	513	-
	4,469,946	529,057
Net loss	**(4,370,065)**	**(529,057)**
Other comprehensive income		
Foreign exchange gain on self-sustaining foreign operations	503,538	285,608
Comprehensive loss	**(3,866,527)**	**(243,449)**
Deficit, beginning of period	(529,057)	-
Deficit, end of period	**(4,899,122)**	**(529,057)**
Net loss per share (Note 6)		
Basic and diluted	**($0.24)**	**($0.06)**

See accompanying notes to the consolidated financial statements

CONSOLIDATED STATEMENTS OF CASH FLOWS

PetroFrontier Corp.

(Canadian Dollars)

(Audited)

	For the year ended December 31, 2010	For the period from February 6, 2009 (date of incorporation) to December 31, 2009
Cash provided by (used in)		
Operating		
Net loss	(4,370,065)	(529,057)
Stock based compensation (Note 6)	2,035,328	172,421
Non-cash general and administrative	150,000	
Depreciation	513	-
	(2,184,224)	(356,636)
Change in non-cash working capital (note 7)	2,229,191	78,508
	44,967	(278,128)
Financing		
Issuance of common shares net of share issue costs	55,362,928	9,411,608
Issuance of common shares from exercise of stock options	195,000	-
	55,557,928	9,411,608
Investing		
Expenditure on petroleum and natural gas properties	(6,563,014)	(843,561)
Restricted cash (Note 3)	(58,467)	-
Changes in non-cash working capital (note 7)	(1,549,892)	(10,919)
	(8,171,373)	(854,480)
Increase in cash and cash equivalents	47,431,522	8,279,000
Cash and cash equivalents, beginning of period	8,279,000	-
Cash and cash equivalents, end of period	**55,710,522**	**8,279,000**

See accompanying notes to the consolidated financial statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

PetroFrontier Corp.
For the years ended December 31, 2010
Audited
(Canadian Dollars)

PetroFrontier Corp. ("the Corporation") was incorporated as Australia Energy Corp. ("AEC") on February 6, 2009. AEC amalgamated with Pendulum Capital Corporation ("Pendulum") on December 31 2010, and the amalgamated company changed its name to PetroFrontier. PetroFrontier is engaged in the business of international petroleum exploration in Australia, through its wholly owned Australian subsidiary, PetroFrontier (Australia) Pty Ltd. ("PetroFrontier (Australia)").

1. EXPLORATION STAGE CORPORATION

Since incorporation, PetroFrontier has been engaged primarily in the pursuit of petroleum and natural gas through exploration efforts in Northern Territory, Australia. To date, the Corporation has not earned revenue from these operations and is considered to be in the development stage. The recoverability of the costs incurred to date is uncertain and dependent upon achieving commercial production or sale, the ability of the Corporation to obtain sufficient financing to fulfill its obligations under the petroleum exploration licenses and upon future profitable operations.

These financial statements have been prepared by management in accordance with accounting principles applicable to a going concern, which assumes that the Corporation will continue in operation for the foreseeable future and will be able to realize upon its assets and discharge its liabilities in the normal course of operations. At December 31, 2010, the Corporation had working capital of $55,001,333 and a deficit of $4,899,122. The Corporation's petroleum licenses are in the exploration stage. During December 2010, the Corporation closed a series of private placement offerings for gross proceeds of $58,500,000 through the issuance of 29,250,000 common shares of the Corporation at $2.00 per common share. With current working capital on hand, the Corporation has adequate funding to provide for general operations and to meet the Corporation's minimum work requirements with the government of the Northern Territory of Australia for a period of at least 12 months.

2. SIGNIFICANT ACCOUNTING POLICIES

Nature of Business and Basis of Presentation

PetroFrontier is involved in the exploration for petroleum and natural gas in Australia. These consolidated financial statements are stated in Canadian dollars and have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). The preparation of financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the period. Actual results may differ from those estimates.

Joint Operations

Substantially all of the Corporation's exploration activities are conducted in joint participation with others and the accounts reflect only the Corporation's proportionate interest in such activities.

Measurement Uncertainty

The preparation of financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period.

A) Petroleum and Natural Gas Properties

(i) Oil and natural gas properties

The Corporation follows the full cost method of accounting for oil and natural gas operations, whereby all costs related to the acquisition, exploration and development of oil and natural gas reserves are capitalized. Such costs include lease acquisition costs, geological and geophysical costs, carrying charges of undeveloped properties, costs of drilling both productive and nonproductive wells, the cost of oil and natural gas production equipment and overhead charges directly related to exploration and development activities.

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

Oil and natural gas properties ("the properties") are assessed by the Corporation in each reporting period to determine if there are events or circumstances that would indicate it is unlikely the carrying value of the properties will not be recovered in the future. If there are costs that are considered unlikely to be recovered, they are charged to earnings.

Proceeds from the disposition of oil and natural gas properties are applied against capitalized costs except for dispositions that would change the rate of depletion and depreciation by 20 percent or more, in which case a gain or loss would be recorded.

(ii) Other capital assets

Administrative capital assets are depreciated over their estimated useful lives at annual rates ranging from 10% to 100%. Leasehold improvements are amortized on a straight-line basis over the remaining lease term.

B) Cash and Short-Term Investments

Cash and short-term investments consist of cash in the bank, less outstanding cheques and short-term deposits with an original maturity of less than three months.

C) Asset Retirement Obligations

The Corporation records a liability for the fair value of legal obligations associated with the retirement of long-lived tangible assets in the period in which they are incurred, normally when the asset is purchased or developed. On recognition of the liability there is a corresponding increase in the carrying amount of

the related asset known as the asset retirement cost, which is depleted on a unit-of-production basis over the life of the reserves. The liability is adjusted each reporting period to reflect the passage of time, with the accretion charged to earnings, and for revisions to the estimated future cash flows. Actual costs incurred upon settlement of the obligations are charged against the liability. As at December 31, 2010, the Corporation has not recorded an asset retirement liability as no wells or facilities have been constructed.

D) Income Taxes

The Corporation follows the asset and liability method of accounting for income taxes. Temporary differences arising from the differences between the tax basis of an asset or liability and its carrying amount on the balance sheet are used to calculate future income tax assets or liabilities. Future income tax assets or liabilities are calculated using tax rates anticipated to apply in the periods that the temporary differences are expected to reverse. Future income tax assets are recognized with respect to deductible temporary differences and loss carryforwards only to the extent that their realization is considered more likely than not.

E) Stock Based Compensation

The Corporation follows the fair value method for valuing stock option grants. Under this method, compensation cost, attributable to stock options granted issued to employees and directors of PetroFrontier, is measured at fair value at the grant date and expensed over the vesting period with a corresponding increase to contributed surplus. Upon the exercise of the stock options, consideration paid together with the amount previously recognized in contributed surplus is recorded as an increase to share capital.

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

F) Foreign currency translation

The functional currency of the Australian Subsidiary is the Australian dollar. Therefore, assets and liabilities denominated in a foreign currency of self-sustaining foreign operations are translated into Canadian dollars at the rate of exchange in effect at the balance sheet date. Revenues and expenses are translated at rates in effect at the time of the transactions. Unrealized exchange gains and losses resulting from changes in the foreign exchange rate at the measurement date are included in the financial statements of the Corporation as Other Comprehensive Income/(loss) within a separate component of shareholders' equity entitled Accumulated Other Comprehensive Income. Realized gains and losses of foreign currency transactions are included in earnings.

G) Per share amounts

Net loss per common share is computed by dividing net loss for the period by the weighted average number of common shares outstanding in the period. Diluted per share amounts reflect the potential dilution that could occur if securities or other contracts to issue common shares were exercised or converted to common shares. The treasury stock method is used to determine the dilutive effect of stock options and other dilutive instruments, whereby it is assumed that the exercise of "in the money" stock options and warrants are used by the Corporation to repurchase Corporation shares at the weighted average market price during the year.

H) Financial Instruments

The Corporation accounts for Financial Instruments in one of five ways: (i) held for trading; (ii) held to maturity; (iii) loans and receivables; (iv) available-for-sale; or (v) other financial liabilities. The Corporation's cash and short term deposits are considered held for trading and the values they are carried at approximate their fair values due to their short term nature. Accounts receivable, accounts payable and related accruals are considered loans and receivables and are carried at amortized costs. The Corporation does not currently participate in any hedging activities.

Other comprehensive income represents items such as the change in equity arising from unrealized gains and losses from financial instruments designated as available-for-sale, changes in fair market value of derivatives designated as hedges and unrealized gains/losses on translation of foreign subsidiaries, are presented as a separate component of shareholders' equity on the balance sheet.

PetroFrontier classifies the fair value of the financial instruments according to the following hierarchy based on the amount of observable inputs used to value the instrument.

- Level 1 – Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions occur in sufficient frequency and volume to provide pricing information on an ongoing basis.

- Level 2 – Pricing inputs are other than quoted prices in active markets included in Level 1. Prices are either directly or indirectly observable as of the reporting date. Level 2 valuations are based on inputs, including quoted forward prices for commodities, time value and volatility factors, which can be substantially observed or corroborated in the marketplace.

- Level 3 – Valuations in this level are those with inputs for the asset or liability that are not based on observable market data.

Assessment of the significance of a particular input to the fair value measurement requires judgment and may affect the placement within the fair value hierarchy level.

The fair value of accounts receivable, accounts payable and accrued liabilities approximate their carrying amounts due to their short-terms to maturity.

Future Accounting Changes

International Financial Reporting Standards (IFRS)

On February 13, 2008, the Accounting Standards Board (AcSB) confirmed that the changeover to IFRS from Canadian GAAP will be required for publicly accountable enterprises for interim and annual financial statements, effective for fiscal years beginning on or after January 1, 2011, including comparatives for 2010. The objective is to improve financial reporting by having a single set of accounting standards that are comparable with other entities on an international basis. The transition from current Canadian GAAP to IFRS is a significant undertaking that will materially affect the Corporation’s reported financial position and results of operations. The Corporation 37 continues to monitor standards developments issued by the International Accounting Standards Board and the AcSB, as well as regulatory developments issued by the Canadian Securities Administrators which may affect the timing, nature or disclosure of its adoption of IFRS.

Business Combinations

In 2009 a new standard 1582, Business Combinations replaced the previous business combinations standard. The new standard applies prospectively to business combinations on or after January 1, 2011 with earlier adoption permitted. Under this standard, the purchase price used in a business combination is based on the fair value of shares exchanged at the market price at the acquisition or closing date. Under the current standard, the purchase price used is based on the market price of the shares for a reasonable period before and after the date the acquisition is announced. In addition, the new standard requires all acquisition costs to be expensed while the current standard allows for the capitalization of these costs as part of the purchase price. The new standard also addresses contingent liabilities, which will be required to be recognized at fair value on acquisition and subsequently re-measured at each reporting period until settled. The current standard requires only contingent liabilities that are payable to be recognized. The new standard requires negative goodwill to be recognized in earnings rather than the current standard of deducting from non-current assets in the purchase price allocation. The Corporation is currently assessing the impact of the standard. The adoption of section 1582 will also require the adoption of sections 1601 "Consolidated Financial Statements" and 1602 "Non-controlling interests". The Corporation is currently assessing the impact of the standard.

Consolidated Financial Statements and Non-Controlling Interests

In 2009 two new standards, 1601, Consolidated Financial Statements and 1602, Non-Controlling Interests, were issued which replace the existing guidance under section 1600, Consolidated Financial Statements. Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 provides guidance on accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. These standards are effective for business combinations occurring on or after January 1, 2011, with early application permitted. The Corporation is currently assessing the impact of the standard.

3. RESTRICTED CASH

On June 15, 2010, PetroFrontier (Australia) deposited $1,500,000 (Australian) into PetroFrontier (Australia)'s lawyers' trust account as evidence that it has the financial capacity to complete its obligations under the Baraka Farmin Agreements. However, if the Corporation decides to cease operations under the Baraka Farmin Agreements this deposit is fully refundable. At December 31, 2010, $1,442,457 (Australian) had been refunded to the Corporation to fund future capital expenditures. At December 31, 2010, the trust account balance of $58,467 (Canadian equivalent) has been classified as restricted cash.

4. ACQUISITIONS

Effective December 31, 2010, Pendulum acquired all of the issued and outstanding shares of AEC. As consideration, Pendulum issued 47,146,801 common shares on the basis of one Pendulum share for every one AEC share. Although the legal parent in the acquisition is Pendulum, the transaction under securities regulations and for accounting purposes deemed control to pass to the legal subsidiary, AEC, and accordingly, reverse takeover accounting applied (note 6).

The transaction was accounted for by the purchase method based on fair values as follows:

	$
Net assets acquired:	
Cash	280,826
Other net working capital	7,502
	288,328
Consideration:	
Common shares	288,328

5. PROPERTY, PLANT AND EQUIPMENT

	December 31 2010 $	December 31 2009 $
Land costs and acquisitions	3,338,892	1,154,835
Seismic acquisition	4,626,007	974,173
Drilling preparations	2,249,027	-
Office furniture and equipment	2,563	-
Accumulated depreciation	(513)	-
	10,215,976	**2,129,008**

No amounts relating to general and administrative expenses or stock based compensation were capitalized in 2010 or 2009.

Effective October 7, 2010, AEC entered into a purchase and sale agreement (the “NTO Agreement”), with Northern Territory Oil Pty. Ltd. (“NTO”), whereby AEC agreed to purchase (the “NTO Acquisition”) NTO’s entire 25% working interest in EP 127 and EP 128, which EP`s cover approximately 7.8 million gross acres before royalties of undeveloped land. Under the terms of the NTO Agreement, AEC agreed pay to NTO the sum of $2,000,000 ($1,000,000 by the payment of cash and $1,000,000 by the issuance of common shares). On December 31, 2010, the Corporation closed this acquisition.

6. SHARE CAPITAL

A) Authorized

Unlimited number of common voting shares, no par value.
Unlimited number of preferred shares, no par value, issuable in series.

B) Issued – common shares of Pendulum

	December 31, 2010		December 31, 2009	
	Number of Shares	($)	Number of Shares	($)
Common shares				
Balance, beginning of period (Note 4)	7,000,000	288,328	-	-
Issued for cash	-	-	7,000,000	500,000
Agent options			-	(15,900)
Share issue costs	-	-	-	(108,368)
Consolidation of outstanding common shares (1-for-12 basis) (v)	(6,416,667)	-	-	-
Shares issued to acquire outstanding shares of AEC	47,146,801	66,950,631	-	-
Balance, end of period	**47,730,134**	**67,238,959**	**7,000,000**	**375,732**

Under reverse takeover accounting, the authorized and issued share capital is that of Pendulum, while the stated value is that of AEC. Immediately following the amalgamation of Pendulum and AEC the name of the amalgamated company was changed to PetroFrontier.

C) Issued – common shares of AEC

	December 31, 2010		December 31, 2009	
	Number of Shares	($)	Number of Shares	($)
Common shares				
Balance, beginning of period	16,631,801	10,411,608	-	-
Issued upon incorporation	-	-	1	-
Private placement (i)	100,000	100,000		
Issued upon acquisition of exploration permits (ii)	500,000	1,000,000	4,000,000	1,000,000
Shares issued for services (iii)	75,000	150,000		
Private placements(iv)	29,250,000	58,500,000	12,631,800	10,039,200
Exercise of stock options (vi)	590,000	314,423	-	-
Share issue costs	-	(3,525,400)	-	(627,592)
Balance, end of period	**47,146,801**	**66,950,631**	**16,631,801**	**10,411,608**

Issue of Common Shares

(i) On September 1, 2010, a director of AEC acquired 100,000 common shares at an issue price of $1.00 per common share for total proceeds of $100,000.

(ii) Effective October 7, 2010, the AEC entered into a purchase and sale agreement (the "NTO Agreement"), with Northern Territory Oil Pty. Ltd. ("NTO"), whereby AEC agreed to purchase (the "NTO Acquisition") NTO's entire 25% working interest in EP 127 and EP 128, which EP`s cover approximately 7.8 million gross acres before royalties of undeveloped land. Under the

terms of the NTO Agreement, AEC agreed pay to NTO the sum of $2,000,000 ($1,000,000 by the payment of cash and $1,000,000 by the issuance of common shares). On December 31, 2010, the Corporation closed this acquisition, which resulted in the issuance of 500,000 common shares at $2.00 per common share.

(iii) On October 15, 2010, 75,000 AEC common shares valued at $2.00 per common share were issued to an arm's length third party as consideration for professional services rendered.

(iv) On December 8, 2010, AEC closed a brokered private placement for gross proceeds of $53,000,000 by issuing 26,500,000 subscription receipts of AEC at $2.00 per subscription receipt. The subscription receipts were automatically converted to common shares of the Corporation at no additional consideration, upon amalgamation with Pendulum. On December 22 and 29, 2010, AEC closed a non-brokered private placement for gross proceeds of $4,546,500 and $953,500 by issuing 2,273,250 and 476,750 common shares of AEC at $2.00 per common share.

(v) On December 31, 2010, AEC and Pendulum amalgamated resulting in 1-for-12 consolidation of 6,416,667 common shares.

(vi) For the twelve months ended December 31, 2010, 590,000 stock options were exercised having an average exercise price of $0.33 per common share.

D) Stock options

Employees, officers, directors and consultants of PetroFrontier may be granted options to purchase common shares. Options granted have a term of five years to expiry and typically vest equally over a two year period on the basis of one-third on the date of grant, one-third on the first anniversary date of the grant, and one-third on the second anniversary date of the grant. The exercise price of each option equals the market price of the Corporation's common shares on the date of grant.

The following table summarizes the changes to the Corporation's option plan for the year ended December 31, 2010:

	Number of options	Weighted average price ($)
Balance, December 31, 2009	1,600,000	0.65
Granted	3,040,000	1.74
Exercised	(590,000)	0.33
Cancelled	(10,000)	0.75
Balance, December 31, 2010	**4,040,000**	**1.52**

The following table summarizes stock options outstanding and exercisable under the plan at December 31, 2010.

	Options outstanding			Options exercisable	
Exercise price	**Number outstanding at period end**	**Weighted average remaining contractual life**	**Weighted average exercise price**	**Number exercisable at period end**	**Weighted average exercise price**
$0.25	220,000	3.2	$0.25	146,668	$0.25
$1.00	1,375,000	4.2	$1.00	458,333	$1.00
$1.20	230,000	4.8	$1.20	76,666	$1.20
$2.00	2,215,000	5	$2.00	738,326	$2.00
	4,040,000	**4.6**	**$1.52**	**1,419,993**	**$1.45**

In addition, there were 58,333 Pendulum stock options and 25,000 Pendulum agent`s options outstanding as at December 31, 2010 with strike prices of $1.20 and remaining contractual lives of 1 year and 1.6 years, respectively. No stock based compensation has been recorded for these options as all were fully vested at the time of the amalgamation and as such any associated stock based compensation was recorded as part of the reverse takeover accounting.

E) Stock Based Compensation

The Corporation accounts for its stock based compensation plan using the fair value method. Under this method, a compensation cost is charged over the vesting period for stock options granted to employees, officers, directors and consultants of PetroFrontier, with a corresponding increase to contributed surplus.

The following table summarizes the changes in contributed surplus:

	December 31, 2010 ($)	**December 31, 2009 ($)**
Balance, beginning of period	172,421	-
Stock based compensation expense	2,035,328	172,421
Exercise of stock options	(119,423)	-
Balance, end of period	**2,088,326**	**172,421**

The fair value of the options granted during the year ended December 31, 2010 was estimated on the date of grant using the Black-Scholes option pricing model with weighted average assumptions and resulting values for grants as follows:

Assumptions	**December 31, 2010**	**December 31, 2009**
Risk free interest rate (%)	2.26	4.12
Expected life (years)	5.00	5.00
Expected volatility (%)	104	55
Expected dividends	-	-
Weighted average fair value of options granted	**$1.34**	**$0.34**

F) Per common share amounts

The basic weighted average number of common shares outstanding for the years ended December 31, 2010 and 2009 were 18,592,270 and 8,662,428. As the Corporation has recorded a loss for the years ended December 31, 2010 and 2009, no addition is made to the basic weighted average number of common shares when calculating diluted weighted average number of common shares as the diluted per common share amounts are anti-dilutive.

G) Accumulated Other Comprehensive Income

	December 31, 2010 ($)	December 31, 2009 ($)
Balance, beginning of period	285,608	-
Foreign exchange gain on translation of self-sustaining foreign operations	503,538	285,608
Balance, end of period	**789,146**	**285,608**

H) Management of capital structure

The Corporation's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain the future development of the business.

The Corporation manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of the underlying petroleum and natural gas assets. The Corporation considers its capital structure to include shareholders' equity, bank debt and working capital, however as at December 31, 2010, the Corporation has no bank debt.

As the Corporation is in the development phase and has not yet generated funds from operations, it is unable to monitor capital based on the ratio of net debt to annualized funds generated from operations. Therefore the Corporation monitors capital based on the projected rate of capital spending and available funds on hand. In order to adjust the capital structure, the Corporation may from time to time issue shares and/or adjust its capital spending levels.

During December 2010, the Corporation closed a series of private placement offerings for gross proceeds of $58,500,000 through the issuance of 29,250,000 common shares of the Corporation at $2.00 per common share. With current working capital on hand, the Corporation has adequate funding to provide for general operations and to meet the Corporation’s minimum work requirements with the government of the Northern Territory of Australia for a period of at least 12 months.

7. Supplemental Cash Flow Information

Changes in non-cash working capital

	Year ended December 31, 2010 ($)	Period ended December 31, 2009 ($)
Accounts receivable	**(1,664,522)**	(10,919)
Prepaid expenses and deposits	**(321,411)**	-
Accounts payables and accrued liabilities	**2,686,161**	78,347
Other	**(20,929)**	161
Change in non-cash working capital	**679,299**	67,589
Relating to:		
Investing activities	**(1,549,892)**	(10,919)
Operating activities	**2,229,191**	78,508
Financing activities	**-**	-
	679,299	67,589

8. FUTURE INCOME TAXES

The recovery of income taxes differs from the amount computed by applying the combined statutory Canadian federal and provincial tax rates to losses before income taxes as follows:

	Year ended December 31, 2010 ($)	Period ended December 31, 2009 ($)
Net loss before recovery	**(4,370,065)**	(529,057)
Statutory income tax rate	**28%**	29.00%
Expected recovery	**(1,223,618)**	(153,427)
Add (deduct):		
Non-deductible stock based compensation	**569,892**	50,002
Impact of changes and differences in tax rates	**5,440**	13,612
Change in valuation allowance	**648,286**	89,813
Future income tax recovery	-	**-**

The tax effects of temporary differences that give rise to significant portions of the future income tax assets and liabilities at December 31, 2010 and 2009 for the Canadian and Australian entities are as follows:

	2010		2009	
Future income tax assets	**Australia**	**Canada**	Australia	Canada
	($)	**($)**	($)	($)
Non-capital loss carryforwards	**3,070,982**	**675,692**	563,894	109,473
Share issue costs	-	**805,103**	-	128,613
Property, plant and equipment and other	**(2,823,982)**	-	(553,068)	**-**
Valuation allowance	**(247,000)**	**(1,480,795)**	(10,826)	(238,086)
Net future income tax asset	-	-	-	-

The Corporation has non-capital losses as at December 31, 2010 of approximately $10.2 million (2009 - $1.8 million) in Australia which have no expiry and $2.7 million (2009 - $0.4 million) in Canada which expire between 2029 and 2030.

9. FINANCIAL INSTRUMENTS

Fair value of financial assets

The fair value of accounts receivable, accounts payable and accrued liabilities approximate their carrying amounts due to their short-terms to maturity.

Credit risk

Credit risk is the risk that a third party fails to meet its contractual obligations that could result in the Corporation incurring a loss. The Corporation's accounts receivable are primarily with joint venture partners. Receivables from joint partners arise when the Corporation invoices them for their share of the costs. As at December 31, 2010, there was no allowance for doubtful accounts for the joint venture receivables as all amounts are considered collectable.

Currency risks

PetroFrontier is exposed to exchange rate fluctuations in relation to amounts due to services it must purchase in foreign currencies including the Australian Dollar and the United States dollar. As at December 31, 2010, the Corporation's cash and cash equivalents included approximately $1,691,376 denominated in Australian Dollars. Management continually monitors the Corporation's currency risk and believes this exposure is not material to its overall operations. No foreign currency derivative transactions have been undertaken by the Corporation since inception.

Interest rate risk

The Corporation is exposed to interest rate fluctuations in relation to the interest income earned on cash and cash equivalent balances. As at December 31, 2010, the Corporation had $55,710,552 in cash and cash equivalents. Management believes this exposure is not material to its overall operations.

Liquidity risk

Liquidity risk relates to the risk the Corporation will encounter difficulty in meeting obligations associated with financial liabilities. The financial liabilities on its balance sheet are limited to accounts payable. The Corporation anticipates it will continue to have adequate liquidity to fund its existing financial liabilities and ongoing operating and general administrative expenses through its existing working capital. The pace of future capital investment and the related financial liabilities incurred from the capital investment program will be dependent upon the Corporation's capacity to secure additional equity financing on favorable terms. The Corporation had no defaults or breaches on any of its financial liabilities.

Market risk

Market risk is comprised of currency risk, interest rate risk and other price risks which consist primarily of fluctuations in petroleum and natural gas prices. With no bank debt as at December 31, 2010, there is no direct exposure to fluctuations in interest rates. As the Corporation is in the development stage, fluctuations in commodity prices bear no direct risk to the Corporation's revenue, however adverse fluctuations in interest rates, exchange rates and commodity prices may indirectly affect the Corporation's ability to obtain equity financing and future bank debt, if required, and on favorable terms.

10. RELATED PARTY TRANSACTIONS

On February 26, 2009, the Corporation issued 2,000,000 common shares to each of Rodinia Oil Corp. ("Rodinia") and Odin Capital Inc. ("Odin") in exchange for the transfer of all of Rodinia's and Odin's rights, title and interest in EP 103 and EP 104 in accordance with the Farmout and Participation Agreement between Rodinia, Odin and Texalta Australia Pty. Ltd., a wholly-owned subsidiary of Texalta Petroleum Ltd. Rodinia maintains significant influence over the Corporation by virtue of its 4% ownership of the issued and outstanding common shares of the Corporation and because the Corporation and Rodinia share five common directors and three common executives. Mr. Peter A. Philipchuk (the Vice President Exploration of the Corporation) and Mr. Matthew P. Philipchuk (President and a director of the Corporation) control Odin. The transaction was measured at exchange value and has been included in property, plant and equipment on the balance sheet of the Corporation for the period ended December 31, 2009.

In accordance with the terms of an Administrative Services Agreement ("ASA"), Rodinia provides certain administrative services and office accommodations to the Corporation on a cost recovery basis. ASA charges are recorded to general & administrative services in the Corporation's financial statements.

11. COMMITMENTS

EP 103 Minimum Work Plan Commitment

In accordance with the terms of the EP 103 agreement with the government of the Northern Territory of Australia, the Corporation has the following minimum work commitments and timelines:

Year	Start	End	Minimum work requirements	Status/cost estimates as at December 31, 2010
Year 1	November 21, 2006	November 20, 2007	Seismic studies, reprocessing and interpretation	Completed
6 month extension of license – October 3, 2008				
6 month extension of license – March 12, 2009				
Year 2	November 21, 2007	November 20, 2009	Acquire 100 km 2D seismic	Completed
6 month extension and variation of license – January 8, 2010				
Year 3	November 21, 2009	May 20, 2011	Acquire 150 km 2D seismic	Completed
Year 4	May 21, 2011	May 20, 2012	Drill one exploration well	Outstanding
Year 5	May 21, 2012	May 20, 2013	Drill one exploration well	Outstanding

EP 104 Minimum Work Plan Commitment

In accordance with the terms of the EP 104 agreement with the government of the Northern Territory of Australia, the Corporation has the following minimum work commitments and timelines:

Year	Start	End	Minimum work requirements	Status/cost estimates as at December 31, 2010
Year 1	November 21, 2006	November 20, 2007	Seismic studies, reprocessing and interpretation	Completed
6 month extension of license – October 3, 2008				
6 month extension of license – March 12, 2009				
Year 2	November 21, 2007	November 20, 2009	Acquire 100 km 2D seismic	Completed
6 month extension and variation of license – January 8, 2010				
Year 3	November 21, 2009	May 20, 2011	Acquire 150 km 2D seismic	Completed
Year 4	May 21, 2011	May 20, 2012	Drill one exploration well	Outstanding
Year 5	May 21, 2012	May 20, 2013	Drill one exploration well	Outstanding

On April 1, 2010, the Corporation entered into two farmin agreements (the "Baraka Farmin Agreements") with Baraka Petroleum Limited ("Baraka), pursuant to which the Corporation earned a 50% working interest in 7.8 million gross undeveloped acres before royalties (3.9 million net) in EP 127 and EP 128 in the Northern Territory, Australia. These exploration permits offset the Corporation's EP 103 and EP 104 to the north, west and south in the Southern Georgina Basin. The Corporation will be the Operator under the Baraka Farmin Agreements.

Under the terms of the Baraka Farmin Agreements, the Corporation is required to:

i) meet the minimum (governmental) work commitments on EP127 and EP128 for the year 3 work program (beginning in June 2010), being the "acquisition of seismic data";

ii) commence the drilling of one horizontal well into the basal Arthur Creek Shale zone on either of EP127 or EP128 by the first day of the 6th month of the year 3 work program; and

iii) commission a resource evaluation report in respect of EP127 and/or EP128, to be prepared by a reputable engineering firm of Georgina's choice, before the date that is 4 months after the date of the Baraka Farmin Agreement.

As at December 31, 2010, the Corporation had completed requirement iii) above under the Baraka Farmin Agreements. The remaining commitments under the Baraka Farmin Agreement will be met in accordance with the EP 127 and EP 128 Minimum Work Plan Commitments below.

EP 127 Minimum Work Plan Commitments

In accordance with the terms of the EP 127 agreement with the government of the Northern Territory, Australia, the Corporation has the following minimum work commitments and timelines:

Year	**Start**	**End**	**Minimum work requirements**	**Status/cost estimates as at December 31, 2010**
Year 1	December 14, 2007	December 13, 2008	Geological and geophysical studies	Completed
6 month extension and variation of license – March 17, 2010				
Year 2	December 14, 2008	June 13, 2010	Stratigraphic review Satellite structural and fracture image study	Completed
Year 3	June 14, 2010	June 13, 2011	Acquire seismic data	Outstanding
Year 4	June 14, 2011	June 13, 2012	Acquire seismic data Contingent on seismic results, drill one well	Outstanding
Year 5	June 14, 2012	June 13, 2013	Drill one well Contingent on Year 4 drilling, drill two wells	Outstanding

EP 128 Minimum Work Plan Commitments

In accordance with the terms of the EP 128 agreement with the government of the Northern Territory, Australia, the Corporation has the following minimum work commitments and timelines:

Year	Start	End	Minimum work requirements	Status/cost estimates as at December 31, 2010
Year 1	December 14, 2007	December 13, 2008	Geological and geophysical studies	Completed
6 month extension and variation of license – March 17, 2010				
Year 2	December 14, 2008	June 13, 2010	Stratigraphic review Satellite structural and fracture image study	Completed
Year 3	June 14, 2010	June 13, 2011	Acquire seismic data	Outstanding
Year 4	June 14, 2011	June 13, 2012	Acquire seismic data Contingent on seismic results, drill one well	Outstanding
Year 5	June 14, 2012	June 13, 2013	Drill one well Contingent on Year 4 drilling, drill two wells	Outstanding

As at December 31, 2010, the Corporation had the following material contracts and commitments:

	Total	2011	2012	2013	2014	2015
EP 103 minimum commitments	3,700,532	-	1,850,266	1,850,266	-	-
EP 104 minimum commitments	3,742,092	-	1,871,046	1,871,046	-	-
EP 127 minimum commitments	9,837,713	5,732,161	-	4,105,552	-	-
EP 128 minimum commitments	8,469,195	258,091	4,105,552	4,105,552	-	-
Office lease	13,934	13,934	-	-	-	-
	25,763,466	**6,004,186**	**7,826,864**	**11,932,416**	**-**	**-**

12. SUBSEQUENT EVENTS

On March, 21, 2011, the Corporation and Texalta Petroleum Ltd. ("Texalta") entered into an Arrangement Agreement (the "Arrangement Agreement") to complete a business combination (the "Transaction") pursuant to which the Corporation will acquire all of the outstanding shares of Texalta.

Pursuant to the terms of the Arrangement Agreement, each Texalta shareholder shall be entitled to receive, at their election: (i) C$1.58 cash for each Class A common share of Texalta ("**Texalta Share**"); (ii) 0.45 of a common share of PetroFrontier for each Texalta Share; or (iii) any combination of (i) or (ii) in respect of the Texalta Shares held thereby, subject to no more than an aggregate of $10,000,000 in cash being paid to Texalta shareholders. The Transaction requires approval by the Texalta shareholders at a special shareholders meeting expected to be held in May 2011. All directors and officers of Texalta, as well as certain shareholders representing in aggregate 30.95% of the outstanding Texalta shares, have entered into lock-up agreements to vote in favour of the Transaction. Subject to receipt of shareholder, court and regulatory approval, the Transaction is expected to close in late May 2011. Pursuant to the terms of the Arrangement Agreement, each of PetroFrontier and Texalta have agreed to pay to the other party a termination fee of $2,000,000 under certain circumstances.

NOTES *(continued)*

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Chief Executive Officer
PetroFrontier Corp.
Calgary, Alberta

Matthew P. Philipchuk
President
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Martin P. McGoldrick, P. Eng., MBA
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Kent Jespersen, BSc., MSc.
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Dr. James W. Buckee
Businessman
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Officers
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Chief Executive Officer

Matthew P. Philipchuk
President

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