

United Hunter Oil & Gas Corp.

Consolidated Financial Statements

(expressed in US dollars)

December 31, 2012 and 2011

INDEPENDENT AUDITORS' REPORT

To the Shareholders of United Hunter Oil & Gas Corp.

We have audited the accompanying consolidated financial statements of United Hunter Oil & Gas Corp. and its subsidiaries, which comprise the consolidated statements of financial position as at December 31, 2012, and December 31, 2011 and the consolidated statements of loss and comprehensive loss, changes in equity and cash flows for the years then ended and 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 International Financial Reporting Standards, 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 the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated 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 United Hunter Oil & Gas Corp. and its subsidiaries as at December 31, 2012, and December 31, 2011 and the results of its operations and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

Emphasis of Matter

Without qualifying our opinion, we draw attention to Note 2 in the consolidated financial statements which describes matters and conditions that indicate the existence of material uncertainties that may cast significant doubt about the Company's ability to continue as a going concern.

Collins Barrow Toronto LLP

Licensed Public Accountants
Chartered Accountants
April 25, 2013
Toronto, Ontario

United Hunter Oil & Gas Corp.

Consolidated Statements of Financial Position

(expressed in US dollars)

	Notes	As at December 31,	
		2012	2011
		\$	\$
Assets			
Current			
Cash		142,322	413,967
Accounts receivable		31,281	118,587
Prepaid expenses		43,846	145,015
		<u>217,449</u>	<u>677,569</u>
Exploration and evaluation	2 and 5	4,727,088	4,745,297
Property, plant and equipment	6	230,972	717,879
		<u>5,175,509</u>	<u>6,140,745</u>
Liabilities			
Current			
Accounts payable and accrued liabilities		324,770	347,021
Due to joint venture partner		-	25,507
Consideration payable	7	800,000	800,000
		<u>1,124,770</u>	<u>1,172,528</u>
Decommissioning liabilities		53,919	52,749
		<u>1,178,689</u>	<u>1,225,277</u>
Shareholders' equity			
Share capital	8	7,923,357	7,519,574
Warrants	8	-	403,783
Contributed surplus		2,136,458	1,959,250
Deficit		(6,062,995)	(4,967,139)
		<u>3,996,820</u>	<u>4,915,468</u>
		<u>5,175,509</u>	<u>6,140,745</u>
Going-concern	2		
Subsequent event	14		

Approved by the Board:

Arthur Halleran
Director

William Smith
Director

United Hunter Oil & Gas Corp.

Consolidated Statements of Loss and Comprehensive Loss

(expressed in US dollars)

	Notes	Years ended December 31,	
		2012	2011
		\$	\$
Revenues			
Oil sales	11	729,463	315,196
Royalties		14,590	-
Net revenues		714,874	315,196
Gain on revaluation of warrant liability		-	432,389
Foreign exchange gain		5,058	18,502
Interest income		348	15,774
		720,280	781,861
Expenses			
Operating and transportation		198,554	394,880
Depletion	6	528,943	210,843
Impairment losses	6	24,807	735,130
Loss on sale of exploration and evaluation		-	326,829
Professional fees		169,420	165,487
Management fees		-	48,750
Salaries		387,154	586,037
Consulting fees		61,049	192,060
Share-based compensation	8	177,208	365,156
Premises		2,550	44,629
General and administrative		82,084	57,139
Public company costs		33,693	25,544
Investor relations		29,698	155,808
Travel		38,241	69,375
Permitting		105,445	193,642
Gain on reduction in joint venture interest	5	(32,972)	-
Other loss		10,262	-
		1,816,136	3,571,309
Net loss and comprehensive loss		(1,095,856)	(2,789,448)
Basic and diluted loss per share		(0.01)	(0.02)
Weighted average number of shares outstanding - basic and diluted		120,302,722	120,302,722

United Hunter Oil & Gas Corp.

Consolidated Statements of Changes in Equity

(expressed in US dollars)

	Share capital \$	Warrants \$	Contributed surplus \$	Deficit \$	Total \$
Balance, December 31, 2011	7,519,574	403,783	1,959,250	(4,967,139)	4,915,468
Share-based compensation	-	-	177,208	-	177,208
Fair value of expired warrants	403,783	(403,783)	-	-	-
Loss	-	-	-	(1,095,856)	(1,095,856)
Balance, December 31, 2012	7,923,357	-	2,136,458	(6,062,994)	3,996,820
Balance, December 31, 2010	7,519,574	403,783	1,594,094	(2,177,691)	7,339,760
Share-based compensation	-	-	365,156	-	365,156
Loss	-	-	-	(2,789,448)	(2,789,448)
Balance, December 31, 2011	7,519,574	403,783	1,959,250	(4,967,139)	4,915,468

United Hunter Oil & Gas Corp.

Consolidated Statements of Cash Flows

(expressed in US dollars)

	Years ended December 31,	
	2012	2011
	\$	\$
Cash flow from operating activities		
Loss	(1,095,856)	(2,789,448)
Items not affecting cash		
Depletion	528,943	210,843
Impairment losses	24,807	735,130
Share-based compensation	177,208	365,156
Loss on sale of exploration and evaluation	-	326,829
Gain on reduction in joint venture interest	(32,972)	-
Gain on revaluation of warrant liability	-	(432,389)
Changes in non-cash working capital		
Accounts receivable	87,306	(33,635)
Due to joint venture partner	(25,507)	128,901
Prepaid expenses	101,169	(76,398)
Accounts payable and accrued liabilities	(22,252)	(528,635)
Due to joint venture partner	-	25,507
Decommissioning liabilities	1,169	-
	<u>(255,983)</u>	<u>(2,068,139)</u>
Cash flow from investing activities		
Proceeds on sale of exploration and evaluation	-	300,000
Exploration and evaluation expenditures	51,182	(1,459,649)
Property, plant and equipment	(66,843)	-
	<u>(15,662)</u>	<u>(1,159,649)</u>
Net change in cash	(271,645)	(3,227,788)
Cash, beginning of year	413,967	3,641,755
Cash, end of year	<u>142,322</u>	<u>413,967</u>
Supplementary information		
Interest received	348	15,744
Interest paid	-	-
Income taxes paid	-	-

United Hunter Oil & Gas Corp.

Notes to Consolidated Financial Statements

(expressed in US dollars)

December 31, 2012 and 2011

1. Nature of operations

United Hunter Oil & Gas Corp. (the "Company") is a public company engaged in the exploration and development of oil and gas properties. On January 1, 2012, the Company amalgamated with its wholly-owned subsidiary United Hydrocarbon Corporation. The Company owns a 65% indirect joint venture interest in Excelaron, LLC ("Excelaron"), an exploration stage company based in San Luis Obispo, California; a 25% joint venture interest (2011 – 45%) in Alamo Creek Oil LLC ("Alamo"), an exploration stage company based in San Luis Obispo, California; and interests in oil and gas properties in Alberta.

The Company was incorporated under the Business Corporations Act of Ontario on February 22, 2008 and its registered office is located at 181 Bay Street, Suite 1800, Toronto, ON M5J 2T9.

2. Going concern

The consolidated financial statements were prepared on a going concern basis, which assumes that the Company will continue in operation for the foreseeable future and will be able to realize its assets and discharge its liabilities and commitments in the normal course of business.

The Company has financed its operations through the issue of equity. At December 31, 2012, the Company had a working capital deficit of \$907,321 (December 31, 2011 – \$494,959) and for the year ended December 31, 2012, the Company incurred losses of \$1,095,856 (2011 - \$2,789,448) and negative cash flows from operations of \$255,983 (2011 - \$2,068,139). The working capital deficiency and losses limit the Company's ability to fund operations and the exploration and development of oil and gas properties. In addition, there is uncertainty whether the Company will secure conditional use permits for its planned exploration and development of the Huasna property and in the event the conditional use permits are secured, the Company is committed to make a payment of \$800,000. As a result, there is significant doubt about the Company's ability to continue as a going concern.

The continuation of the Company as a going concern is dependent on completing an equity financing and securing conditional use permits for its Huasna property. The Company will work to raise the necessary financing and secure the conditional use permits, but the outcome of these efforts cannot be predicted at this time.

The consolidated financial statements do not reflect the adjustments to the carrying values of assets and liabilities and the reported expenses and balance sheet classifications that would be necessary were the going concern assumption inappropriate.

3. Basis of presentation

Statement of compliance

The consolidated financial statements are prepared in accordance with IFRS as issued by the International Accounting Standards Board.

The consolidated financial statements were approved and authorized for issue by the Board of Directors on April 25, 2013.

Basis of measurement

These consolidated financial statements have been prepared on the historical cost basis.

Functional and presentation currency

These consolidated financial statements are presented in US dollars, which is the functional currency of the Company and its joint ventures.

Use of estimates

The preparation of financial statements in conformity with IFRS requires the Company's management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

United Hunter Oil & Gas Corp.

Notes to Consolidated Financial Statements

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December 31, 2012 and 2011

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the year in which the estimates are revised and in any future years affected.

Judgments

The key judgments made in applying accounting policies that have the most significant effect on the amounts recognized in these consolidated financial statements are as follows:

Identification of cash generating units

Cash generating units ("CGUs") are defined as the lowest grouping of integrated assets that generate identifiable cash inflows that are largely independent of the cash inflows of other assets or groups of assets. The classification of assets into cash generating units requires significant judgment and interpretations with respect to shared infrastructure, geographical proximity, petroleum type and similar exposure to market risk and materiality.

Estimates

Information about assumptions and estimation uncertainties that have a significant risk of resulting in a material adjustment within the next financial year are as follows:

Impairment of exploration and evaluation

Expenditures on exploration and evaluation are initially capitalized with the intent to establish commercially viable reserves. The Company makes estimates about future events and circumstances in determining whether the carrying amount of exploration and evaluation exceeds its recoverable amount.

Estimates of oil and natural gas reserves

Depletion and depreciation as well as the amounts used in impairment calculations are based on estimates of oil reserves. Reserves estimates are based on engineering data, estimated future prices, expected future rates of production and the timing of future capital expenditures, all of which are subject to many uncertainties and interpretations. At least once per year, a reserves estimate is prepared by independent qualified reserves evaluators. The Company expects that, over time, its reserves estimates will be revised upward or downward based on updated information such as the results of future drilling, testing and production levels, and may be affected by changes in commodity prices. See note 6.

Recoverable amounts of CGUs

The recoverable amount of a CGU used in the assessment of impairment of property, plant and equipment is the greater of its value in use ("VIU") and its fair value less costs to sell ("FVLCTS"). VIU is determined by estimating the present value of the future net cash flows from the continued use of the CGU, and is subject to the risks associated with estimating the value of reserves. FVLCTS refers to the amount obtainable from the sale of a CGU in an arm's length transaction between knowledgeable, willing parties, less costs of disposal.

Recoverable amounts of the Company's CGUs were based on their estimated VIU. The key assumptions and estimates of the value of oil reserves are valid at the time of reserves estimation and market assessment and are subject to change as new information becomes available. Changes in international and regional factors including supply and demand of commodities, inventory levels, drilling activity, currency exchange rates, weather, geopolitical and general economic environment factors may result in significant changes to the estimated recoverable amounts of CGUs. See note 6.

Decommissioning liabilities

Decommissioning liabilities are estimated based on the Company's net ownership interest in all wells and facilities, estimated costs to reclaim and abandon these wells and facilities and the estimated timing of the costs to be incurred in future years, based on current legal and constructive requirements and technology. The estimated liabilities and actual costs may change significantly due to changes in regulations, technology, timing of the expenditure, and the discount rates used to determine the net present value of the obligations.

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Deferred income taxes

Deferred income tax assets and liabilities are measured using enacted or substantively enacted tax rates at the reporting date in effect for the period in which the temporary differences are expected to be recovered or settled. The effect on deferred income tax assets and liabilities of a change in tax rates is recognized as part of the provision for income taxes in the period that includes the enactment date. The recognition of deferred income tax assets is based on the assumption that it is probable that taxable profit will be available against which the deductible temporary differences can be utilized. See note 12.

Share-based compensation

The Company uses the Black-Scholes option pricing model in determining share-based compensation, which requires a number of assumptions to be made, including the risk-free interest rate, expected life, forfeiture rate and expected share price volatility. Consequently, the actual share-based compensation expense may vary from the amount estimated. See note 8.

4. Significant accounting policies and future accounting changes

The accounting policies set out below have been applied consistently to all years presented in these consolidated financial statements.

Basis of consolidation

Subsidiaries

Subsidiaries are entities controlled by the Company. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

Jointly controlled operations

Many of the Company's activities are conducted jointly with others. The consolidated financial statements include the Company's proportionate share of the joint ventures.

Transactions eliminated on consolidation

All intercompany transactions and balances are eliminated on consolidation.

Foreign currencies

Transactions in foreign currencies are translated to US dollars at exchange rates in effect on the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are translated to US dollars at the period end exchange rate. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are translated to US dollars at the exchange rate in effect on the date that the fair value was determined. Foreign currency differences arising on translation are recognized in the consolidated statement of loss and comprehensive loss.

Financial instruments

Non-derivative financial assets

The Company initially recognizes loans and receivables and deposits on the date that they are originated. All other financial assets (including assets designated at fair value through profit or loss) are recognized initially on the trade date, which is the date that the Company becomes a party to the contractual provisions of the instrument.

The Company derecognizes a financial asset when the contractual rights to the cash flows from the asset expire, or it transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. Any interest in transferred financial assets that is created or retained by the Company is recognized as a separate asset or liability.

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Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Company has a legal right to offset the amounts and intends either to settle on a net basis or to realize the asset and settle the liability simultaneously.

The Company classifies non-derivative financial assets into the following categories: financial assets at fair value through profit or loss, held-to-maturity financial assets, loans and receivables and available-for-sale financial assets.

Financial assets at fair value through profit or loss

A financial asset is classified at fair value through profit or loss if it is classified as held for trading or is designated as such upon initial recognition. Financial assets are designated at fair value through profit or loss if the Company manages such investments and makes purchase and sale decisions based on their fair value in accordance with the Company's documented risk management or investment strategy. Attributable transaction costs are recognized in profit or loss as incurred. Financial assets at fair value through profit or loss are measured at fair value, and changes therein are recognized in profit or loss.

The Company has not classified any financial asset as fair value through profit or loss.

Held-to-maturity financial assets

If the Company has the positive intent and ability to hold debt securities to maturity, then such financial assets are classified as held-to-maturity. Held-to-maturity financial assets are recognized initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition held-to-maturity financial assets are measured at amortized cost using the effective interest method, less any impairment losses.

The Company has not classified any financial asset as held-to-maturity.

Loans and receivables

Loans and receivables are financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are recognized initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition, loans and receivables are measured at amortized cost using the effective interest method, less any impairment losses.

The Company has classified cash and accounts receivables as loans and receivables.

Available-for-sale financial assets

Available-for-sale financial assets are non-derivative financial assets that are designated as available for sale or are not classified in any of the above categories of financial assets. Subsequent to initial recognition, they are measured at fair value and changes therein, other than impairment losses and foreign currency differences on available-for-sale assets, are recognized in other comprehensive income and presented in the fair value reserve in equity. When an investment is derecognized, the gain or loss accumulated in equity is reclassified to profit or loss.

The Company has not classified any financial asset as available-for-sale.

Non-derivative financial liabilities

The Company initially recognizes debt securities issued and subordinated liabilities on the date that they are originated. All other financial liabilities (including liabilities designated at fair value through profit or loss) are recognized initially on the trade date, which is the date that the Company becomes a party to the contractual provisions of the instrument.

The Company derecognizes a financial liability when its contractual obligations are discharged, cancelled or expire.

The Company classifies non-derivative financial liabilities into the other financial liabilities category. Such financial liabilities are recognized initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition, these financial liabilities are measured at amortized cost using the effective interest method.

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The Company has classified accounts payable and accrued liabilities and consideration payable as other financial liabilities.

Derivative financial liabilities

Derivative financial liabilities, including warrant liability, are recorded at "fair value through profit or loss" and accordingly recorded on the balance sheet date at fair value. Unrealized gains and losses on derivatives held for trading are recorded as part of other gains or losses in earnings. Fair values for derivative instruments are determined using valuation techniques, using assumptions based on market conditions existing at the balance sheet date.

The Company has not classified any financial liability as a derivative liability.

Impairment of non-derivative financial assets

A financial asset is assessed at each reporting date to determine whether there is objective evidence that it is impaired. A financial asset is impaired if objective evidence indicates that a loss event has occurred after the initial recognition of the asset, and that the loss event had a negative effect on the estimated future cash flows of that asset that can be estimated reliably.

Financial assets carried at amortized cost

An impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the asset's original effective interest rate. The carrying amount of the financial asset is reduced by the amount of the impairment loss and the impairment loss is recognized in profit or loss. When a subsequent event causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through profit or loss.

Available-for-sale financial assets

An impairment loss in respect of a financial asset classified as available-for-sale is calculated as the difference between the acquisition cost and the current fair value, less any impairment loss recognized previously in profit or loss. The impairment loss is recognized by reclassifying the loss from equity to profit or loss. When a subsequent event causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through profit or loss, except in the case of equity investments where the decrease in impairment loss is recognized in other comprehensive income.

Exploration and evaluation

Recognition and measurement

Pre-license costs are expensed when incurred.

Exploration and evaluation, including the costs of acquiring licenses and directly attributable general and administrative costs, initially are capitalized as exploration and evaluation. The costs are accumulated in cost centres by well, field or exploration area pending determination of technical feasibility and commercial viability.

Impairment

Exploration and evaluation are allocated to the related CGU's to assess for impairment, both at the time of any triggering facts and circumstances as well as upon their eventual reclassification to producing assets (oil interests in property, plant and equipment).

Exploration and evaluation are assessed for impairment if (i) sufficient data exists to determine technical feasibility and commercial viability, and (ii) facts and circumstances suggest that the carrying amount exceeds the recoverable amount. For purposes of impairment testing, exploration and evaluation is tested at a well level.

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The technical feasibility and commercial viability of extracting an oil and gas resource is considered to be determinable when proved and/or probable reserves are determined to exist. A review of each exploration license or field is carried out, at least annually, to ascertain whether proved and/or probable reserves have been discovered. Upon determination of proved and/or probable reserves, exploration and evaluation attributable to those reserves are first tested for impairment and then reclassified from exploration and evaluation to property, plant and equipment or expensed to the statement of loss and comprehensive loss to the extent of any impairment.

Property, plant and equipment

Recognition and measurement

Property, plant and equipment, including costs incurred to develop oil reserves and maintain or enhance production and directly attributable general and administration costs, are measured at cost less accumulated depletion and accumulated impairment losses.

The gain or loss on disposal of property, plant and equipment is determined by comparing the proceeds from disposal with the carrying amount of the property, plant and equipment, and is recognized in profit or loss.

Subsequent costs

Costs incurred subsequent to the determination of technical feasibility and commercial viability and the costs of replacing parts of property, plant and equipment are recognized as oil and natural gas interests only when they increase the future economic benefits embodied in the specific asset to which they relate. All other expenditures are recognized in earnings as incurred. Capitalized oil and natural gas interests generally represent costs incurred in developing proved and/or probable reserves and bringing on or enhancing production from such reserves, and are accumulated on a field or geotechnical area basis.

Depletion and depreciation

The net carrying value of development or production assets is depleted on a field by field basis using the unit of production method by reference to the ratio of production in the year to the related proven and probable reserves, taking into account estimated future development costs necessary to bring those reserves into production. Future development costs are estimated taking into account the level of development required to produce the reserves. These estimates are reviewed by independent reserve engineers at least annually.

Impairment

The carrying amounts of property, plant and equipment are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, the estimated recoverable amount is calculated. For the purpose of impairment testing, assets are grouped together into CGUs, the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets. The recoverable amount of an asset or a CGU is the greater of its VIU and its FVLCTS.

In assessing VIU, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money. VIU is generally computed by reference to the present value of the future cash flows expected to be derived from production of proved and probable reserves.

When significant parts of an item of property, plant and equipment, including oil interests, have different useful lives, they are accounted for as separate items (components).

An impairment loss is recognized in the statement of loss and comprehensive loss if the carrying amount of an asset or its CGU exceeds its estimated recoverable amount.

Impairment losses previously recognized are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of accumulated depletion and depreciation, if no impairment loss had been recognized.

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Decommissioning liabilities

The Company's activities give rise to dismantling, decommissioning and site disturbance remediation activities. Provision is made for the estimated cost of site restoration. Decommissioning obligations are measured at the present value of management's best estimate of expenditures required to settle the present obligation at the balance sheet date. The fair value of the estimated obligation is recorded as a liability with a corresponding increase in the carrying amount of the related asset. The obligation is subsequently adjusted at the end of each period to reflect the passage of time and changes in the estimated future cash flows underlying the obligation. The increase in the provision due to the passage of time is recognized as accretion costs whereas increases or decreases due to changes in the estimated future cash flows or changes in the discount rate are capitalized. Actual costs incurred upon settlement of the decommissioning obligations are charged against the provision to the extent the provision was established.

Share capital

Common shares are classified as equity. Incremental costs directly attributable to the issue of common shares are recognized as a deduction from equity, net of any tax effects.

Revenue and expenses from the sale of oil

Revenue from the sale of oil is recognized based on volume delivered at contractual delivery points and rates.

Expenses associated with the delivery, including operating, transportation and production-based royalties, are recognized in the period that the related revenue is recognized.

Share-based payments

The Company offers a stock option plan for its employees. The fair value of stock options for each vesting period is determined using the Black-Scholes option pricing model and is recorded over the vesting period as an increase to stock-based compensation and contributed surplus. A forfeiture rate is estimated on the grant date and is adjusted to reflect the actual number of options that vest. Upon the exercise of stock options, the proceeds received by the Company and the related contributed surplus are recorded as an increase to share capital. In the event that vested stock options expire, previously recognized share-based compensation is not reversed. In the event that stock options are cancelled or forfeited, previously recognized share-based compensation associated with the unvested portion of those stock options is reversed.

The fair value of share-based payment transactions to non-employees and other share-based payments are based on the fair value of the goods and services received. If the fair value cannot be estimated reliably, the share-based payment transaction is measured at the fair value of the equity instruments granted at the date the Company receives the goods or services.

Provisions

A provision is recognized if, as a result of a past event, the Company has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability. The unwinding of the discount is recognized as a finance cost.

Income tax

Income tax expense comprises current and deferred tax. Current tax and deferred tax is recognized in profit or loss except to the extent that it relates to a business combination, or items recognized directly in equity or in other comprehensive income.

Current tax is the expected tax payable or receivable on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years. Current tax payable also includes any tax liability arising from the declaration of dividends.

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Deferred tax is recognized in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognized for:

- temporary differences on the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit or loss;
- temporary differences related to investments in subsidiaries and jointly controlled entities to the extent that it is probable that they will not reverse in the foreseeable future; and
- taxable temporary differences arising on the initial recognition of goodwill.

Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

A deferred tax asset is recognized for unused tax losses, tax credits and deductible temporary differences, to the extent that it is probable that future taxable profits will be available against which they can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

Loss per share

The Company presents basic and diluted loss per share data for its common shares. Basic earnings per share is calculated by dividing the loss attributable to ordinary shareholders of the Company by the weighted average number of common shares outstanding during the period, adjusted for own shares held. Diluted earnings per share is determined by adjusting the loss attributable to common shareholders and the weighted average number of common shares outstanding, adjusted for own shares held, for the effects of all dilutive potential ordinary shares, which comprise outstanding warrants and stock options.

New standards and interpretations not yet adopted

The following new standards, amendments to standards and interpretations are effective for periods beginning on or after January 1, 2013:

IFRS 10, Consolidation ("IFRS 10")

IFRS 10 requires an entity to consolidate an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Under existing IFRS, consolidation is required when an entity has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. IFRS 10 replaces SIC-12 Consolidation—Special Purpose Entities and parts of IAS 27 Consolidated and Separate Financial Statements.

IFRS 11, Joint Arrangements ("IFRS 11")

IFRS 11 requires a venturer to classify its interest in a joint arrangement as a joint venture or joint operation. Joint ventures will be accounted for using the equity method of accounting whereas for a joint operation the venturer will recognize its share of the assets, liabilities, revenue and expenses of the joint operation. Under existing IFRS, entities have the choice to proportionately consolidate or equity account for interests in joint ventures. IFRS 11 supersedes IAS 31, Interests in Joint Ventures, and SIC-13, Jointly Controlled Entities—Non-monetary Contributions by Venturers.

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IFRS 12, Disclosure of Interests in Other Entities ("IFRS 12")

IFRS 12 establishes disclosure requirements for interests in other entities, such as joint arrangements, associates, special purpose vehicles and off-balance sheet vehicles. The standard carries forward existing disclosures and also introduces significant additional disclosure requirements that address the nature of, and risks associated with, an entity's interests in other entities.

IFRS 13, Fair Value Measurement ("IFRS 13")

IFRS 13 is a comprehensive standard for fair value measurement and disclosure requirements for use across all IFRS standards. The new standard clarifies that fair value is the price that would be received to sell an asset, or paid to transfer a liability in an orderly transaction between market participants, at the measurement date. It also establishes disclosures about fair value measurement.

Amendments to other standards

In addition, there have been amendments to existing standards, including IAS 27, Separate Financial Statements (IAS 27), and IAS 28, Investments in Associates and Joint Ventures (IAS 28). IAS 27 addresses accounting for subsidiaries, jointly controlled entities and associates in non-consolidated financial statements. IAS 28 has been amended to include joint ventures in its scope and to address the changes in IFRS 10-13.

The following amendment to standards and interpretations is effective for periods beginning on or after January 1, 2015:

IFRS 9, Financial Instruments ("IFRS 9")

IFRS 9 addresses classification and measurement of financial assets and replaces the multiple category and measurement models in IAS 39 for debt instruments with a new mixed measurement model having only two categories: amortized cost and fair value through profit or loss. IFRS 9 also replaces the models for measuring equity instruments, and such instruments are either recognized at fair value through profit or loss or at fair value through other comprehensive income. Where such equity instruments are measured at fair value through other comprehensive income, dividends are recognized in profit or loss to the extent not clearly representing a return of investment; however, other gains and losses (including impairments) associated with such instruments remain in accumulated comprehensive income indefinitely.

Requirements for financial liabilities were added in October 2010 and they largely carried forward existing requirements in IAS 39, *Financial Instruments - Recognition and Measurement*, except that fair value changes due to credit risk for liabilities designated at fair value through profit and loss would generally be recorded in other comprehensive income.

Effect of new standards

IFRS 9, IFRS 10, IFRS 11 and IFRS 12 are expected to have an effect on the consolidated financial statements of the Company. The Company has not determined the extent of the impact of these standards and does not plan to early adopt these new standards.

5. Exploration and evaluation

	Huasna \$	Atlee Buffalo \$	Leduc Woodbend \$	Porter Ranch \$	Total \$
Balance, December 31, 2010	4,665,138	476,300	332,142	50,000	5,523,580
Additions	23,299	1,187,551	189,282	6,860	1,406,992
Disposition	—	—	(521,424)	—	(521,424)
Transfer to property, plant and equipment	—	(1,663,851)	—	—	(1,663,851)
Balance, December 31, 2011	4,688,437	—	—	56,860	4,745,297
Loss on reduction in joint venture interest	—	—	—	(18,209)	(18,209)
Balance, December 31, 2012	4,688,437	—	—	38,651	4,727,088

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Exploration and evaluation consists of the Company's exploration projects which are pending the determination of proved or probable reserves. Additions represent the Company's share of costs incurred on exploration and evaluation during the period.

Huasna

The Company holds an indirect 65% joint venture interest in Excelaron, which holds a 100% interest in an oil and natural gas property consisting of 260 acres on the western edge of the Huasna Basin, an existing California Department of Oil, Gas and Geothermal Resources designated oilfield within the Meridian Anticline located in Arroyo Grande, California. Huasna is subject to a 5% assignable gross overriding royalty payable on all amounts received directly or indirectly by the Company that can be attributed to the Company's 65% joint venture interest in Excelaron.

The planned exploration and development of Huasna requires Excelaron to secure necessary permits from regulatory authorities. On August 21, 2012, the Board of Supervisors of San Luis Obispo County ("County") denied Excelaron's application for conditional use permits. On November 19, 2012, Excelaron filed a petition for writ of mandate, complaint inverse condemnation and damages action ("Petition") in the Superior Court of the State of California, County of San Luis Obispo ("Superior Court") against the County seeking a writ commanding the County to set aside its decision denying Huasna and either approving or remanding Huasna to the Board of Supervisors for further consideration consistent with the Court's opinion on the merits or to recover just compensation for the value of Huasna, as well as reasonable attorney's fees, expenses, and costs of the suit. See note 14 for subsequent event.

Although the Company holds a 65% joint venture interest in Excelaron, the joint operating agreement has established joint control over Excelaron by all parties with a joint venture interest. As at and for the years ended December 31, the consolidated financial statements included the following amounts related to the Company's 65% joint venture interest in Excelaron:

	2012	2011
	\$	\$
Statements of financial position		
Current assets	31,621	21,668
Exploration and evaluation	1,143,547	1,143,547
Current liabilities	57,429	85,435
Statements of loss and comprehensive loss		
Expenses	192,791	340,406
Net loss	192,791	340,406
Statements of cash flows		
Cash flow from operating activities	(339,772)	(308,828)
Cash flow from financing activities	355,384	318,489
Cash flow from investing activities	-	(22,376)

Atlee Buffalo

The Company owns a 95% working interest in a portion of the Alberta Mannville G oil field ("Atlee Buffalo") subject to gross overriding royalties of 2% payable to a company controlled by a director and officer of the Company and to a former director and officer of the Company.

Production commenced at Atlee Buffalo in 2011 and the related costs were transferred to property, plant and equipment.

Leduc Woodbend

On November 2, 2011, the Company sold its interest in Leduc Woodbend for cash of C\$300,000 and a 12% gross overriding royalty ("GOR") on the production from the test well completed by the Company. The purchaser has agreed to tie in the test well and attempt production. To the extent that the tie in costs exceeds C\$200,000, the purchaser will be entitled to recover up to C\$150,000 of the costs as a reduction to the GOR payable to the Company. In the event that the purchaser has not tied in the test well and attempted production within 8 months of the sale, the purchaser will pay

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C\$150,000 to the Company as an advance royalty, which will be deducted from the GOR payable to the Company. Provided that the purchaser has tied in the test well and pursued production for 6 Leduc months after the tie-in and the test well is not capable of economic production, the purchaser's obligation to continue production will terminate. As a result of the sale, the Company recorded a loss on the sale of exploration and evaluation of \$326,829 in 2011. Within 8 months of the sale, the purchaser tied in the well, attempted production and then shut-in the well.

Porter Ranch

The Company owns a 25% joint venture interest in Alamo Creek Oil LLC ("Alamo") which has leased 4,068 acres ("Porter Ranch") adjacent to the Santa Maria Basin, which is south east of the Company's Huasna property. Effective March 31, 2012, the Company declined to pay its share of a cash call and its joint venture interest in Alamo was reduced from 45% to 25% and the Company recorded a gain of \$32,972 on the reduction of its interest in Porter Ranch.

6. Property, plant and equipment

In 2011, the Company commenced operations at Atlee Buffalo.

Cost

	\$
Balance, December 31, 2010	—
Transfer from exploration and evaluation	1,663,851
Balance, December 31, 2011	1,663,851
Additions	66,844
Balance, December 31, 2012	1,730,695

Accumulated depletion and impairment losses

	\$
Balance, December 31, 2010	—
Depletion	210,843
Impairment losses	735,130
Balance, December 31, 2011	945,973
Depletion	528,943
Impairment losses	24,807
Balance, December 31, 2012	1,499,723

Carrying amounts

	\$
At December 31, 2010	—
At December 31, 2011	717,879
At December 31, 2012	230,972

Impairment losses

During the year ended December 31, 2012, the Company recorded impairment losses of \$22,648 (2011 - \$735,130) based upon VIU using reserve estimates from its independent qualified reserve evaluators, a discount rate of 10% and the following estimated oil prices:

Year	\$ per bbl
2013	65.01
2014	66.44
2015	68.58
2016	70.01
2017	71.44

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At December 31, 2012, if the discount rate had been 5% higher or lower, the impairment losses recognized would have been revised as follows:

	\$
Reduction of impairment loss using 5% discount rate	8,238
Additional impairment using 15% discount rate	8,566

7. Consideration payable

The Company is committed to pay \$800,000 when Excelaron secures its permits for its planned operations on its oil and gas properties. In the event that Excelaron does not secure such permits or the Company does not pay the \$800,000, the Company's 65% joint venture interest in Excelaron will be reduced to a 40% joint venture interest.

8. Share capital

Authorized

An unlimited number of common shares

Unlimited number of preference shares, issuable in series.

Outstanding

	Share capital	
	Number of shares	Amount \$
Balance, December 31, 2010 and December 31, 2011	120,302,722	7,519,574
Fair value of expired warrants	–	403,783
Balance, December 31, 2012	120,302,722	7,923,357

Consolidation of outstanding shares

On December 10, 2012, a proposed consolidation of the issued common shares on the basis of 1 new share for 4 old common shares did not receive shareholder approval.

Warrants

A summary of the Company's warrants is presented below:

	Number of warrants	Weighted- average exercise price C\$	\$
Balance, December 31, 2010 and December 31, 2011	33,525,000	0.38	403,783
Expired	(33,525,000)	0.38	(403,783)
Balance, December 31, 2012	–	–	–

Stock options

Under its stock option plan, the Company may grant options to its employees to acquire up to 10% of the issued and outstanding common shares at the time of the grant. As at December 31, 2012, there were 12,030,272 common shares available for issuance under the stock option plan.

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A summary of the Company's stock options is presented below:

	Number of options	Weighted- average exercise price C\$
Balance, December 31, 2010	9,775,000	0.15
Granted	1,600,000	0.15
Expired	(1,000,000)	0.15
Balance, December 31, 2011	10,375,000	0.15
Granted	350,000	0.10
Expired	(1,000,000)	0.15
Cancelled	(750,000)	0.15
Balance, December 31, 2012	8,975,000	0.15

A summary of the Company's outstanding stock options at December 31, 2012 is presented below:

Exercise price	Expiry date	Options outstanding	Options exercisable
C\$0.15	May 12, 2015	5,600,000	3,733,333
C\$0.15	July 20, 2015	1,000,000	1,000,000
C\$0.15	August 31, 2015	425,000	283,333
C\$0.15	January 18, 2016	650,000	433,333
C\$0.15	May 5, 2016	600,000	400,000
C\$0.15	September 19, 2016	350,000	233,333
C\$0.10	September 4, 2017	350,000	116,667
		8,975,000	6,200,000

The weighted average remaining contractual life of outstanding stock options is 2.66 years.

A summary of the stock options granted and the assumptions for the calculation of the fair value of those stock options using the Black-Scholes option pricing model is presented below:

	January 18, 2011	May 5, 2011	September 19, 2011	September 4, 2012
Options granted	650,000	600,000	350,000	350,000
Exercise price	C\$0.15	C\$0.15	C\$0.15	C\$0.10
Share price	C\$0.08	C\$0.12	C\$0.085	C\$0.02
Expiry date	January 18, 2016	May 5, 2016	September 19, 2016	September 4, 2017
Fair value	\$35,000	\$54,000	\$20,000	\$4,000
Risk-free interest rate	2.58%	2.50%	1.43%	1.32%
Expected volatility	100%	100%	100%	100%
Expected life of options	5 years	5 years	5 years	5 years
Expected dividend yield	Nil	Nil	Nil	Nil
Forfeiture rate	Nil	Nil	Nil	Nil
Vesting	1/3 on date of grant and 1/3 each in 2 annual instalments			

Expected volatility was based on historical volatility of securities of comparable companies. The weighted-average grant date fair value of stock options granted during year was \$0.01 per stock option (2011 - \$0.07).

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9. Determination of fair values

A number of the Company's accounting policies and disclosures require the determination of fair value, for both financial and non-financial assets and liabilities. Fair values have been determined for measurement and/or disclosure purposes based on the following methods. When applicable, further information about the assumptions made in determining fair values is disclosed in the notes specific to that asset or liability.

Cash, accounts receivable, accounts payable and accrued liabilities, and consideration payable

The fair values of cash, accounts receivable, accounts payable and accrued liabilities and consideration payable are estimated as the present value of future cash flows, discounted at the market rate of interest at the reporting date. At December 31, 2012 and December 31, 2011, the fair value of these balances approximated their carrying value due to their short term to maturity.

Exploration and evaluation and property, plant and equipment

The Company estimated the VIU to determine the recoverable amounts of the Company's CGUs for impairment testing based on consideration of the following:

- net present value of proved plus probable reserves using a pre-tax discount rate of 10% as determined by independent qualified reserves evaluators;
- management's estimate of the fair value of undeveloped land; and
- a review of the values indicated by the metrics of recent market transactions of similar assets within the oil and gas industry.

The market value of other items of exploration and evaluation and property, plant and equipment is based on the quoted market prices for similar items.

Share-based payments

Share-based payments are measured using a Black-Scholes option pricing model. Measurement inputs include share price on grant date, exercise price, expected volatility (based on historical volatility of securities of comparable companies), weighted average expected life and forfeiture rate (both based on historical experience and general option holder behaviour), expected dividends, and the risk-free interest rate (based on government bonds).

Classification of fair value of financial instruments

The Company classified the fair value of its financial instruments measured at fair value according to the following hierarchy based on the amount of observable inputs used to value the instrument:

- Level 1 - quoted prices in active markets for identical assets and liabilities;
- Level 2 - inputs, other than the quoted prices included in Level 1, that are observable for the asset or liability, either directly or indirectly;
- Level 3 - inputs for the asset or liability that are not based on observable market data

The carrying value of cash, accounts receivable, accounts payable and accrued liabilities and consideration payable approximate fair value due to their short-term nature.

10. Financial risk management

The Company's activities expose it to a variety of financial risks that arise as a result of its exploration, development, production and financing activities, including credit risk, liquidity risk and market risk.

This note presents information about the Company's exposure to each of the above risks, the Company's objectives, policies and processes for measuring and managing risk, and the Company's management of capital. Further quantitative disclosures are included throughout these consolidated financial statements.

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

Credit risk

Credit risk is the risk of financial loss to the Company if a counterparty to a financial instrument fails to meet its contractual obligations. Credit risk arises principally from the Company's cash balances and receivables. The maximum exposure to credit risk is equal to the balances of cash and receivables.

The Company's limits its exposure to credit risk on its cash by holding its cash balances in deposits with a high credit quality Canadian chartered bank.

Liquidity risk

Liquidity risk is the risk that the Company will encounter difficulty in meeting its financial liabilities that are settled in cash or other financial assets. The Company's approach to managing liquidity risk is to ensure, as far as possible, that it will have sufficient liquidity to meet its liabilities as they come due. The amounts for accounts payable and accrued liabilities and consideration payable are due in less than one year.

Market risk

Market risk is the risk that changes in market prices, such as equity prices, foreign exchange rates, and interest rates will affect the Company's income or the value of its financial instruments.

Currency risk

Currency risk arises from the Company's financial instruments and purchases that are denominated in a currency other than the US dollar, the Company's functional currency. As at December 31, 2012, the Company had the following monetary assets and liabilities denominated in Canadian dollars:

	C\$
Assets	
Cash	102,841
Accounts receivable	30,340
	<hr/> 133,181
Liabilities	
Accounts payable and accrued liabilities	260,672
	<hr/> (127,491)

As at December 31, 2012, a 5% change in the exchange rate between the US dollar and Canadian dollar would have resulted in an impact on operations of \$6,375.

Interest rate risk

The Company's exposure to interest rate risk is limited due to the short-term nature of its financial instruments.

Capital management

Capital of the Company consists of share capital, warrants, contributed surplus and deficit. The Company's objective when managing capital is to safeguard the Company's ability to continue as a going concern so that it can acquire, explore and develop oil and gas properties for the benefit of its shareholders. The Company manages its capital structure and makes adjustments based on the funds available to the Company in light of changes in economic conditions. The Board of Directors has not established quantitative return on capital criteria for management, but rather relies on the expertise of the Company's management to sustain the future development of the Company. In order to facilitate the management of its capital requirements, the Company prepares annual expenditure budgets that consider various factors, including successful capital deployment and general industry conditions. Management reviews its capital management approach on an ongoing basis and believes that this approach, given the relative size of the Company, is reasonable.

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The Company's principal source of capital is from the issue of common shares. In order to achieve its objectives, the Company intends to raise additional funds as required.

The Company is not subject to externally imposed capital requirements and there were no changes to the Company's approach to capital management during the year.

11. Revenues

For the year ended December 31, 2012, revenues of \$729,463 (2011 - \$315,196) were derived from one external customer.

12. Income taxes

The Company's effective income tax rate differs from the amount that would be computed by applying the federal and provincial statutory rate of 26.5% (2011 – 28.25%) to the loss for the year. The reasons for the difference are as follows:

	2012	2011
	\$	\$
Income tax reduction based on statutory rate	(285,536)	(788,019)
Share-based compensation and non-deductible expenses	44,302	101,753
Change in future tax rates and other	(140,745)	131,610
Effect of higher tax rates in foreign jurisdiction	(42,952)	(83,816)
Change in valuation allowance	424,931	638,472
	—	—

Deferred income tax liability

A continuity of the net deferred income tax liability is as follows:

	2012	2011
	\$	\$
Exploration and evaluation	669,000	287,000
Non-capital losses	1,588,000	1,493,000
Share issue costs	89,000	142,000
Consideration payable	200,000	200,000
Benefit of deferred income taxes not recognized	(2,546,000)	(2,122,000)
	—	—

Due to losses incurred in the current year with respect to the Company's Canadian operations, and expected future operating results, management has determined that it is probable that the deferred income tax assets will not be realized.

Losses carried forward

At December 31, 2012, the Company had non-capital loss carryforwards of approximately \$5,697,000 which expire between 2029 and 2032.

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13. Related party transactions

	Years ended December 31,	
	2012	2011
	\$	\$
Royalties		
Payable to two directors	14,590	14,590
Legal fees		
Paid to a firm, of which, a director is a partner	86,931	84,172
Rent		
Paid to a company controlled by a director for office premises	—	12,643
Paid to a company controlled by an officer for office premises	—	17,700
Salaries		
Paid to a person related to a director for administration services	21,017	31,859
Office		
Paid to a company controlled by an officer for office services	4,616	2,535

These transactions were in the normal course of business and recorded at fair value.

Compensation of key management personnel

The Company considers its directors and officers to be key management personnel. Transactions with key management personnel are set out as follows:

	Years ended December 31,	
	2012	2011
	\$	\$
Salaries	347,585	473,339
Share-based payments, representing amortization of share-based compensation	132,259	289,333
	<u>479,844</u>	<u>762,672</u>

14. Subsequent event

Huasna

On March 18, 2013, the Superior Court ruled to dismiss the Petition. On April 8, 2012, the Company filed an Appeal of the Judgment of Dismissal after an order sustaining a demurrer by the Superior Court of California, County of San Luis Obispo.