Interim Consolidated Financial Statements
(Unaudited – Prepared by Management)
(Expressed in Canadian dollars)

# MONARCH ENERGY LIMITED

Three months ended December 31, 2010 and 2009

**MANAGEMENT’S COMMENTS ON**
**UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

NOTICE OF NO AUDITOR REVIEW OF INTERIM FINANCIAL STATEMENTS

In accordance with National Instrument 51-102 the Company discloses that these interim financial statements of Monarch Energy Limited have been prepared by and are the responsibility of the Company’s management.

These financial statements have not been reviewed or audited by the Company’s independent external auditors.

# MONARCH ENERGY LIMITED

Consolidated Balance Sheets
(Unaudited – Prepared by Management)

| | December 31, 2010 | September 30, 2010 |
|---|---|---|
| **Assets** | | |
| Current assets: | | |
| Cash | $ 250,213 | $ 428,926 |
| Amounts receivable (note 4) | 27,726 | 11,310 |
| Prepaid expenses | 23,829 | 10,000 |
| | 301,768 | 450,236 |
| Equipment (note 5) | 1,848 | 1,997 |
| Reclamation bond | 27,634 | 27,634 |
| | $ 331,250 | $ 479,867 |
| **Liabilities and Shareholders' Equity** | | |
| Current liabilities: | | |
| Accounts payable and accrued liabilities | $ 1,520,721 | $ 1,592,369 |
| Due to related parties (note 8) | - | 103,008 |
| | 1,520,721 | 1,695,377 |
| Asset retirement obligation (note 6) | 59,590 | 57,932 |
| | 1,580,311 | 1,753,309 |
| Shareholders' equity: | | |
| Capital stock (note 7) | 15,943,341 | 15,943,341 |
| Contributed surplus (note 7(c)) | 1,271,009 | 1,271,009 |
| Deficit | (18,463,411) | (18,487,792) |
| | (1,249,061) | (1,273,442) |
| | $ 331,250 | $ 479,867 |

See accompanying notes to consolidated financial statements.

Approved on behalf of the Board:

*"George Langdon"* Director

*"Michael Turko"* Director

# MONARCH ENERGY LIMITED

Consolidated Statements of Operations, Comprehensive Income (Loss) and Deficit
(Unaudited – Prepared by Management)

Three months ended December 31, 2010 and 2009

| | 2010 | 2009 |
|---|---|---|
| **Revenue** | | |
| Petroleum and natural gas sales | $ 39,105 | $ 33,470 |
| Royalties | (1,576) | (3,283) |
| | 37,529 | 30,187 |
| **Expenses** | | |
| Accretion of asset retirement obligation | 1,658 | 1,658 |
| Consulting | 17,500 | - |
| Depletion | - | 2,013 |
| Depreciation | 149 | 222 |
| Filing fees | 2,860 | 1,550 |
| Foreign exchange (gain) loss | (44,876) | (19,995) |
| Investor relations | 50 | 50 |
| Management fees | - | 15,000 |
| Office and miscellaneous | 2,953 | 653 |
| Printing | 5 | 24 |
| Production expenses | 17,234 | 37,797 |
| Professional fees | 25,746 | 34,156 |
| Project evaluation | - | 30,624 |
| Rent | 6,957 | 5,077 |
| Transfer agent fees | 2,331 | 846 |
| Transportation costs | 1,542 | 878 |
| Travel | 936 | - |
| | (35,045) | (110,553) |
| Income (loss) before other items | 2,484 | (80,366) |
| **Other items** | | |
| Gain on settlement of debt | 21,897 | - |
| Income (loss) and comprehensive income (loss) for the period | 24,381 | (80,366) |
| Deficit, beginning of period | (18,487,792) | (18,313,416) |
| Deficit, end of period | $ (18,463,411) | $ (18,393,782) |
| Income (loss) per share, basic and diluted | $ (0.00) | $ (0.00) |
| Weighted average number of common shares outstanding, basic and diluted | 53,226,852 | 93,146,991 |

See accompanying notes to consolidated financial statements.

# MONARCH ENERGY LIMITED

Consolidated Statements of Cash Flows
(Unaudited – Prepared by Management)

Three months ended December 31, 2010 and 2009

| | 2010 | 2009 |
|---|---|---|
| Cash flows used in operating activities: | | |
| Income (loss) for the period | $ 24,381 | $ (80,366) |
| Items not involving cash: | | |
| Accretion of asset retirement obligation | 1,658 | 1,658 |
| Depletion | - | 2,013 |
| Depreciation | 149 | 222 |
| Changes in non-cash operating working capital: | | |
| Amounts receivable | (16,416) | (6,893) |
| Prepaid expenses | (13,829) | - |
| Accounts payable and accrued liabilities | (71,648) | 69,280 |
| Net cash used in operating activities | (75,705) | (14,086) |
| Cash flows from financing activities: | | |
| Increase in amounts due to related parties | (103,008) | 22,442 |
| Net cash from financing activities | (103,008) | 22,442 |
| Increase (decrease) in cash | (178,713) | 8,356 |
| Cash, beginning of period | 428,926 | 47,611 |
| Cash, end of period | $ 250,213 | $ 55,967 |
| Supplementary information: | | |
| Income taxes paid | $ - | $ - |
| Interest paid | - | - |
| Non-cash financing and investing transactions: | | |
| Petroleum and natural gas properties reduction upon adjustment of asset retirement obligation | - | - |
| Petroleum and natural gas expenditures included in accounts payable | (1,292,424) | (1,576,706) |

See accompanying notes to consolidated financial statements.

## 1. NATURE AND CONTINUANCE OF OPERATIONS:

Monarch Energy Limited ("the Company") was incorporated in British Columbia and is engaged in the exploration and development of petroleum and natural gas properties.

The Company is in the process of exploring its petroleum and natural gas properties and has yet to determine whether its properties contain reserves that are economically recoverable. The recoverability of amounts shown for petroleum and natural gas properties is dependent upon the discovery of economically recoverable reserves, the ability of the Company to obtain the necessary financing to complete exploration and development of its properties, confirmation of the Company's interest in the underlying permits and licenses, and future profitable production or proceeds from the disposition of the Company's properties.

These consolidated financial statements have been prepared assuming the Company will continue on a going-concern basis. The Company has incurred losses since inception and the ability of the Company to continue as a going-concern depends upon its ability to develop profitable operations and to continue to raise adequate financing.

The current market conditions and volatility increase the uncertainty of the Company's ability to continue as a going concern given the need to both curtail expenditures and to raise additional funds. The Company is experiencing, and has experienced, negative operating cash flows. The Company will continue to search for new or alternate sources of financing but anticipates that the current market conditions may impact the ability to source such funds.

There can be no assurance that the Company will be able to continue to raise funds in which case the Company may be unable to meet its obligations. Should the Company be unable to realize on its assets and discharge its liabilities in the normal course of business, the net realizable value of its assets may be materially less than the amounts recorded on the balance sheets.

During the three months ended December 31, 2010 the Company recorded net income of approximately $24,000 compared to a loss of $(89,366) for the same three month period ended December 31, 2009. For the three month period ending December 31, 2010 and 2009, cash used in operations was approximately $75,000 and $14,000, respectively. In addition, as at December 31, 2010, the Company had an accumulated deficit of approximately $18,463,000 and a working capital deficiency of approximately $1,219,000.

## 2. BASIS OF PRESENTATION:

These consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, Monoil Limited and Monoil UK Limited. Significant inter-company balances and transactions have been eliminated on consolidation.

These interim consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles. Certain information and footnote disclosure normally included in annual financial statements prepared in accordance with Canadian generally accepted accounting principles have been condensed or omitted.

These interim consolidated financial statements should be read together with the 2010 audited annual financial statements and the accompanying notes. In the opinion of the Company, these unaudited interim consolidated financial statements contain all adjustments necessary in order to present a fair statement of the results of the interim periods presented.

## 3. RECENT ACCOUNTING PRONOUNCEMENTS:

### New accounting standards:

Effective for the year ended September 30, 2010, the Company adopted new accounting standards that were issued by the Canadian Institute of Chartered Accountants ("CICA"), as listed below. These standards were adopted on a prospective basis and are primarily related to disclosures. There were no adjustments recorded to the opening balance sheet items or deficit as a result of the Company's initial adoption of these standards.

*Goodwill and intangible assets*

Effective October 1, 2009, the Company adopted the CICA Handbook Section 3064, "Goodwill and Intangible Assets", which replaced Section 3062, "Goodwill and Other Intangible Assets". The new standard establishes revised standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. The new standard also provides guidance for the treatment of pre-production and start-up costs and requires that these costs be expensed as incurred. The adoption of this standard did not have a significant effect on these financial statements.

*Business combinations, consolidated financial statements and non-controlling interest*

Effective October 1, 2009, the Company adopted the CICA Handbook Section 1582, "Business Combinations", Section 1601, "Consolidations", and Section 1602, "Non-Controlling Interests". These sections replaced the former Section 1581, "Business Combinations", and Section 1600, "Consolidated Financial Statements", and establish a new section for accounting for a non-controlling interest in a subsidiary. Section 1582 establishes standards for the accounting for a business combination, and states that all assets and liabilities of an acquired business will be recorded at fair value. Obligations for contingent considerations and contingencies will also be recorded at fair value at the acquisition date. The standard also states that acquisition-related costs will be expensed as incurred and that restructuring charges will be expensed in the periods after the acquisition date. It provides the Canadian equivalent to IFRS 3, Business Combinations (January 2008).

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

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

These standards are effective January 1, 2011, however early adoption is permitted. The Company adopted these sections on October 1, 2009, the adoption of these sections did not have a significant effect on the Company's financial statements.

## 3. RECENT ACCOUNTING PRONOUNCEMENTS (continued)

### Future accounting policies

*International Financial Reporting Standards ("IFRS")*

In 2006 the Canadian Accounting Standards Board ("AcSB") published a strategic plan that will significantly affect financial reporting requirements for Canadian companies. The strategic plan outlines the convergence of Canadian GAAP with IFRS over an expected five year transitional period. In February 2008, the AcSB announced that 2011 is the changeover date for publicly-listed companies to use IFRS, replacing Canada's existing GAAP. The date is for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. For the Company the transition date will be October 1, 2011 and this will require the restatement for comparative purposes of amounts reported by the Company for the year ended September 30, 2011. The Company has completed the diagnostic phase of planning for the implementation of IFRS. It has determined that the principal areas of impact will be IFRS 1 – first time adoption; presentation of financial statements; asset retirement obligations; impairment of assets; flow through shares and share-based payments. The Company expects its detailed analysis of relevant IFRS requirements and of IFRS 1 will be complete by the end of its fiscal quarter ending June 30, 2011, along with its determination of changes to accounting policies and choices to be made. The Company has not yet reached the stage where a quantified impact of conversion on its financial statements can be measured. The Company expects to complete its quantification of financial statement impacts by the end of its fiscal year ending September 30, 2011.

## 4. AMOUNTS RECEIVABLE:

| | December 31, 2010 | September 30, 2010 |
|---|---|---|
| GST | $ 5,129 | $ 2,971 |
| Petroleum and natural gas sales, net | 22,597 | 8,339 |
| | $ 27,726 | $ 11,310 |

## 5. EQUIPMENT:

| | December 31, 2010 | September 30, 2010 |
|---|---|---|
| Computer equipment | $ 5,264 | $ 5,264 |
| Office equipment | 2,679 | 2,679 |
| | 7,943 | 7,943 |
| Accumulated depreciation | (6,095) | (5,946) |
| | $ 1,848 | $ 1,997 |

## 6. ASSET RETIREMENT OBLIGATION:

The following table presents the reconciliation of the beginning and ending aggregate carrying amounts of the obligation associated with the retirement of the Company's petroleum and natural gas properties:

| | December 31, 2010 | September 30, 2010 |
|---|---|---|
| Asset retirement obligation, beginning of year | $ 57,932 | $ 51,300 |
| Accretion expense | 1,658 | 6,632 |
| Asset retirement obligation, end of year | $ 59,590 | $ 57,932 |

The undiscounted amount of cash flows, required over the estimated reserve life of the underlying assets, to settle the obligation, adjusted for inflation, is estimated at $60,906 (September 30, 2010 - $60,906). The obligation was calculated using a credit-adjusted risk free discount rate of 10% and an inflation rate of 2%. It is expected that this obligation will be funded from general Company resources at the time the costs are incurred with the majority of the costs expected to occur between 2011 and 2015.

## 7. CAPITAL STOCK:

(a) Authorized:

Unlimited number of common shares without par value

(b) Issued:

| | Number of shares | Stated value |
|---|---|---|
| Balance, September 30, 2010 and December 31, 2010 | 53,226,852 | $ 15,943,341 |

As at September 30, 2010 and December 31, 2010 there are no shares held in escrow.

Subsequent to September 30, 2010, the Company consolidated its common shares on the basis of one new share for every 1.75 old shares. As at September 30, 2010, the number of unconsolidated outstanding common shares was 93,146,991. The number of common shares outstanding following the consolidation are 53,226,852.

(c) Contributed surplus:

| | |
|---|---|
| Balance, September 30, 2010 and December 31, 2010 | $ 1,271,009 |

## 7. CAPITAL STOCK (continued):

(d) Stock options:

The Company has a stock option plan under which it is authorized to grant options to directors, employees and consultants enabling them to acquire up to 10% of the issued and outstanding common shares of the Company. Under the plan, the exercise price of each option equals the market price, minimum price, or a discounted price of the Company's shares as calculated on the date of grant. The options can be granted for a maximum term of 5 years. Options issued to consultants vest at 25% every three months. Options to directors and employees fully vest immediately upon granting but the common shares on exercise are subject to a four month hold period from the date of grant.

The continuity of common share stock options for the three months ended December 31, 2010 is as follows:

| Exercise price | Expiry date | September 30, 2010 | Granted | Cancelled/ expired | Exercised | December 31, 2010 |
|---|---|---|---|---|---|---|
| $0.35 | October 23, 2011 | 485,714 | - | - | - | 485,714 |
| 0.53 | March 11, 2012 | 371,429 | - | - | - | 371,429 |
| 0.53 | May 21, 2012 | 757,143 | - | - | - | 757,143 |
| | | 1,614,286 | - | - | - | 1,614,286 |
| Weighted average exercise price | | $0.47 | $ - | $ - | $ - | $0.47 |
| Weighted average remaining life | | | | | | 1.21 years |

## 8. RELATED PARTY TRANSACTIONS AND AMOUNTS DUE:

During the three months ended December 31, 2010 and 2009, the Company was charged the following amounts by an officer, directors and companies controlled by directors of the Company:

| | 2010 | 2009 |
|---|---|---|
| Consulting fees | $ 17,500 | $ - |
| Management fees | - | 15,000 |
| | $ 17,500 | $ 15,000 |

All related party transactions were incurred in the normal course of operations and were measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

## 9. FINANCIAL RISK EXPOSURE AND RISK MANAGEMENT:

The Company is exposed in varying degrees to a number of risks arising from financial instruments. The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework. Management's close involvement in the operations allows for the identification of risks and variances from expectations. The Board approves and monitors the risk management process.

The types of risk exposure and the way in which such exposures are managed are as follows:

(a) Credit risk:

Credit risk is the risk of financial loss to the Company if a counterparty to a financial instrument fails to meet its payment obligations. The Company's exposure to credit risk includes cash, short-term investments and amounts receivable. The risk exposure is limited to their carrying amounts at the balance sheet date.

Cash and short-term investments are held as cash deposits maintained with one financial institution. The risk is mitigated because the financial institution is a prime Canadian bank.

Amounts receivable primarily consist of HST refunds due and revenues due from the sale of oil and gas. To reduce credit risk, the Company regularly reviews the collectability of the amounts receivable and there is no indication that these amounts will not be fully recoverable.

(b) Liquidity risk:

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due. The Company's ability to continue as a going concern is dependent on management's ability to raise required funding through future equity financings. The Company manages its liquidity risk by actively forecasting, planning, reviewing and monitoring expenditures and commitments and anticipating financing requirements.

During 2008, exploration work on the North Sea projects depleted much of the Company's cash reserves. Additional financing is required as the Company does not currently have sufficient resources to meet its obligations to creditors and without financing there is substantial doubt as to the Company's ability to continue as a going concern.

(c) Market risk:

Market risk is the risk of loss that may arise from changes in market factors. The significant market risks to which the Company is exposed are currency and interest rate risk.

*(i) Currency risk*

The Company currently has foreign property interests, which gives rise to a risk that earnings and cash flows may be negatively impacted by fluctuations in foreign exchange rates. To the date of these financial statements, the Company has not entered into foreign currency contracts to mitigate this risk.

*(ii) Interest rate risk*

Fluctuations in interest rates impact the value of cash and cash equivalents. The Company's policy is to invest excess cash in investment-grade short-term deposit certificates issued by its banking institution. The Company manages risk by monitoring changes in interest rates in comparison to prevailing market rates. As of December 31, 2010, the Company did not have any investment certificates.

**9. FINANCIAL RISK EXPOSURE AND RISK MANAGEMENT (continued):**

(c) Market risk (continued):

*(iii) Price risk*

The Company is exposed to price risk with respect to commodity and equity prices. Equity price risk is defined as the potential adverse impact on the Company's earnings due to movements in individual equity prices or general movements in the level of the stock market. Commodity price risk is defined as the potential adverse impact on earnings and economic value due to commodity price movements and volatility. The Company closely monitors commodity prices of resources, individual equity movements, and the stock market to determine the appropriate course of action to be taken by the Company.

**10. SUBSEQUENT EVENTS**

a) On January 6, 2011, the Company entered into an agreement to sell its UK subsidiary Monoil Limited and, Monoil's wholly owned subsidiary Monoil UK Limited, to a third party. For the consideration of USD$1, the third party company will assume all interests or equity of any person (including any right to acquire, option or right of pre-emption) or any mortgage, charge, pledge, lien, assignment, hypothecation, security, interest, title, retention or any other security or arrangement.

b) On January 6, 2011, the Company announced it has entered into a Letter of Intent with Tectonics Inc. ("Tectonics"), of Calgary, Alberta, for the acquisition of an interest in mineral properties located on and offshore Long Point, on the Port au Port Peninsula, Newfoundland and Labrador. The acquisition will be a related party transaction, as the principal of Tectonics is George S. Langdon, who is the President and a director of the Company. Accordingly the acquisition will also be subject to approval by the disinterested shareholders of the Company.

The Company will purchase a 60% working interest (subject to a 2% net smelter royalty) in certain mineral licenses. The Company will enter into a joint venture with the holder of the remaining 40% interest for the exploration and development of the licensed area. The consideration payable by the Company will be the issuance to Tectonics of 39,450,000 common shares, following a 1.75:1 consolidation.

The acquisition and related matters have been approved by the TSX Venture Exchange.

c) On January 25, 2011, the Company consolidated its common shares on the basis of one new share for every 1.75 old shares. As at September 30, 2010, the number of unconsolidated outstanding common shares was 93,146,991. The number of common shares outstanding following the consolidation are 53,226,852.

d) On February 1, 2011, the Company cancelled its remaining outstanding stock options and has granted incentive stock options to directors, officers and a consultant to purchase a total of 5,300,000 shares. The options are exercisable at $0.10 for a period of five years.