

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 20-F

(Mark One)

REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE  
SECURITIES EXCHANGE ACT OF 1934

OR

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934

For the fiscal year ended May 31, 2011

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934

OR

SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

Date of event requiring this shell company report

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 000-26296

Petaquilla Minerals Ltd.

(Exact name of Registrant as specified in its charter)

Not Applicable

(Translation of Registrant's name into English)

Province of British Columbia, Canada

(Jurisdiction of incorporation or organization)

Suite 410, 475 West Georgia Street, Vancouver, British Columbia, Canada V6B 4M9

(Address of principal executive offices)

Ezequiel Sirotinsky, telephone (604) 694-0021, facsimile (604) 694-0063,

Suite 410, 475 West Georgia Street, Vancouver, British Columbia, Canada V6B 4M9

(Name, Telephone, E-mail and/or Facsimile number and Address of Company Contact Person)

Securities registered or to be registered pursuant to Section 12(b) of the Act.

|                             |   |
|-----------------------------|---|
| Title of each class<br>None | Name of each exchange on which registered<br>Not applicable |
|-----------------------------|---|

Securities registered or to be registered pursuant to Section 12(g) of the Act.

Common Shares Without Par Value  
(Title of Class)

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act.

Not Applicable  
(Title of Class)

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report.

176,429,501 common shares, without par value, as at May 31, 2011

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  
 Yes  No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

Yes  No

Note – Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 from their obligations under those Sections.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding year (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding year (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer                       Accelerated filer                       Non-accelerated filer

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP                       International Financial Reporting Standards as issued  
by the International Accounting Standards Board                       Other

If "Other" has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow.

Item 17       Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes    No



**PETAQUILLA MINERALS LTD.  
SECURITIES AND EXCHANGE COMMISSION  
FORM 20-F  
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## GLOSSARY OF MINING TERMS

The following is a glossary of some of the terms used in the mining industry and referenced herein:

|  |  |
|--|--|
| cutoff grade                                     | the deemed grade of mineralization, established by reference to economic factors, above which material is included in mineral deposit calculations and below which material is considered waste. May be either an external cutoff grade, which refers to the grade of mineralization used to control the external or design limits of an open pit based upon the expected economic parameters of the operation, or an internal cutoff grade, which refers to the minimum grade required for blocks of mineralization present within the confines of an open pit to be included in mineral deposit estimates  |
| diamond drill                                    | a machine designed to rotate under pressure an annular diamond-studded cutting tool to produce a more or less continuous solid sample (drill core) of the material that is drilled   |
| epithermal                                       | a term applied to those mineral deposits formed in and along fissures or other openings in rocks by deposition at shallow depths from ascending hot solutions  |
| exploration information                          | geological, geophysical, geochemical, sampling, drilling, trenching, analytical testing, assaying, mineralogical, metallurgical and other similar information concerning a particular property that is derived from activities undertaken to locate, investigate, define or delineate a mineral prospect or mineral deposit  |
| indicated mineral resource                       | that part of a Mineral Resource for which quantity, grade or quality, densities, shape and physical characteristics, can be estimated with a level of confidence sufficient to allow the appropriate application of technical and economic parameters, to support mine planning and evaluation of the economic viability of the deposit. The estimate is based on detailed and reliable exploration and testing information gathered through appropriate techniques from locations such as outcrops, trenches, pits, workings and drill holes that are spaced closely enough for geological and grade continuity to be reasonably assumed                          |
| inferred mineral resource                        | that part of a Mineral Resource for which quantity, grade or quality can be estimated on the basis of geological evidence and limited sampling and reasonably assumed, but not verified, geological and grade continuity. The estimate is based on limited information and sampling gathered through appropriate techniques from locations such as outcrops, trenches, pits, workings and drill holes  |
| junior resource company                          | as used herein means a company whose mineral resource properties are in the exploration phase only and which is wholly or substantially dependent on equity financing or joint ventures to fund its ongoing activities   |
| measured mineral resource                        | that part of a Mineral Resource for which quantity, grade or quality, densities, shape and physical characteristics are so well established that they can be estimated with confidence sufficient to allow the appropriate application of technical and economic parameters, to support production planning and evaluation of the economic viability of the deposit. The estimate is based on detailed and reliable exploration, sampling and testing information gathered through appropriate techniques from locations such as outcrops, trenches, pits, workings and drill holes that are spaced closely enough to confirm both geological and grade continuity |
| mineral deposit, deposit or mineralized material | a mineralized body which has been physically delineated by sufficient drilling, trenching and/or underground work and found to contain a sufficient average grade of metal or metals to warrant further exploration and/or development expenditures. Such a deposit does not qualify under standards of the Securities Exchange Commission as a commercially mineable ore body or as containing ore reserves, until final legal, technical and economic factors have been resolved   |
| mineral reserve                                  | the economically mineable part of a Measured or Indicated Mineral Resource demonstrated by at least a Preliminary Feasibility Study. This Study must include adequate information on mining, processing, metallurgical, economic and other relevant factors that demonstrate, at the time of reporting, that economic extraction   |

|                               |  |
|-------------------------------|--|
|                               | can be justified. A Mineral Reserve includes diluting materials and allowances for losses that may occur when the material is mined  |
| mineral resource              | a concentration or occurrence of diamonds, natural solid inorganic material or natural solid fossilized organic material including base and precious metals, coal and industrial minerals in or on the Earth's crust in such form and quantity and of such a grade or quality that it has reasonable prospects for economic extraction. The location, quantity, grade, geological characteristics and continuity of a Mineral Resource are known, estimated or interpreted from specific geological evidence and knowledge   |
| open pit mining               | the process of mining an ore body from the surface in progressively deeper steps. Sufficient waste rock adjacent to the ore body is removed to maintain mining access and to maintain the stability of the resulting pit   |
| ore                           | a natural aggregate of one or more minerals which, at a specified time and place, may be mined and sold at a profit, or from which some part may be profitably separated   |
| ounces                        | troy ounces  |
| oz/tonne                      | troy ounces per metric ton   |
| ppb                           | parts per billion  |
| ppm                           | parts per million  |
| porphyry deposit              | a disseminated mineral deposit often closely associated with porphyritic intrusive rocks;  |
| preliminary feasibility study | a comprehensive study of the viability of a mineral project that has advanced to a stage where the mining method, in the case of underground mining, or the pit configuration, in the case of an open pit, has been established and an effective method of mineral processing has been determined, and includes a financial analysis based on reasonable assumptions of technical, engineering, legal, operating, economic, social and environmental factors and the evaluation of other relevant factors which are sufficient for a Qualified Person, acting reasonably, to determine if all or part of the Mineral Resource may be classified as a Mineral Reserve |
| probable mineral reserve      | the economically mineable part of an Indicated mineral resource and, in some circumstances, a Measured Mineral Resource demonstrated by at least a Preliminary Feasibility Study. Such Study must include adequate information on mining, processing, metallurgical, economic and other relevant factors that demonstrate, at the time of reporting, that economic extraction can be justified   |
| proven mineral reserve        | the economically mineable part of a Measured Mineral Resource demonstrated by at least a Preliminary Feasibility Study. Such study must include adequate information on mining, processing, metallurgical, economic and other relevant factors that demonstrate, at the time of reporting, that economic extraction is justified   |
| qualified person              | an individual who is an engineer or geoscientist with at least five years of experience in mineral exploration, mine development or operation or mineral project assessment, or any combination of these; has experience relevant to the subject matter of the mineral project and the technical report; and is a member or licensee in good standing of a professional association  |
| stockwork                     | a rock mass so interpenetrated by small veins of ore that the whole must be mined together. Stockworks are distinguished from tabular or sheet deposits, (i.e. veins or beds), which have a small degree of thickness in comparison with their extension in the main plane of the deposit  |
| strike length                 | the longest horizontal dimensions of a body or zone of mineralization  |
| stripping ratio               | the ratio of waste material to ore that is experienced in mining an ore  |
| tonne                         | body, metric ton (2,204 pounds)  |

## **CAUTIONARY NOTE REGARDING RESOURCE AND RESERVE ESTIMATES**

The terms “mineral reserve”, “proven mineral reserve” and “probable mineral reserve” are Canadian mining terms as defined in accordance with Canadian National Instrument 43-101 – Standards of Disclosure for Mineral Projects (“NI 43-101”) and the Canadian Institute of Mining, Metallurgy and Petroleum (the “CIM”) - CIM Definition Standards on Mineral Resources and Mineral Reserves, adopted by the CIM Council, as amended. These definitions differ from the definitions in SEC Industry Guide 7 under the United States Securities Act of 1993, as amended (the “Securities Act”). Under SEC Industry Guide 7 standards, a “final” or “bankable” feasibility study is required to report reserves, the three-year historical average price is used in any reserve or cash flow analysis to designate reserves and the primary environmental analysis or report must be filed with the appropriate governmental authority.

In addition, the terms “mineral resource”, “measured mineral resource”, “indicated mineral resource” and “inferred mineral resource” are defined in and required to be disclosed by NI 43-101; however, these terms are not defined terms under SEC Industry Guide 7 and are normally not permitted to be used in reports and registration statements filed with the SEC. Investors are cautioned not to assume that any part or all of mineral deposits in these categories will ever be converted into reserves. “Inferred mineral resources” have a great amount of uncertainty as to their existence and great uncertainty as to their economic and legal feasibility. It cannot be assumed that all or any part of an inferred mineral resource will ever be upgraded to a higher category. Under Canadian rules, estimates of inferred mineral resources may not form the basis of feasibility or pre-feasibility studies, except in rare cases. Investors are cautioned not to assume that all or any part of an inferred mineral resource exists or is economically or legally mineable. Disclosure of “contained ounces” in a resource is permitted disclosure under Canadian regulations; however, the SEC normally only permits issuers to report mineralization that does not constitute “reserves” by SEC Industry Guide 7 standards as in place tonnage and grade without reference to unit measures.

Accordingly, information contained in this Annual Report contains descriptions of our mineral deposits that may not be comparable to similar information made public by U.S. companies subject to the reporting and disclosure requirements under the United States federal securities laws and the rules and regulations thereunder.

## **CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION**

This Annual Report on Form 20-F contains forward-looking information and forward-looking statements as defined in applicable securities laws. These statements relate to future events or our future performance. All statements other than statements of historical fact are forward-looking statements.

Forward-looking statements include, but are not limited to, statements with respect to the future price of gold, silver and other minerals, the estimation of mineral reserves and resources, the realization of mineral reserve estimates, the timing and amount of estimated future production, costs of production, capital expenditures, costs and timing of the development of new deposits, success of exploration activities, permitting time lines, currency exchange rate fluctuations, requirements for additional capital, government regulation of mining operations, environmental risks, unanticipated reclamation expenses, title disputes or claims and limitations on insurance coverage.

Generally, these forward-looking statements can be identified by the use of forward-looking terminology such as “plans”, “expects” or “does not expect”, “is expected”, “budget”, “scheduled”, “estimates”, “forecasts”, “intends”, “anticipates” or “does not anticipate” or “believes”, or variations of such words and phrases or state that certain actions, events or results “may”, “could”, “would”, “might” or “will be taken”, “occur” or “be achieved”.

Forward-looking statements are subject to known and unknown risks, uncertainties and other factors that may cause our actual results, level of activity, performance or achievements to be materially different from those expressed or implied by such forward-looking statements, including but not limited to: risks related to international operations; risks related to joint venture operations; actual results of current exploration activities; conclusions of economic evaluations; changes in project parameters as plans continue to be refined; future prices of gold and silver; possible variations in ore reserves, grade or recovery rates; failure of plant, equipment or processes to operate as anticipated; accidents, labour disputes and other risks of the mining industry; delays in obtaining governmental approvals or financing or in the completion of development or construction activities, as well as those factors discussed in the section entitled “Risk Factors” in this Annual Report on Form 20-F. Although we have attempted to identify important factors that could cause actual results to differ materially from those contained in forward-looking

statements, there may be other factors that cause results not to be anticipated, estimated or intended. There can be no assurance that such statements will prove to be accurate, as actual results and future events could differ materially from those anticipated in such statements. Accordingly, readers should not place undue reliance on forward-looking statements.

Statements in this Annual Report on Form 20-F regarding expected completion dates of feasibility studies, anticipated mining or metal production operations, projected quantities of future metal production and anticipated production rates, operating efficiencies, costs and expenditures are forward-looking statements. Actual results could differ materially depending upon the availability of materials, equipment, required permits or approvals and financing, the occurrence of unusual weather or operating conditions, the accuracy of reserve estimates, lower than expected ore grades or the failure of equipment or processes to operate in accordance with specifications. Additional information about these and other assumptions, risks and uncertainties that may affect our future financial performance are set out in *Item 3.D. – Key Information – Risk Factors*.

Forward-looking statements in this Annual Report on Form 20-F are as of August 29, 2011. We do not undertake to update any forward-looking statements that are incorporated by reference herein, except in accordance with applicable securities laws.

### **CURRENCY PRESENTATION**

This Annual Report on Form 20-F contains references to United States dollars and Canadian dollars. Unless otherwise indicated, all dollar amounts referred to herein are expressed in United States dollars and all financial information presented has been prepared in accordance with Canadian generally accepted accounting principles. Measurement differences between Canadian generally accepted accounting principles and those in the United States, as applicable to our company, are set forth in Item 3.A. and Note 30 to the accompanying financial statements of our company. Canadian dollars are referred to as “CAD\$”.

## INTRODUCTION

Petaquilla Minerals Ltd. is organized under the British Columbia Business Corporations Act. As used in this Annual Report on Form 20-F (the “Annual Report”), the terms “Petaquilla”, “we”, “us” and “our” refer to Petaquilla Minerals Ltd. and our subsidiaries unless otherwise indicated or if the context otherwise requires. We refer you to the actual corporate documents for more complete information than may be contained in this Annual Report.

Our principal corporate offices are located at Suite 410, 475 West Georgia Street, Vancouver, British Columbia, Canada V6B 4M9. Our telephone number is 604-694-0021.

We file reports and other information with the Securities and Exchange Commission (the “SEC”) located at 100 F Street NE, Washington, D.C. 20549; you may obtain copies of our filings with the SEC by accessing its website located at [www.sec.gov](http://www.sec.gov). Further, we file reports under Canadian regulatory requirements on the System for Electronic Document Analysis and Retrieval of the Canadian Securities Administrators (“SEDAR”); you may access our reports filed on SEDAR by accessing the following website: [www.sedar.com](http://www.sedar.com).

The information set forth in this Annual Report is as at August 29, 2011, unless an earlier or later date is indicated.

## PART I

### ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

### ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable

### ITEM 3. KEY INFORMATION

#### 3.A. Selected Financial Data

The following tables summarize our selected consolidated financial data prepared in accordance with Canadian generally accepted accounting principles (“Canadian GAAP”) and reconciled for measurement differences to United States generally accepted accounting principles (“U.S. GAAP”). The information in the tables was extracted from the more detailed financial statements and related notes included with this filing and should be read in conjunction with these financial statements and with the information appearing under the heading “Item 5 – Operating and Financial Review and Prospects”. Note 30 of our consolidated financial statements, included with this filing, sets forth the material variations in U.S. GAAP. Results for the periods presented are not necessarily indicative of results for future periods.

**INFORMATION IN ACCORDANCE WITH CANADIAN GAAP:**

|     |   | Year<br>Ended<br>May 31 | Year<br>Ended<br>May 31 | Year<br>Ended<br>May 31 | 1 Month<br>Ended<br>May 31 | Year<br>Ended<br>April 30 | 3 Months<br>Ended<br>April 30 | Year<br>Ended<br>January 31 |
|-----|---|-------------------------|-------------------------|-------------------------|----------------------------|---------------------------|-------------------------------|-----------------------------|
|     |   | 2011                    | 2010                    | 2009                    | 2008                       | 2008                      | 2007                          | 2007                        |
| (a) | Total revenue   | 71,708,685              | 27,827,935              | \$0                     | \$0                        | \$0                       | \$0                           | \$0                         |
| (b) | (Loss) before<br>extraordinary<br>items (1)                             |                         |                         |                         |                            |                           |                               |                             |
|     | Total   | \$(3,937,326)           | \$(26,982,082)          | \$(21,099,866)          | \$(5,544,998)              | \$(16,111,007)            | \$(8,492,639)                 | \$(30,712,592)              |
|     | Per share <sup>(1)</sup>  | \$(0.03)                | \$(0.25)                | \$(0.22)                | \$(0.06)                   | \$(0.17)                  | \$(0.09)                      | \$(0.40)                    |
| (c) | Total assets  | \$115,519,276           | \$80,262,195            | \$81,543,823            | \$71,208,177               | \$58,789,331              | \$24,981,649                  | \$22,743,078                |
| (d) | Total long-term debt  | \$12,290,539            | \$520,464               | \$52,939,642            | \$30,939,670               | \$1,367,249               | \$631,775                     | \$739,159                   |
| (e) | Total shareholders'<br>equity (deficiency)                              | \$17,812,950            | \$(21,353,115)          | \$(8,920,288)           | \$14,606,134               | \$18,765,944              | \$14,370,149                  | \$18,647,224                |
| (f) | Cash dividends<br>declared per share                                    | n/a                     | n/a                     | n/a                     | n/a                        | n/a                       | n/a                           | n/a                         |
| (g) | Capital stock<br>(number of issued<br>and outstanding<br>common shares) | 176,429,501             | 125,281,951             | 96,040,121              | 95,958,641                 | 95,958,641                | 89,367,031                    | 89,367,031                  |
| (h) | Net earnings (loss)<br>for the period                                   |                         |                         |                         |                            |                           |                               |                             |
|     | Total   | \$(3,937,326)           | \$(26,982,082)          | \$(21,099,866)          | \$(5,544,998)              | \$(16,111,007)            | \$(8,492,639)                 | \$(30,712,592)              |
|     | Per share <sup>(1)</sup>  | \$(0.03)                | \$(0.25)                | \$(0.22)                | \$(0.06)                   | \$(0.17)                  | \$(0.09)                      | \$(0.40)                    |

(1) The effect of potential share issuances pursuant to the exercise of options and warrants would be anti-dilutive and, therefore, basic and diluted losses per share are the same.

**INFORMATION IN ACCORDANCE WITH U.S. GAAP:**

|     |  | Year<br>Ended<br>May 31 | Year<br>Ended<br>May 31 | Year<br>Ended<br>May 31 | 1 Month<br>Ended<br>May 31 | Year<br>Ended<br>April 30 | 3 Months<br>Ended<br>April 30 | Year<br>Ended<br>January 31 |
|-----|--|-------------------------|-------------------------|-------------------------|----------------------------|---------------------------|-------------------------------|-----------------------------|
|     |  | 2011                    | 2010                    | 2009                    | 2008                       | 2008                      | 2007                          | 2007                        |
| (a) | Total revenue  | \$71,708,685            | \$55,776,410            | \$0                     | \$0                        | \$0                       | \$0                           | \$0                         |
| (b) | (Loss) before<br>extraordinary<br>items                                    |                         |                         |                         |                            |                           |                               |                             |
|     | Total  | \$(21,523,843)          | \$(26,675,905)          | \$(46,852,067)          | \$(3,597,227)              | \$(49,752,062)            | \$(14,635,836)                | \$(35,682,285)              |
|     | Per share <sup>(1)</sup>   | \$(0.15)                | \$(0.25)                | \$(0.49)                | \$(0.04)                   | \$(0.53)                  | \$(0.16)                      | \$(0.46)                    |
| (c) | Total assets   | \$50,470,139            | \$23,745,094            | \$26,542,454            | \$37,419,662               | \$36,108,361              | \$19,470,848                  | \$19,202,974                |
| (d) | Total long-term debt   | \$23,869,120            | \$5,486,053             | \$59,727,593            | \$17,303,337               | \$1,367,249               | \$631,775                     | \$739,159                   |
| (e) | Total<br>shareholders'<br>equity<br>(deficiency)                           | \$(56,308,612)          | \$(83,013,583)          | \$(70,709,608)          | \$(5,546,048)              | \$(3,915,026)             | \$8,859,348                   | \$15,107,120                |
| (f) | Cash dividends<br>declared per share                                       | n/a                     | n/a                     | n/a                     | n/a                        | n/a                       | n/a                           | n/a                         |
| (g) | Capital stock<br>(number of<br>issued and<br>outstanding<br>common shares) | 176,429,501             | 125,281,951             | 96,040,121              | 95,958,641                 | 95,958,641                | 89,876,951                    | 89,367,031                  |
| (h) | Net earnings<br>(loss) for the<br>period                                   |                         |                         |                         |                            |                           |                               |                             |
|     | Total  | \$(21,523,843)          | \$(26,675,095)          | \$(46,852,067)          | \$(3,597,227)              | \$(49,752,062)            | \$(14,635,836)                | \$(35,682,285)              |
|     | Per share <sup>(1)</sup>   | \$(0.15)                | \$(0.25)                | \$(0.49)                | \$(0.04)                   | \$(0.53)                  | \$(0.16)                      | \$(0.46)                    |

(1) The effect of potential share issuances pursuant to the exercise of options and warrants would be anti-dilutive and, therefore, basic and diluted losses per share are the same.

We have not declared nor paid any dividends since incorporation and we do not anticipate doing so in the foreseeable future. Our present policy is to retain all available funds for use in our operations and the expansion of our business.

**Difference Between Canadian and United States Generally Accepted Accounting Principles Loss for the periods**

|  | Year<br>ended May 31<br>2011 | Year<br>ended May 31<br>2010 | Year<br>ended May 31<br>2009 | One month<br>ended May 31<br>2008 |
|--|------------------------------|------------------------------|------------------------------|-----------------------------------|
| (Loss) for the period – Canadian GAAP  | \$(3,937,326)                | \$(26,982,082)               | \$(21,099,866)               | \$(5,544,998)                     |
| Gain on dilution of equity investment  | (453,775)                    | -                            | (2,238,492)                  | -                                 |
| Mineral properties expensed under U.S. GAAP  | (15,371,440)                 | (3,411,935)                  | (17,562,548)                 | (1,884,160)                       |
| Revenue recognized   | -                            | 27,948,475                   | 653,941                      | -                                 |
| Cost of goods sold   | (231,896)                    | (24,275,977)                 | (1,260,127)                  | -                                 |
| Amortization   | -                            | (1,825,067)                  | (640,425)                    | -                                 |
| Amortization of balls mills included in mineral properties under U.S. GAAP                                 | (419,345)                    | (419,345)                    | -                            | -                                 |
| Depletion of mineral properties under Canadian GAAP  | 7,489,645                    | 3,338,116                    | -                            | -                                 |
| Loss of variable interest entity under U.S. GAAP   | -                            | 69,765                       | -                            | -                                 |
| Expensing of opening inventory reclassified in prior year  | -                            | (2,868,999)                  | -                            | -                                 |
| Write down of inventory in finished goods and work in progress   | -                            | -                            | (2,404,695)                  | -                                 |
| Change in fair value of warrants denominated in Canadian dollars under U.S. GAAP                           | (8,420,089)                  | 1,692,320                    | 22,871,582                   | -                                 |
| Change in fair value of share capital issued with warrants denominated in Canadian dollars under U.S. GAAP | -                            | 58,824                       | -                            | -                                 |
| Foreign exchange on difference in mineral properties expensed under U.S. GAAP                              | -                            | -                            | (9,639,262)                  | -                                 |
| Foreign exchange on difference in senior secured notes under U.S. GAAP                                     | -                            | -                            | 3,180,313                    | -                                 |
| Share issuance costs relating to warrants expensed under U.S. GAAP   | (357,395)                    | -                            | -                            | -                                 |
| Additional loss relating to redemption and modification of senior secured note agreement under U.S. GAAP   | 177,778                      | -                            | (18,712,488)                 | 3,831,931                         |
| Net loss – U.S. GAAP   | \$(21,523,843)               | \$(26,675,905)               | \$(46,852,067)               | \$(3,597,227)                     |
| Basic and diluted loss per share – U.S. GAAP   | \$(0.15)                     | \$(0.25)                     | \$(0.49)                     | \$(0.04)                          |

|  | Year<br>ended April 30<br>2008 | Three months<br>ended April 30<br>2007 | Year<br>ended January 31<br>2007 |
|--|--------------------------------|--|----------------------------------|
| (Loss) for the period – Canadian GAAP                                | \$(16,111,007)                 | \$(8,492,639)                          | \$(30,712,592)                   |
| Gain on dilution of equity investment                                | (12,582,085)                   | (632,396)                              | (1,701,589)                      |
| Mineral properties expensed under U.S. GAAP                          | (22,680,970)                   | (5,510,801)                            | (3,540,104)                      |
| Foreign exchange on difference in mineral properties under U.S. GAAP | 1,622,000                      | -                                      | 272,000                          |
| Net loss – U.S. GAAP   | \$(49,752,062)                 | \$(14,635,836)                         | \$(35,682,285)                   |
| Basic and diluted loss per share – U.S. GAAP                         | \$(0.53)                       | \$(0.16)                               | \$(0.46)                         |

| <b>Balance Sheets</b>                                       | <b>May 31,<br/>2011</b> | <b>May 31,<br/>2010</b> | <b>May 31,<br/>2009</b> | <b>May 31,<br/>2008</b> |
|---|-------------------------|-------------------------|-------------------------|-------------------------|
| Total assets – Canadian GAAP                                | \$115,519,276           | \$80,262,195            | \$81,543,823            | \$71,208,177            |
| Depletion of mineral properties added to ending inventory   | (513,513)               | (281,617)               | -                       | -                       |
| Mineral properties expensed or charged to cost of sales and | (64,535,624)            | (56,235,484)            | (55,001,369)            | (33,788,515)            |
| Total assets – U.S. GAAP                                    | \$50,470,139            | \$23,745,094            | \$26,542,454            | \$37,419,662            |
| Total liabilities – Canadian GAAP                           | \$95,199,170            | \$101,615,310           | \$90,464,111            | \$56,602,043            |
| Allocation of fair value of senior notes under U.S. GAAP    | -                       | -                       | -                       | (13,636,333)            |
| Derivative liability– warrants                              | 11,578,581              | 4,965,589               | 6,292,830               | -                       |
| Equity component of convertible debt treated as a liability | -                       | 177,778                 | 495,121                 | -                       |
| Total liabilities – U.S. GAAP                               | \$106,777,751           | \$106,758,677           | \$97,252,062            | \$42,965,710            |

|  |                |                |                |               |
|--|----------------|----------------|----------------|---------------|
| Shareholders' equity (deficit) Canadian – GAAP   | \$17,812,950   | \$(21,353,115) | \$(8,920,288)  | \$14,606,134  |
| Mineral properties expensed or charged to cost of sales and revenue under U.S. GAAP  | (64,536,624)   | (56,235,484)   | (55,001,369)   | (33,788,515)  |
| Exercise of warrants denominated in Canadian dollars under U.S. GAAP   | 13,478,944     | 272,000        | -              | -             |
| Depletion added to ending inventory  | (513,513)      | (281,617)      | -              | -             |
| (Decrease) increase in retained earnings due to translation of prior year mineral property expenses and senior secured notes | (4,564,949)    | (4,564,949)    | (4,564,949)    | 1,622,000     |
| Difference in accumulated other comprehensive income   | 4,564,949      | 4,564,949      | 4,564,949      | (1,622,000)   |
| Increase in net income due to the change in fair value of warrants denominated in Canadian dollars under                     | 14,463,183     | 22,883,272     | 22,871,582     | -             |
| Increase in net income due to the change in fair value of warrants denominated in Canadian dollars under                     | (38,489,476)   | (28,120,861)   | (29,164,412)   | -             |
| Decrease in warrants due to fair value of warrants denominated in Canadian dollars under U.S. GAAP                           | (1,031,232)    | -              | -              | -             |
| Decrease in warrants due to the fair value of finders' warrants  | (14,591,713)   | (14,591,713)   | (14,903,816)   | 3,831,931     |
| Additional loss relating to redemption and modification of senior secured note agreement under                               | 14,591,713     | 14,591,713     | 14,903,816     | 9,804,402     |
| Allocation of fair value of senior secured notes under U.S. GAAP   | 2,507,156      | -              | -              | -             |
| Equity adjustment of non-controlling interest  | -              | (177,778)      | (495,121)      | -             |
| Equity component of convertible debenture treated as a liability under U.S. GAAP.  | \$(56,308,612) | \$(83,013,583) | \$(70,709,608) | \$(5,546,048) |

| <b>Balance Sheets</b>   | <b>April 30,<br/>2008</b> | <b>April 30,<br/>2007</b> | <b>January 31,<br/>2007</b> |
|---|---------------------------|---------------------------|-----------------------------|
| Total assets – Canadian GAAP  | \$58,789,331              | \$24,981,649              | \$22,743,078                |
| Mineral properties expensed or charged to cost of sales and revenue under U.S. GAAP | (22,680,970)              | (5,510,801)               | (3,540,104)                 |
| Total assets – U.S. GAAP  | \$36,108,361              | \$19,470,848              | \$19,202,974                |
| Shareholders' equity (deficit) -Canadian GAAP                                       | \$18,765,944              | \$14,370,149              | \$18,647,224                |
| Mineral properties expensed under U.S. GAAP   | (22,680,970)              | (5,510,801)               | (3,540,104)                 |
| Shareholders' equity (deficit) – U.S. GAAP  | \$(3,915,026)             | \$8,859,348               | \$15,107,120                |

### **3. B. Capitalization and Indebtedness**

Not applicable.

### **3.C. Reasons for the Offer and Use of Proceeds**

Not applicable.

### **3.D. Risk Factors**

The following is a brief discussion of those distinctive or special characteristics of our operations and industry, which may have a material impact on, or constitute risk factors in respect of, our financial performance. However, there may be additional risks unknown to us and other risks, currently believed to be immaterial, that could turn out to be material. These risks, either individually or simultaneously, could significantly affect the group's business and financial results.

We operate in a dynamic and rapidly changing environment that involves numerous risks and uncertainties. Investors should carefully consider the risks described below before investing in our securities. The occurrence of any of the following events could harm us. If these events occur, the trading price of our common shares could decline, and investors may lose part or even all of their investment.

*Mining operations and projects are vulnerable to supply chain disruptions and our operations and development projects could be adversely affected by shortages of, as well as lead times to deliver, strategic spares, critical consumables, mining equipment or metallurgical plant equipment.*

Our operations and development projects could be adversely affected by shortages of, as well as lead times to deliver, strategic spares, critical consumables and processing equipment. In the past, we and other gold mining companies have experienced shortages in critical consumables, particularly as production capacity in the global mining industry has expanded in response to increased demand for commodities, and we have experienced increased delivery times for these items. These shortages have also resulted in unanticipated increases in the price of certain of these items. Shortages of strategic spares, critical consumables or mining equipment, which could occur in the future, could result in production delays and production shortfalls, and increases in prices result in an increase in both operating costs and the capital expenditure to maintain and develop mining operations. We and other gold mining companies, individually, have limited influence over manufacturers and suppliers of these items. In certain cases there are only limited suppliers for certain strategic spares, critical consumables and processing equipment and they command superior bargaining power relative to us, or we could at times face limited supply or increased lead time in the delivery of such items. If we experience shortages, or increased lead times in delivery of strategic spares, critical consumables or processing equipment our results of operations and our financial condition could be adversely affected.

*We face uncertainty and risks in our exploration and project evaluation activities.*

Exploration activities are speculative in nature and project evaluation activities necessary to determine whether a viable mining operation exists or can be developed are often unproductive. These activities also often require substantial expenditure to establish the presence, and to quantify the extent and grades (metal content), of mineralized material through exploration drilling. Once mineralization is discovered it can take several years to determine whether adequate ore reserves exist. During this time, the economic feasibility of production may change owing to fluctuations in factors that affect revenue, as well as cash and other operating costs, including:

- future metal and other commodity prices;
- anticipated tonnage, grades and metallurgical characteristics of the ore to be mined and processed;
- anticipated recovery rates of gold from the ore; and
- anticipated capital expenditure and cash operating costs.

These estimates depend upon the data available and the assumptions made at the time the relevant estimate is made. Resource estimates are not precise calculations and depend on the interpretation of limited information on the location, shape and continuity of the occurrence and on the available sampling results. Further exploration and

studies can result in new data becoming available that may change previous resource estimates which will impact upon both the technical and economic viability of production of the relevant mining project. Changes in the forecast prices of commodities, exchange rates, production costs or recovery rates may change the economic status of resources resulting in revisions to previous resource estimates. These revisions could impact depreciation and amortization rates, asset-carrying values provisions for closedown, restoration and environmental clean-up costs. These estimates depend upon the data available and the assumptions made at the time the relevant estimate is made.

We undertake revisions to our resource estimate based upon actual exploration and production results, new information on geology and fluctuations in production, operating and other costs and which could adversely affect the life-of-mine plans and consequently the total value of our mining asset base. Resource restatements could negatively affect our results, financial condition and prospects, as well as our reputation. The increased demand for gold and other commodities, combined with a declining rate of discovery, has resulted in existing reserves being depleted at an accelerated rate in recent years. We, therefore, face intense competition for the acquisition of attractive mining properties.

From time to time, we evaluate the acquisition of exploration properties and operating mines, either as stand-alone assets or as part of companies. Our decisions to acquire these properties have historically been based on a variety of factors including estimates of and assumptions regarding the extent of resources, cash and other operating costs, gold prices and projected economic returns and evaluations of existing or potential liabilities associated with the relevant property and our operations and how these factors may change in the future. All of these factors are uncertain and could have an impact upon revenue, cash and other operating issues, as well as the uncertainties related to the process used to estimate resources.

As a result of these uncertainties, the exploration programs and acquisitions engaged in by us may not result in the expansion or replacement of the current production with new resources or operations. Our operating results and financial condition are directly related to the success of our exploration and acquisition efforts and our ability to replace or increase existing resources. If we are not able to maintain or increase our resources, our results of operations and our financial condition and prospects could be adversely affected.

*We face many risks related to the development of our mining projects that may adversely affect our results of operations and profitability.*

The profitability of mining companies depends, in part, on the actual costs of developing and operating mines, which may differ significantly from estimates determined at the time a relevant mining project was approved. The development of mining projects may also be subject to unexpected problems and delays that could increase the cost of development and the ultimate operating cost of the relevant project. Our decision to develop a mineral property is based on estimates made as to the expected or anticipated project economic returns. These estimates are based on assumptions regarding:

- future gold prices;
- anticipated tonnage, grades and metallurgical characteristics of ore to be mined and processed;
- anticipated recovery rates of gold extracted from the ore; and
- anticipated capital expenditure and cash operating costs.

Actual cash operating costs, production and economic returns may differ significantly from those anticipated by such estimates.

There are a number of uncertainties inherent in the development and construction of an extension to an existing mine, or in the development and construction of any new mine. In addition to those discussed above, these uncertainties include the:

- timing and cost of the construction of mining and processing facilities, which can be considerable;
- availability and cost of skilled labor, power, water and transportation facilities;
- need to obtain necessary environmental and other governmental permits and the time to obtain such permits; and
- availability of funds to finance construction and development activities.

New mining operations could experience unexpected problems and delays during development, construction and

mine start-up. In addition, delays in the commencement of mineral production could occur. Finally, operating cost and capital expenditure estimates could fluctuate considerably as a result of changes in the prices of commodities consumed in the construction and operation of mining projects. Accordingly, our future development activities may not result in the expansion or replacement of current production with new production, or one or more new production sites or facilities may be less profitable than currently anticipated or may not be profitable at all. Our operating results and financial conditions are directly related to the success of our project developments. A failure in our ability to develop and operate mining projects in accordance with, or in excess of, expectations could negatively affect our results of operations and our financial condition and prospects.

*We may require additional funding in order to continue our operations.*

We have been producing since January 8, 2010, when we achieved commercial production at our Molejon gold property. Considering our increase in cash margin, our improvements in throughput and production capacity at our Molejon gold processing plant and the future start up of the on/off leach pad project in our second quarter of fiscal year 2012, the potential of our requiring additional funding in order to continue operations has been largely mitigated. In addition, our net income for the three months period ended May 31, 2011, reflects a positive trend in our finance and operational structure. This positive trend will enable us to manage our cash flow from operations for operational requirements and for planned exploration and development programs. Our 6% reduction of debt as at May 31, 2011, compared to May 31, 2010, our improvement in liquidity and our positive operational results for the last quarter demonstrates that this risk has been managed properly. Alternative sources of funding, depending on market conditions and the potential desire of investors wishing to increase their participation in our company's business, could be possible. There can be no assurance, however, that funding from these sources would be sufficient in the future to satisfy our operational requirements, debt repayments and cash commitments. This is dependent on market expectations and our production and results.

We have a history of losses, as at May 31, 2011, we have an accumulated deficit of \$150,694,344. However, during the year ended May 31, 2011 we obtained an operating profit of \$21,215,882 and during the last two quarters of year ended May 31, 2011, we obtained a net income of \$7,503,883.

The consolidated financial statements are prepared on a going concern basis, which assumes that we will be able to realize our assets at the amounts recorded and discharge our liabilities in the normal course of business in the foreseeable future.

Our 2012 fiscal year budget approved by our Board of Directors indicates that we will be able to continue as a going concern without obtaining additional financing. We expect to fund our operations including our working capital deficiency via internal cash flows generated from our Molejon gold mine. However, we will continue to strategically seek external financing to reduce our overall cost of capital and to support further expansion of our business.

*Our consolidated financial statements are prepared on a going concern basis*

Our consolidated financial statements are prepared on a going concern basis, which assumes that we will be able to realize our assets at the amounts recorded and discharge our liabilities in the normal course of business in the foreseeable future. Our management believes that based on the our currently consolidated production performance, our proven cost management system and our substantially reduced debt profile, in addition to favourable market conditions going into fiscal year 2012, that sustainability of our business has been assured and no further going concern uncertainty should be considered.

*Our level of indebtedness could adversely affect our business.*

Although this risk could affect our financial situation, it has been managed appropriately and such management has enabled us to payout all Notes and Convertible Notes on each due date during the year ended May 31, 2011. In addition, the subordination of the remaining outstanding balances of Notes and Convertible Notes to the Forward Gold Purchase Agreement, signed with Deutsche Bank AG, London Branch, during our 2011 fiscal year has improved our liquidity and indebtedness profiles. During the year ended May 31, 2011, our total indebtedness decreased 87% compared to May 31, 2010.

As a result of new acquisitions and our growth strategy, we may incur additional indebtedness in the future. A significant increase in our debt levels may have important consequences for us, including, but not limited to the following:

- Our ability to obtain additional financing for working capital, capital expenditures, general corporate and other purposes or to fund future operations may not be available on terms favourable to us or at all;
- A significant amount of our operating cash flow is dedicated to the payment of interest and principal on our indebtedness, thereby diminishing funds that would otherwise be available for our operations and for other purposes;
- Increasing our vulnerability to current and future adverse economic and industry conditions;
- A substantial decrease in net operating cash flows or increase in our expenses could make it more difficult for us to meet our debt service requirements, which could force us to modify our operations;
- Our leveraged capital structure may place us at a competitive disadvantage by hindering our ability to adjust rapidly to changing market conditions or by making us vulnerable to a downturn in our business or the economy in general;
- We may have to offer debt or equity securities on terms that may not be favourable to us or to our shareholders;
- Limiting our flexibility in planning for, or reacting to, changes and opportunities in our business and our industry; and
- Our level of indebtedness increases the possibility that we may be unable to generate cash sufficient to pay the principal or interest due in respect of our indebtedness.

*We face many risks related to our operations that may adversely affect our cash flows and overall profitability.*

Gold mining is susceptible to numerous events that may have an adverse impact on our mining business, our ability to produce gold and meet our production targets. These events include, but are not limited to:

- environmental hazards, including discharge of metals, pollutants or hazardous chemicals;
- industrial accidents;
- fires;
- labour disputes;
- mechanical breakdowns;
- electrical power interruptions;
- encountering unexpected geological formations;
- unanticipated ground conditions;
- ingresses of water;
- process water shortages;
- failure of mining pit slopes, water dams, waste stockpiles and tailings dam walls;
- legal and regulatory restrictions and changes to such restrictions;
- safety-related stoppages;
- other natural phenomena, such as floods, droughts or inclement weather conditions, potentially exacerbated by climate change.

*Mineral prices can fluctuate dramatically and have a material adverse effect on our results of operations.*

Our revenues are primarily derived from the sale of gold and the market price for gold fluctuates widely. These fluctuations are caused by numerous factors beyond our control including:

- speculative positions taken by investors or traders in gold;
- changes in the demand for gold as an investment;
- changes in the demand for gold used in jewellery and for other industrial uses, including as a result of prevailing economic conditions;
- changes in the supply of gold from production, disinvestment, scrap and hedging;

- financial market expectations regarding the rate of inflation;
- strength of the US dollar (the currency in which the gold price trades internationally) relative to other currencies;
- changes in interest rates;
- actual or expected sales or purchases of gold by central banks and the International Monetary Fund;
- gold hedging and de-hedging by gold producers;
- global or regional political or economic events; and
- the cost of gold production in major gold producing countries.

On August 26, 2011, the afternoon fix price of gold on the London Bullion Market was \$1,788 per ounce. The price of gold is often subject to sharp, short-term changes resulting from speculative activities. While the overall supply of and demand for gold can affect its market price, because of the considerable size of above-ground stocks of the metal in comparison to other commodities, these factors typically do not affect the gold price in the same manner or degree that the supply of and demand for other commodities tends to affect their market price. In addition, the recent shift in gold demand from physical demand to investment and speculative demand may exacerbate the volatility of gold prices.

A sustained period of significant gold price volatility may adversely affect our ability to evaluate the feasibility of undertaking new capital projects or continuing existing operations or to make other long-term strategic decisions. If revenue from gold sales falls below the cost of production for an extended period, we may experience losses and be forced to curtail or suspend some or all of our capital projects or existing operations. In addition, we would have to assess the economic impact of low gold prices on our ability to recover any losses that may be incurred during that period and on our ability to maintain adequate cash reserves.

*We face risks related to operations in foreign countries.*

Currently our properties are located only in Panama, a country with a developing mining sector but with no other commercially producing mines. Consequently, we are subject to, and our mineral exploration and mining activities may be affected in varying degrees by, certain risks associated with foreign ownership including inflation, political instability, political conditions and government regulations. Any changes in regulations or shifts in political conditions are beyond our control and may adversely affect our business. Operations may be affected by government regulations with respect to restrictions on production, restrictions on foreign exchange and repatriation, price controls, export controls, restriction of earnings distribution, taxation laws, expropriation of property, environmental legislation, water use, mine safety and renegotiation or nullification of existing concessions, licenses, permits, and contracts.

Failure to comply strictly with applicable laws, regulations and local practices relating to mineral rights applications and tenure could result in loss, reduction or expropriation of entitlements, or the imposition of additional local or foreign parties as joint venture partners with carried or other interests. The occurrence of these various factors and uncertainties cannot be accurately predicted and could have an adverse effect on our operations or profitability.

As part of our strategy to manage geopolitical risk, we are looking to diversify our project portfolio. As such, on April 6, 2011, we entered into a binding letter of intent with Iberian Resources Corp. (“Iberian”) pursuant to which we propose to acquire all of the outstanding shares of Iberian, which owns 100% of the Lomero-Poyatos mine, through its wholly-owned Spanish affiliate Corporacion de Recursos Iberia S.L. The Lomero-Poyatos mine is located about 110 kilometres northeast of Seville, in the heart of the Iberian Pyrite Belt. Iberian also owns several other exploration licenses in Iberia, through its wholly-owned Spanish and Portuguese affiliates. This proposed transaction has been unanimously approved by Iberian’s shareholders and currently is subject to the approval of the shareholders of our company at our special meeting to be held on August 31, 2011. With this proposed transaction we will add approximately 2 million ounces of gold to our resources and diversify our geopolitical within our project portfolio.

*The requirements of the Ley Petaquilla may have an adverse impact on us.*

Our operations in Panama are governed primarily by Law No. 9 of the Legislative Assembly of Panama (the “Ley Petaquilla”), a project-specific piece of legislation enacted in February 1997 to deal with the orderly development of the Cerro Petaquilla Concession.

The Ley Petaquilla granted a mineral exploration and exploitation concession to Minera Panama, S.A. (formerly known as Minera Petaquilla, S.A. (“MPSA”)), a Panamanian company formed in 1997 to hold the Cerro Petaquilla

Concession covering approximately 136 square kilometers in north-central Panama. Although we no longer hold an interest in the copper deposits therein, we continue to hold the rights to the Molejon gold deposit and, as the Cerro Petaquilla Concession encompasses this deposit, the Ley Petaquilla governs our exploration activities.

The Ley Petaquilla contains fiscal and legal stability clauses necessary in order to obtain project financing and includes tax exemptions on income, dividends and imports. The Ley Petaquilla also provides for an increase in the annual available infrastructure tax credit, higher depreciation rates for depreciable assets which cannot be used in the infrastructure tax credit pool, and a favorable depletion allowance.

In order to maintain the Cerro Petaquilla Concession in good standing, MPSA must pay to the Government of Panama an annual rental fee of \$0.50 per hectare during the first two years of the concession, \$1.00 per hectare in the third and fourth years of the concession and \$1.50 per hectare thereafter. The concession was granted for a 20-year term with up to two 20-year extensions permitted, subject to the requirement to begin mine development and to make a minimum investment of \$400 million in the development of the Cerro Petaquilla Concession.

Under the Ley Petaquilla, MPSA was required to begin mine development by May 2001. However, MPSA was able to defer commencing development operations by one month for every month that the price of copper remained below \$1.155 per pound for up to a further five years (i.e. until May 2006 at the latest). In September 2005, the multi-phase Petaquilla Mine Development Plan (the "Plan") submitted to the Government of Panama by us and MPSA was approved by Ministerial Resolution. The Molejon gold mineral deposit forms part of the Cerro Petaquilla Concession and the first phase of the Plan focused on the advancement of the Molejon gold deposit by us as commenced in 2006. Subsequent phases of the Plan are the responsibility of MPSA.

The Ley Petaquilla also requires MPSA to (i) deliver an environmental report to the General Directorate of Mineral Resources of the Ministry of Commerce and Industries ("MICI") for evaluation; (ii) submit, prior to extraction, an environmental feasibility study specific to the project area in which the respective extraction will take place; (iii) submit annually a work plan comprising the projections and approximate costs for the respective year to the MICI; (iv) post letters of credit in support of required compliance and environmental protection guarantees; (v) annually pay surface canons; (vi) annually pay royalties for extracted minerals; (vii) annually present to the MICI detailed reports covering operations and employment and training; (viii) create and participate in the administration of a scholarship fund to finance studies and training courses or professional training for the inhabitants of the communities neighboring the Cerro Petaquilla Concession in the provinces of Cocolé and Colón; and (ix) maintain all mining and infrastructure works and services of the project, always complying with the standards and regulations of general application in force that pertain to occupational safety, health and construction.

For reference, a copy of Law No. 9, as passed by the Legislative Assembly of Panama on February 26, 1997, was provided with our Form 20-F for the fiscal year ended May 31, 2009, as Exhibit 4.V.

*Our operations are subject to environmental and other regulation.*

Our current or future operations, including development activities and production on our properties, require permits from various governmental authorities and such operations are and will be subject to laws and regulations governing prospecting, development, mining, production, exports, taxes, labour standards, occupational health, waste disposal, toxic substances, land use, environmental protection, mine safety, community services and other matters. Companies engaged in the development and operation of mines and related facilities generally experience increased costs and delays in production and other schedules as a result of the need to comply with applicable laws, regulations and permits. Other than the Molejon gold mine, there can be no assurance that approvals and permits required to commence production on our various properties will be obtained. Additional permits and studies, which may include environmental impact studies conducted before permits can be obtained, may be necessary prior to operation of the properties in which we have interests and there can be no assurance that we will be able to obtain or maintain all necessary permits that may be required to commence construction, development or operation of mining facilities at these properties on terms which enable operations to be conducted at economically justifiable costs.

Our potential mining and processing operations and exploration activities in Panama are subject to various federal and provincial laws governing land use, the protection of the environment, prospecting, development, production, exports, taxes, labour standards, occupational health, waste disposal, toxic substances, mine safety, community services and other matters. Such operations and exploration activities are also subject to substantial regulation under these laws by governmental agencies and may require that we obtain permits from various governmental agencies. We believe that we are in substantial compliance with all material laws and regulations that currently apply to corporate activities. There can be no assurance, however, that all permits which may be required for construction of mining facilities and conduct of mining operations will be obtainable on reasonable terms or that such laws and regulations would not have a material adverse effect on any mining project that we might undertake.

Failure to comply with applicable laws, regulations, and permitting requirements may result in enforcement actions there under, including orders issued by regulatory or judicial authorities causing operations to cease or be curtailed, and may include corrective measures requiring capital expenditures, installation of additional equipment, or remedial actions. Parties engaged in mining operations may be required to compensate those suffering loss or damage by reason of the mining activities and may have civil or criminal fines or penalties imposed for violations of applicable laws or regulations.

Amendments to current laws, regulations and permits governing operations and activities of mining companies, or more stringent implementation thereof, could have a material adverse impact on the Company and cause increases in capital expenditures or production costs or reductions in levels of production at producing properties or abandonment or delays in development of new mining properties.

To the best of our knowledge, we are currently operating in compliance with all applicable environmental regulations except as to matters under mitigation as requested by the government of Panama.

*Our directors may have conflicts of interest.*

As of November 6, 2009, one of our directors, David Levy, holds a position with Platinum Management (NY) LLC, an investment advising firm to Platinum Partners Value Arbitrage Fund LP, a New York based investment fund. Platinum Partners Value Arbitrage Fund LP holds securities in us and a portion of our debt. However, Mr. Levy is not a director of nor is he an officer of Platinum Partners Value Arbitrage Fund LP nor are any of our directors insiders of any other reporting company. While currently none of our directors beneficially owns a 10% or greater interest in the voting power of any other mineral resource companies, they could in the future. To the extent that these other companies may participate in ventures in which we may participate, such directors may have a conflict of interest in negotiating and concluding terms respecting the extent of such participation, which could result in competitive harm to us. In the event that such a conflict of interest arises at a meeting of the directors, a director who has such a conflict will abstain from voting for or against the approval of such participation or such terms. In appropriate cases, we will establish a special committee of independent directors to review a matter in which several directors, or management, may have a conflict. In accordance with the laws of the Province of British Columbia, the Company's directors are required to act honestly, in good faith and in our best interests. In determining whether or not we will participate in a particular program and the interest therein to be acquired by it, our directors primarily consider the potential benefits to us, the degree of risk to which we may be exposed and our financial position at that time. Other than as indicated, we have no other procedures or mechanisms to prevent conflicts of interest.

*Environmental protestors are present in Panama.*

Various independent environmental groups or individuals would like to prevent the operation of mining in Panama. Our operations could be significantly disrupted or suspended by activities such as protests or blockades that may be undertaken by such groups or individuals. Although these protests or blockades could happen, we have a contingency plan in place to guarantee the continuity of our operations and activities at our Molejon mine.

*Our common shares are subject to penny stock rules, which could affect trading in our shares.*

Our common shares are classified as "penny stock" as defined in Rule 15g-9 promulgated under the Exchange Act. In response to perceived abuse in the penny stock market generally, the Exchange Act was amended in 1990 to add new requirements in connection with penny stocks. In connection with effecting any transaction in a penny stock, a broker or dealer must give the customer a written risk disclosure document that (a) describes the nature and level of risk in the market for penny stocks in both public offerings and secondary trading, (b) describes the broker's or dealer's duties to the customer and the rights and remedies available to such customer with respect to violations of such duties, (c) describes the dealer market, including "bid" and "ask" prices for penny stock and the significance of the spread between the bid and ask prices, (d) contains a toll-free telephone number for inquiries on disciplinary histories of brokers and dealers and (e) defines significant terms used in the disclosure document or the conduct of trading in penny stocks. In addition, the broker-dealer must provide to a penny stock customer a written monthly account statement that discloses the identity and number of shares of each penny stock held in the customer's account and the estimated market value of such shares. The extensive disclosure and other broker-dealer compliance related to penny stocks may result in reducing the level of trading activity in the secondary market for our common shares, thus limiting the ability of our shareholders to sell their shares.

*U.S. investors may not be able to enforce their civil liabilities against us or our directors, controlling persons and officers.*

Our company, our officers and some of our directors are residents of countries other than the United States, and all of our assets are located outside the United States. As a result, it may not be possible for investors to effect service

of process within the United States upon such persons or enforce in the United States against such persons judgments obtained in United States courts, including judgments predicated upon the civil liability provisions of United States federal securities laws or state securities laws.

We believe that a judgment of a United States court predicated solely upon civil liability under United States securities laws would probably be enforceable in Canada if the United States court in which the judgment was obtained has a basis for jurisdiction in the matter that was recognized by a Canadian court for such purposes. However, there is doubt whether an action could be brought in Canada in the first instance on the basis of liability predicated solely upon such laws.

*If we are characterized as a Passive Foreign Investment Company (“PFIC”), our U.S. shareholders may be subject to adverse U.S. federal income tax consequences.*

We have not made a determination as to whether we are considered a PFIC as such term is defined in the U.S. Internal Revenue Code of 1986, as amended (the “Code”), for U.S. federal income tax purposes for the current tax year and any prior tax years. A non-U.S. corporation generally will be considered a PFIC for any tax year if either (1) at least 75% of its gross income is passive income or (2) at least 50% of the value of its assets (based on an average of the quarterly values of the assets during a taxable year) is attributable to assets that produce or are held for the production of passive income.

In general, if we are or become a PFIC, any gain recognized on the sale of our common stock and any “excess distributions” (as specifically defined in the Code) paid on the common stock must be ratably allocated to each day in a U.S. taxpayer’s holding period for the common stock. The amount of any such gain or excess distribution allocated to prior years of such U.S. taxpayer’s holding period for the common stock generally will be subject to U.S. federal income tax at the highest tax applicable to ordinary income in each such prior year, and the U.S. taxpayer will be required to pay interest on the resulting tax liability for each such prior year, calculated as if such tax liability had been due in each such prior year. For more information, see “Material United States Federal Income Tax Consequences-Passive Foreign Investment Company”.

#### **ITEM 4. INFORMATION ON THE COMPANY**

##### **4.A. History and Development of the Company**

We are a corporation organized under the laws of the Province of British Columbia, Canada. We were incorporated on October 10, 1985, under the name Adrian Resources Ltd. by registration of our Memorandum and Articles of Association with the British Columbia Registrar of Companies pursuant to the Company Act (British Columbia) (the “BCCA”). The BCCA was replaced by the Business Corporations Act (British Columbia) (the “BCA”) in March 2004 and we are now governed by the BCA. Our name was changed from Adrian Resources Ltd. to Petaquilla Minerals Ltd. on October 12, 2004.

Our principal office is located at Suite 410, 475 West Georgia Street, Vancouver, British Columbia, Canada, V6B 4M9. The telephone number for our principal office is (604) 694-0021 and the facsimile number is (604) 694-0063.

We have nineteen subsidiaries and one joint venture interest as detailed below:

- (i) We own all of the issued shares of Adrian Resources (BVI) Ltd., which was incorporated in the British Virgin Islands on December 17, 1999.
- (ii) Adrian Resources (BVI) Ltd. owns all of the issued shares of Petaquilla Minerals, S.A., which was incorporated in the Republic of Panama on April 28, 1992, and holds title to certain of our exploration concessions in the Republic of Panama. Although originally incorporated under the name Adrian Resources, S.A., the name of such subsidiary was changed to Petaquilla Minerals, S.A on February 3, 2005.
- (iii) Petaquilla Minerals, S.A. owns all of the issued shares of Petaquilla Gold, S.A., a Panamanian corporation formed on August 11, 2005. Petaquilla Gold, S.A. holds the Molejon gold property interest and other potential gold deposits within the Cerro Petaquilla Concession lands.
- (iv) Petaquilla Minerals, S.A. owns all of the issued shares of Instituto Petaquilla, S.A., a Panamanian corporation which was formed on April 23, 2007, to conduct training and education programs for our personnel.
- (v) Petaquilla Minerals, S.A. owns all of the issued shares of Brigadas Verdes, S.A., a Panamanian corporation which was formed on March 27, 2007, to coordinate and manage reforestation activities.
- (vi) Compañía Minera Belencillo, S.A., a Panamanian corporation, was formed on September 21, 2005, in accordance with the agreement signed between Petaquilla Minerals, S.A. and Madison Enterprises (Latin

American), S.A. Petaquilla Minerals, S.A. owns 68.88% of Compañía Minera Belencillo, S.A., which in turn holds a 100% interest in Zone 2 of the Rio Belencillo Concession and 68.88% of Zone 1, subject to an option by Madison Enterprises (Latin American), S.A. to earn a 31.12% interest in Zone 1 of the Rio Belencillo Concession. On May 7, 2005, we entered into an option agreement with Gold Dragon Capital Management Ltd. (“Gold Dragon”) whereby Gold Dragon could earn a 100% interest in the concession lands by the expenditure of \$500,000 over two years on mutually agreed upon property expenditures.

- (vii) Petaquilla Gold, S.A. owns 50.2% of the shares of Petaquilla Infraestructura, S.A. (formerly named Petaquilla Power & Water, S.A.), a Panamanian corporation formed on September 21, 2006, primarily for the purposes of (i) designing, constructing, operating, maintaining and installing equipment and networks for the generation, transmission and commercialization of electrical energy; and (ii) developing projects for the production, distribution and commercialization of potable water.
- (viii) Petaquilla Gold, S.A. also owns all of the issued shares of Aqua Azure, S.A., a Panamanian corporation which was formed on October 10, 2006, to purchase, sell, lease, manage, commercialize and hold investment in various moveable goods.
- (ix) We own 49% of the issued shares of Azuero Mining Development, S.A., incorporated in Panama. Azuero Mining Development, S.A., in turn, owns 100% of the issued shares of Vintage Mining (BVI) Ltd., incorporated in the British Virgin Islands. Vintage Mining (BVI) Ltd. holds 24.8% of the issued shares of Iberian Resources Corp., incorporated in British Columbia. Iberian Resources Corp. holds 100% of the issued shares of Sulfuros Complejos Andalucia Mining S.L., incorporated in Spain, Almada Mining S.A., incorporated in Portugal, and Corporacion Recursos Iberia S.L., incorporated in Spain.
- (x) We own 47.78% of the issued shares of Panamanian Development and Infrastructure Ltd., formerly Petaquilla Infraestructura Ltd., incorporated in British Columbia, Canada, on May 29, 2009.
- (xi) We own all of the issued shares of Petaquilla Holdings Ltd. incorporated in British Columbia, Canada, on April 6, 2011.
- (xii) We own all of the issued shares of Petaquilla Infraestructura Ltd., which was incorporated in the British Virgin Islands on February 21, 2008.
- (xiii) Petaquilla Infraestructura Ltd. owns all of the issued shares of Panama Desarrollo de Infraestructuras, S.A., formerly Petaquilla Hidro, S.A., a Panamanian corporation formed on October 10, 2008.
- (xiv) Panama Desarrollo de Infraestructuras, S.A. owns all of the issued shares of Petaquilla Security, S.A., a Panamanian corporation formed on April 25, 2007.
- (xv) Panama Desarrollo de Infraestructuras, S.A. owns all of the issued shares of Panama Central Electrica, S.A., a Panamanian corporation formed on February 16, 2009.

We are engaged in the acquisition, exploration, exploration management and sale of mineral properties, with the primary aim of developing them to a stage where they can be exploited at a profit. We are currently active in the production of gold from our open pit mine at our Molejon gold project, which achieved commercial production status on January 8, 2010, in Panama as well as the exploration of a number of our adjacent mineral concessions in the Republic of Panama.

#### Molejon Property – Panama

Our interest in the Molejon deposit was acquired in 1992 and 1993 through two separate series of transactions and in 2005 by way of an agreement amongst the shareholders of MPSA. Specifically, in June 2005, the shareholders of MPSA agreed to separate the gold deposit and other precious metal mineral deposits that might be developed within the Cerro Petaquilla Concession from the copper mineral deposits within the Cerro Petaquilla Concession. The agreement provided for us, through our subsidiary, Petaquilla Gold, S.A., to own a 100% interest in the Molejon gold deposit, as well as all other gold and precious metal mineral deposits that might be developed within the Cerro Petaquilla Concession, subject to a graduated 5% - 7% Net Smelter Return, based on the future gold price at the time of production, payable to others.

In September 2005, the multi-phase Petaquilla Mine Development Plan (the “Plan”) submitted to the Government of Panama by us and MPSA was approved by Ministerial Resolution. The Molejon gold mineral deposit forms part of the Cerro Petaquilla Concession lands and the first phase of the Plan focused on the advancement of the Molejon gold deposit by us commencing in 2006. Subsequent phases of the Plan are the responsibility of MPSA, the joint venture company in which we no longer hold an interest.

### *Principal Capital Expenditures and Divestitures Over Last Two Fiscal Years*

As at May 31, 2011, we have capitalized \$78,292,958 net of income of \$27,908,659, in mineral property costs.

|   |              |
|---|--------------|
| Plant   | \$50,297,224 |
| Plant equipment   | 2,973,133    |
| Camp  | 5,560,803    |
| Tailings ponds  | 5,059,722    |
| Pre-stripping   | 6,370,240    |
| Site improvements under construction                              | 2,235,957    |
| Asset retirement obligation (see Note 24 of financial statements) | 3,796,085    |
| Capitalized interest expense                                      | 1,999,794    |
|   | <hr/>        |
|   | \$78,292,958 |

A total of \$62,408,006, net of revenue of \$27,908,659 was capitalized in mineral property cost as at May 31, 2010.

### *Current Principal Capital Expenditures and Divestitures*

We have either ongoing or anticipated capital expenditures during our fiscal year ending May 31, 2012. With respect to the planned exploration and advancement of our Molejon property, we anticipate capital expenditures of approximately \$20,000,000 during the fiscal year ending May 31, 2012. Capital expenditures related to our plant expansion comprise approximately \$5,000,000 of this amount and we anticipate financing this portion through a leasing facility. We also anticipate capital expenditures of approximately \$26,000,000 for the infrastructure division of our company, which will focus on our on/off leach pad project, and various other earthworks and construction projects, during the fiscal year ended May 31, 2012. However, such expenditures are subject to further consideration and to our ability to obtain sufficient cash flow from operations. There is no assurance that we will be successful in obtaining such cash flow.

### *Public Takeover Offers*

During the 12 month period ended May 31, 2011, and during the current fiscal year, we did not receive any public takeover offers from third parties nor did we make any such takeover offers.

However, as part of our growth strategy, we entered into a binding letter of intent with a private British Columbian company, Iberian Resources Corp. ("Iberian"), pursuant to which we propose to acquire all of the outstanding shares of Iberian. This proposed transaction has been unanimously approved by Iberian's shareholders and currently is subject to the approval of our shareholders at our special meeting to be held on August 31, 2011. Our shareholders will be voting on an ordinary resolution to issue and reserve of up to 50,000,000 of our common shares (the "Petaquilla Shares") (representing approximately 28.3% of the issued and outstanding number of Petaquilla Shares as at July 27, 2011) (or such number of Petaquilla Shares necessary to complete the proposed acquisition of all Iberian by us as contemplated by the amalgamation agreement dated May 18, 2011, between us, Iberian and Petaquilla Holdings Ltd. (the "Amalgamation Agreement")) as consideration for the acquisition of all of the outstanding securities of Iberian including approximately (i) 44,635,255 Petaquilla Shares to be issued as consideration for all of the issued and outstanding common shares of Iberian as of the Effective Time (as such term is defined in the Amalgamation Agreement); (ii) 1,640,420 Petaquilla Shares issuable to each holder of the Iberian warrants outstanding as of the Effective Time upon duly and valid exercise thereof; and (iii) 3,357,313 Petaquilla Shares issuable to each holder of the options of Iberian outstanding as of the Effective Time upon duly and valid exercise thereof, pursuant to the terms set out in the Amalgamation Agreement. For more information on the proposed acquisition, please refer to our Management Information Circular dated August 2, 2011, publicly available on the SEDAR and EDGAR electronic filing systems.

## **4.B. Business Overview**

### *Molejon Property – Panama*

We currently have no significant properties in Canada and we are not actively exploring, or seeking to acquire interests in, mineral properties in Canada. Our primary focus has been the exploration of the Molejon gold deposit, and, commencing January 8, 2010, the production thereof, and other mineral properties in the Republic of Panama.

For the year ended May 31, 2010, during which we had two production quarters, we generated revenues of \$27,827,935 from our commercial production operations. Gold sold during our 2010 fiscal year totalled 24,250 ounces. For the year ended May 31, 2011, we generated revenues of \$71,708,685 from our commercial production operations. Gold sold during our 2011 fiscal year totalled 53,865 ounces.

The Republic of Panama, through the Ministry of Commerce and Industry, is the regulatory body overseeing the Cerro Petaquilla Concession and potential future development thereof. Law No. 9, the Ley Petaquilla, passed by the Legislative Assembly of Panama on February 26, 1997, is a project-specific piece of legislation dealing with the orderly development of the Cerro Petaquilla Concession, including the Molejon gold deposit. The Ley Petaquilla could be amended by the government of Panama through the enactment of a subsequent law but no such law has been enacted since the Ley Petaquilla legislation was adopted in February 1997. At such time, the Ley Petaquilla granted a mineral exploration and exploitation concession to MPSA, a Panamanian company which was formed in 1997 to hold the 136 square kilometre Cerro Petaquilla Concession. Our Molejon property comprises approximately 10% of the Cerro Petaquilla lands.

The Ley Petaquilla contains fiscal and legal stability clauses necessary in order to obtain project financing and includes tax exemptions on income dividends and imports. The Ley Petaquilla also provides for an increase in the annual available infrastructure tax credit, higher depreciation rates for depreciable assets, which cannot be used in the infrastructure tax credit pool, and a favourable depletion allowance.

There were no competing bidders for the concession at the time the Ley Petaquilla was enacted and the concession was granted for an initial 20-year term with two 20-year extensions permissible subject to the requirements to begin mine development and to make a minimum required investment. In 2005, we and our former partners in MPSA delivered the Plan to the Government of Panama and the Plan was approved by Ministerial Resolution in September 2005. Development of the Molejon gold mineral deposit by us, which commenced in 2006 forms the first phase of the Plan. Subsequent phases of the Plan will be the responsibility of MPSA.

Such government approval of the Plan resulted in the extension of the land tenure for an initial 20-year period which commenced September 2005, subject to MPSA meeting certain other ongoing development and operational conditions. In addition, pursuant to the Ley Petaquilla, in order to maintain the Cerro Petaquilla Concession in good standing, we and MPSA must continue to meet certain obligations.

The Ley Petaquilla comprises the agreement between the Republic of Panama and MPSA and its affiliates and it identifies each party's rights and obligations. The majority of our obligations require that the Republic of Panama be provided with a variety of reports, studies and work plans, payment of surface canons, access and use of port installations, evidence of bonding, etc. An example of an obligation that requires government approvals concerns the environment and states that an Environmental Feasibility Study specific to the project area in which the respective extradition will take place must be submitted to the General Direction of Mineral Resources of the Ministry of Commerce and Industries. Said study shall be evaluated and its approval, modification or rejection shall be defined within a term of 45 days counted as of the date of its presentation to the General Direction of Mineral Resources. After the end of this term, if there is no statement from the General Direction of Mineral Resources, the Environmental Feasibility Study shall be considered approved. For complete disclosure of Panama's requirements, please refer to Law No. 9 as passed by the Legislative Assembly of Panama on February 26, 1997, or the English translation thereof, attached as Exhibits 4.V. and 4.W. to our Form 20-F for the fiscal year ended May 31, 2009.

#### **4.C. Organizational Structure**

The following chart sets out our corporate structure and the mineral properties held by each of our subsidiaries.

**PETAQUILLA MINERALS LTD.**  
[ B.C. corporation ]

49.0%

47.78%

**AZUERO MINING DEVELOPMENT, S.A.**  
[ Panama corporation ]

**ADRIAN RESOURCES (BVI) LTD.**  
[ BVI corporation ]

**PANAMANIAN DEVELOPMENT AND INFRASTRUCTURE LTD.**  
[ B.C. corporation ]

**VINTAGE MINING (BVI) LTD.**  
[ BVI corporation ]

**PETAQUILLA MINERALS, S.A.**  
[ Panama corporation ]

**PETAQUILLA HOLDINGS LTD..**  
[ B.C. corporation ]

24.8%

**IBERIAN RESOURCES CORP.**  
[ B.C. corporation ]

**PETAQUILLA INFRAESTRUCTURA LTD.**  
[ BVI corporation ]

**SULFUROS COMPLEJOS ANDALUCIA MINING S.L.**  
[ Spain corporation ]

**PANAMA DESARROLLO DE INFRAESTRUCTURAS, S.A.**  
[ Panama corporation ]

**ALMADA MINING S.A.**  
[ Portugal corporation ]

**PETAQUILLA SECURITY, S.A.**  
[ Panama Corporation ]

**CORPORACION RECURSOS IBERIA S.L.**  
[ Spain corporation ]

**PANAMA CENTRAL ELECTRICA, S.A.**  
[ Panama Corporation ]

**Petaquilla Concession Lands**

- non-Ley Petaquilla concession lands
- non-Rio Belencillo concession lands
- non-Rio Petaquilla concession lands
- Petaquilla concession lands held by Petaquilla Minerals, S.A. include the Oro del Norte, La Esperanza, Santa Lucia, San Juan, and Oro del Sur concessions

**PETAQUILLA GOLD, S.A.**  
[ Panama corporation ]

- holds the Molejon property interest & other potential gold deposits within the Ley Petaquilla Concession lands ]

**INSTITUTO PETAQUILLA, S.A.**  
[ Panama corporation ]

**BRIGADAS VERDES, S.A.**  
[ Panama corporation ]

68.88%

50.2%

**COMPANIA MINERA BELENCILLO, S.A.**  
[ Panama corporation ]

- Rio Belencillo Concession lands
- Rio Petaquilla Concession lands
- These concession lands are subject to the Gold Dragon Capital Management Ltd. option agreement
  - Gold Dragon has exercised their option on these Lands and is required to pay PTQ by way of Gold Dragon shares which will result in PTQ owning 20% of Gold Dragon
  - Payment by Gold Dragon cannot be "closed" until PTQ is in a position to deliver title to the Lands

**AQUA AZURE, S.A.**  
[ Panama corporation ]

**PETAQUILLA INFRAESTRUCTURA, S.A.**  
[ Panama corporation ]

#### 4.D. Property, Plant and Equipment

With the exception of our Molejon gold project, which has reached commercial production, all of our other properties are in the exploration stage and are without a known body of commercial ore. Commercial production at the Molejon gold mine commenced January 8, 2010, when an average of 70% of design capacity was maintained continuously for a period of 30 days with metallurgical recoveries approaching forecast levels.

For the year ended May 31, 2011, we poured 55,566 ounces of gold and stockpiled an additional 25,088 ounces of gold for our future leach pad project. A total of 53,865 ounces of gold were sold during the 2011 fiscal year.

#### Mineral Concession Lands

##### *Introduction*

We brought our Molejon gold project located on the Cerro Petaquilla Concession to commercial production on January 8, 2010. We also hold the rights to 842 square kilometres of virtually unexplored land surrounding the known deposits of the Cerro Petaquilla Concession.

##### *Property Location*

Our concession lands are located approximately 120 kilometres west of Panama City and 10 kilometres from the Caribbean coast within the Donoso District of the Province of Colon in the Republic of Panama.

*Figure 1  
Mineral Property Location Map*



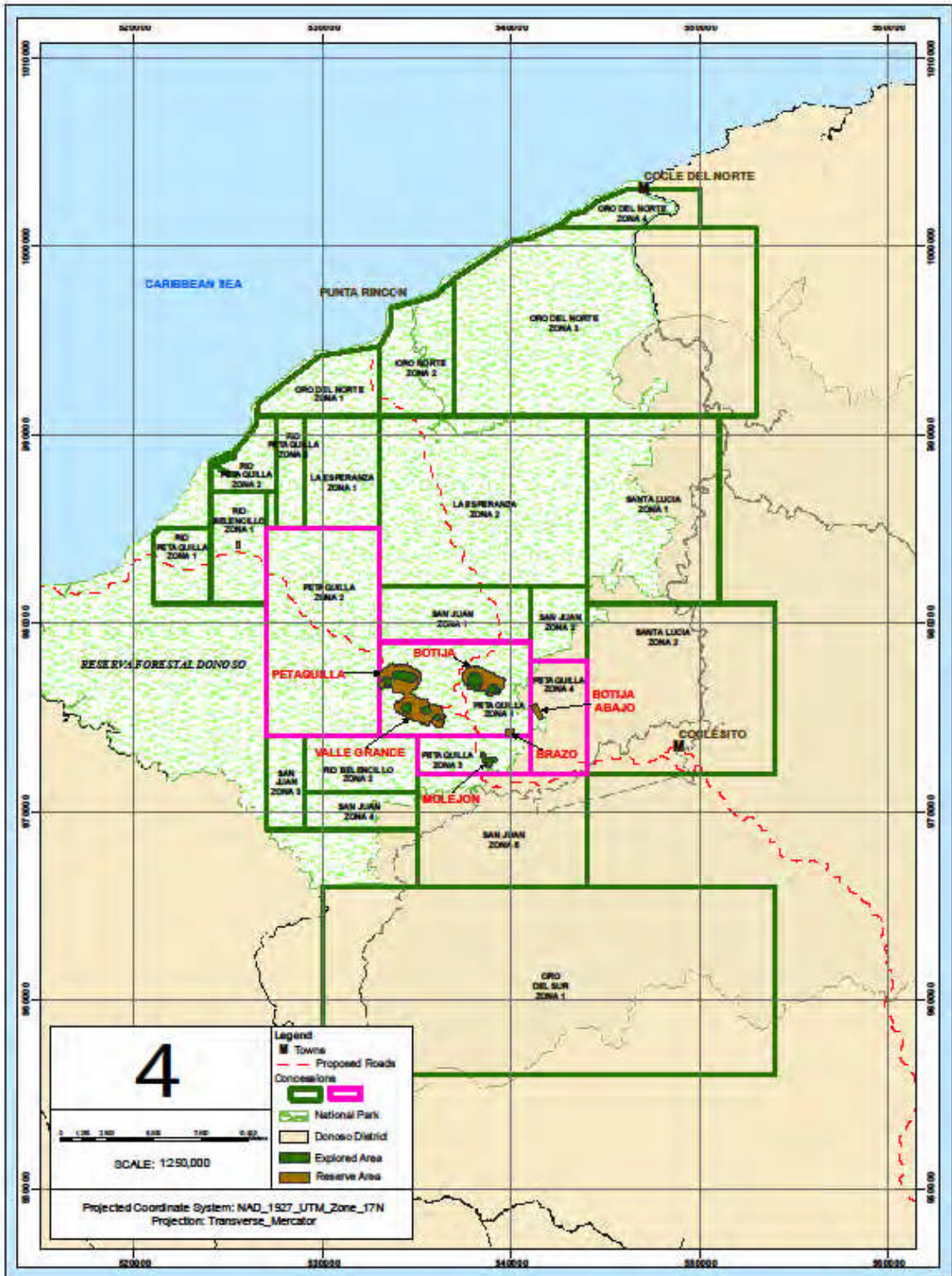
[MS Encarta, 2000]

The Molejon deposit is fully contained within the Petaquilla Zone 3 Concession, part of the Petaquilla Block of claims that is bound by the Petaquilla Zone 1 to the north, Petaquilla Zone 4 to the east, San Juan Zone 6 to the south, and Rio Belencillo Zone 2 to the west. Other deposits with gold mineralization identified in the area include the Botija Abajo and Brazo mineralized zones.

Figure 2  
*Petaquilla Concessions and Molejon Mine Location Map*  
*Mineral Concessions Granted by Law Number 9 (Ley Petaquilla)*



Figure 3  
Concession Map





The Cerro Petaquilla Concession is largely held by MPSA although, pursuant to the Molejon Gold Project Agreement dated June 2, 2005 (the “Molejon Gold Project Agreement”), the full text of which was filed as Exhibit 4.T. to our Annual Report on Form 20-F for the fiscal year ended May 31, 2009, we hold the rights to the Molejon gold deposit found within the concession lands as well as to other gold and precious metal mineral deposits that might be developed within Cerro Petaquilla Concession. This concession contains a large copper-gold porphyry system and our epithermal gold deposit, Molejon, amenable to open pit mining. To date, exploration has identified eight copper-gold porphyry deposits along with our Molejon gold deposit.

Our activities are focused on the Molejon gold deposit and the first phase of the Plan submitted by us and MPSA and approved by the government of Panama in 2005. In addition, we intend to perform further exploration on other identified gold targets within the Cerro Petaquilla Concession and those within our wholly-owned properties surrounding the Cerro Petaquilla Concession.

#### *Location, Access & Physiography*

The Cerro Petaquilla Concession is located 20 kilometres inland from the Caribbean coast and elevation within the concession boundaries ranges between 70 metres and 350 metres above sea level. The Cerro Petaquilla Concession falls within the rainfall shadow of the Continental Divide and the terrain is generally rugged and covered with heavy rainforest vegetation. The climate of the Cerro Petaquilla Concession is characteristic of tropical rainforests. Precipitation is high throughout the year with annual rainfall averaging at least 4,700 mm in the concession area. The heaviest precipitation is evenly distributed from May to December and the months of January to April are typically the driest months.

The Molejon gold property within the Cerro Petaquilla Concession is accessible by road or helicopter. We constructed a 28-kilometre Llano Grande–Coclesito dirt road from Coclesito, a village of approximately 700 inhabitants, to the mine site. As part of the Llano Grande–Coclesito Road Improvement Project, we also constructed two bridges to span the San Juan River. This road replaces a network of trails, which was the previous access, and the new road portion will ultimately be upgraded to rural paved status as part of ongoing development work. While the road has initially been designed to provide access to the mine site, it will ultimately comprise part of a future expansion of the national road network connecting communities with the region. Thirty kilometres of gravel road connects Coclesito with La Pintada, a town of 5,000 people on the country's paved highway network, and the Pan-American Highway to the south. This road will also be upgraded to rural paved status as part of ongoing development work.

#### *Plant and Equipment*

We constructed a gold-processing surface plant at our Molejon gold project, where ore treatment utilizes a three stage crushing plant followed by milling in three parallel ball mills. Subsequent gold recovery is done by a carbon-in-pulp leaching operation as well as a five stage carbon-in-column process. Carbon elution and electrowinning of the gold is performed to produce a gold doré product that is sent for further refinement. Detoxification of the tailings is followed by storage in the site's 40 hectare high-density polyethylene lined tailings facility.

*Figure 6*  
*Molejon Gold Project – Molejon Gold Plant*



*Mine Operations*

Mining at our Molejon gold project, which is divided into three principal regions namely the Northwest Zone, Tajo Abierto Zone and Main Zone, is completely open pit in nature and currently performed under contract. Current production at the pit is conducted through a combination of mechanized mining and blasting.

*Figure 7*  
*Molejon Gold Project - Aerial view of Main Zone*



*Figure 8*  
*Molejon Gold Project – Aerial view of Northwest Zone Pit*



*Figure 9*  
*Molejon Gold Project – Crushing and Conveying*

**Crushing and Conveying**



*Figure 10  
Leaching Tanks*



*Figure 11  
Carbon Column Systems*



*Figure 12  
Tailings Thickener*



*Figure 13  
View of Tailings Pond*



#### *Exploration and Advancement of the Molejon Property*

During the year ended May 31, 2011, we completed construction of tailings pond no. 2 and the walls for the first section of tailings pond no. 1. Further construction of tailings pond no. 1 will extend into the 2012 fiscal year and is planned for completion during the first quarter of our 2012 fiscal year. In addition, during fiscal 2012, construction of a third tailings pond will be initiated.

We also advanced our heap leach project. During our 2011 fiscal year, work progressed to the final engineering and design stage, which is being completed by independent consultants including METCON Research (an affiliate of KD Engineering Ltd.), Knight Piesold Ltd. and Gramsa S.A., all working in conjunction with our mine site personnel. Final engineering and design and construction of the associated infrastructure has commenced.

Beginning in our second quarter of fiscal year 2011, we began to stockpile low grade ore inventory for our heap leach project and by year end we had accumulated 25,088 stockpiled gold ounces. Construction of an on/off leach pad pilot has started in the northwest area of our mine. Final engineering and design of the on/off leach pad operation progressed during the fourth quarter and is being completed by independent consultants Metcon Research (an affiliate of KD Engineering Ltd.), Knight Piesold Ltd. and Gramsa S.A. in coordination with our engineering staff.

Pre-stripping activities at our mine have progressed and are in line with our updated mine plan. Total pre-stripping work, which has been divided into five stages, is anticipated to provide access to 4,100,000 tonnes of ore at 1.98 g/t,

representing approximately 261,000 ounces of contained gold for the parallel feeding of the processing plant and the on/off leach pad operation. As at May 31, 2011, stages one through three of the pre-stripping plan have been completed and, as a result, 30,161 contained gold ounces have been mined and partly processed or stockpiled for future production.

With respect to the planned exploration and advancement of the Molejon property, we anticipate having capital expenditures of approximately \$20,000,000 during the fiscal year ending May 31, 2012, with such funds to be used for equipment items, Phase C of tailings dam construction, plant expansion, water treatment plants, a fibre optics project and spare parts, supplies and other materials as needed. We also anticipate capital expenditures of approximately \$26,000,000 for the infrastructure division of our company, which will focus on our heap leach earthworks and construction project, during the fiscal year ended May 31, 2012. However, such expenditures are subject to further consideration and to our ability to obtain sufficient cash flow from operations. There is no assurance that we will be successful in obtaining such cash flow.

Should the proposed acquisition, as previously mentioned, of Iberian Resources Corp. be approved by our shareholders, we anticipate capital expenditures of approximately \$3,000,000, to be financed through a financial institution. However, such expenditures are subject to further consideration and to our ability to obtain sufficient financing. There is no assurance that we will be successful in obtaining such financing.

#### *Title*

##### **Cerro Petaquilla Concession – Panama**

Prior to October 18, 2006, we owned, through our indirect share ownership of MPSA, a 52% interest in the Cerro Petaquilla Concession. Specifically, our 52% ownership of MPSA was held through our then wholly-owned subsidiary of Georecursos Internacional, S.A. (“Georecursos”). On October 18, 2006, we entered into a Plan of Arrangement with Petaquilla Copper Ltd. (“Copper”), whereby we effectively transferred ownership of Georecursos to Copper and, thereby, our interest in the copper assets within the Cerro Petaquilla Concession lands to Copper.

We retain the rights to the Molejon gold deposit as well as to other gold and precious metal mineral deposits that may be developed within the Cerro Petaquilla Concession and continue to operate under the Ley Petaquilla as does MPSA.

##### **Molejon Property - Panama**

With the above noted and pursuant to the Molejon Gold Project Agreement, the shareholders of MPSA agreed to separate the gold deposit and other precious metal mineral deposits that might be developed from the copper mineral deposits within the Cerro Petaquilla Concession. Such agreement provides for us, through our subsidiary, Petaquilla Gold, S.A., to own a 100% interest in the Molejon gold deposit, as well as all other gold and precious metal mineral deposits that might be developed within the Cerro Petaquilla Concession, subject to a graduated 1% - 5% Net Smelter Return, based on the future gold price at the time of production, payable to shareholders of MPSA.

Pursuant to the contract law under which the Cerro Petaquilla Concession was granted by the government of the Republic of Panama, we with our then partners delivered the phased Plan to the government of Panama. In September 2005, the multi-phase Plan submitted to the Government of Panama by us and MPSA was approved by Ministerial Resolution. This approval resulted in the extension of the land tenure for an initial 20 year period which commenced in September 2005, subject to MPSA meeting certain other development and operational conditions on an ongoing basis. The land tenure provides for two additional 20-year terms that are also subject to MPSA meeting certain other ongoing development and operational conditions.

The Molejon gold mineral deposit, owned 100% by us, forms part of the Cerro Petaquilla Concession lands and the first phase of Plan focuses on the development of the Molejon gold deposit by us which commenced in 2006. The development of the Cerro Petaquilla copper deposit is included in subsequent phases of the Plan, and is the responsibility of MPSA.

##### **Exploration History**

Copper-gold-molybdenum porphyry mineralization was first discovered in the Petaquilla River region during a regional geological and geochemical survey by a UNDP team in 1968. The primary focus was on porphyry copper mineralization. Further exploration by several companies has since outlined three large deposits and a host of smaller ones, as well as epithermal gold mineralization. The table below summarizes the exploration history and ownership of the Petaquilla Concession and provides information about the amount of exploration carried out by

each of the different companies involved in the project through the years until the discovery and development of the Molejon deposit.

#### Summary of Exploration History and Ownership

| <b>Year</b> | <b>Party</b>  | <b>Exploration and Property History Description</b>  |
|-------------|---|--|
| 1968 – 1969 | United Nations Development Program (UNDP)           | Regional geological and geochemical survey of central Panama by the UNDP; widespread silicification and copper mineralization discovered in the area of the Petaquilla and Botija deposits. Stream sediment sampling field magnetometry and preliminary drilling resulted in the discovery of the Petaquilla, Botija, Vega, and Medio deposits.  |
| 1969 – 1976 | Panama Mineral Resources Development Company (PMRD) | Panamanian government tendered Petaquilla Concession exploration rights to international bidding; concession awarded in 1971 to Panama Mineral Resources Development Company (PMRD), a consortium of seven Japanese copper companies. Approximately 14,000 metres of drilling at Petaquilla, Botija, Medio, and Vega; preliminary Resource and Reserve calculations based on prefeasibility report completed. Feasibility work updated; unsuccessful negotiations with the Panamanian government over terms of production; property abandoned in 1980 for 10 years.                      |
| 1990 – 1992 | Minnova Inc.  | Property acquired by Minnova Inc. (now Inmet Mining Corporation) (80%) and Georecursos International, S.A. (20%). Exploration activity included regional litho-geochemical sampling.   |
| 1991 – 1992 | Minnova - Geotec                                    | Minnova and Geotec completed regional geochemical rock sampling covering the southeastern two-thirds of the original Petaquilla concession. Their work identified anomalous gold (>100 ppb) and arsenic (>12 ppm) values at Molejon area.  |
| 1992 – 1993 | Adrian Resources Ltd. (Adrian)                      | Our company, Adrian Resources Ltd. (now Petaquilla Minerals, Ltd.) was granted an option to earn 40% of Minnova's interest through cash payments, work commitment, and production of a feasibility study. We subsequently acquired Georecurso's interest, bringing our total interest to 52%, and started formal exploration at Molejon in 1993 with preliminary geological mapping and silt and rock sampling. Mapping of quartz vein and quartz breccias outcrops returned anomalous gold values between 1.0 and 8.0 g/t gold.   |
| 1992 – 1995 | Adrian  | We carried out grid-based soil sampling and magnetic surveying, geologic mapping of selected areas, and starting February 1994, drilling of approximately 394 diamond drill holes in Petaquilla, Botija, and other exploration targets. Activity included investigation of the Valle Grande deposit and discovery of epithermal gold mineralization at Molejon, as well as identification or investigation of several other targets (Botija Abajo, Brazo, Faldalito, Cuatro Crestas, Lata, Orca).  |
| 1994 – 1995 | Adrian  | Auger drilling completed at 25 metre intervals along lines spaced 50 metres apart in a 1,200 metre by 1,200 metre area. Prospect drilling and magnetic surveys were followed by a second phase of drilling in June 1994. This phase of drilling comprised 4,155.3 metres of drilling in 24 holes and led to the discovery of significant epithermal gold and silver mineralization hosted predominantly within quartz breccia and altered feldspar-quartz porphyry intrusive. We completed a further drilling program at Molejon in 1995 comprised of 10,504.4 metres in 94 drill holes. |
| 1997        | Minera Petaquilla, S.A.                             | Minera Petaquilla, S.A. (Minera Petaquilla) was formed by us, Inmet Mining Corporation, and Teck Corp. The Petaquilla Concession was granted by the Government of Panama to Minera Petaquilla through a Contract Law named " <i>Ley Petaquilla, Contrato N° 9 del 26/02/97</i> " covering a total of 13,600 ha.  |
| 1997        |   | In May 1997, SGS Lakefield Research Ltd. conducted metallurgical test work on Molejon samples. This test work included preliminary flotation tests on six Molejon composite samples.   |
| 2004        | Petaquilla Minerals Ltd.                            | On October 12, 2004, we changed our name to Petaquilla Minerals Ltd. to correspond with our Petaquilla project in Panama. On December 13, 2004, we entered into a letter of intent with Teck and Inmet. Under the letter of intent, we may obtain 100% of the Molejon gold deposit (a gold deposit within the Minera Petaquilla, S.A. project), subject to the Panamanian Government accepting a multi-phase mine development plan on terms acceptable to the us, Teck and Inmet. In December 2004, the Company resumed exploration within the Petaquilla project in Panama.             |
| 2005        | Petaquilla Minerals Ltd. Minera Petaquilla          | We created two companies, a subsidiary in Panama named Petaquilla Gold, S.A. and Petaquilla Copper Ltd., to handle exploration, development, and operations of   |

|             |                          |   |
|-------------|--------------------------|---|
|             |                          | gold interests (Molejon) and copper deposits, respectively. Minera Petaquilla undertook a large trenching program comprised of 5,000 metres in 113 trenches during the summer of 2005. The trenches were often no more than 2 metres deep mostly on weathered material to fresh rock. Minera Petaquilla developed the mine plan (2005) that has been approved by the government.  |
| 2006        | Petaquilla Minerals Ltd. | In 2006, we excavated 12,294 metres of new trenches and drilled 220 core holes on a 14,005 metre Phase II drill program, including 11,398 metres devoted to infill drilling to confirm resource estimates, 980 metres of condemnation drilling to establish the location of the plant site, and 1,627 metres devoted to exploration drilling.   |
| 2007 - 2009 | Petaquilla Minerals Ltd. | Inmet Mining Corporation purchases all of the outstanding shares of Petaquilla Copper Ltd. and makes agreements with Teck creating Cobre Panama, which is the owner of Minera Panama S.A., formerly Minera Petaquilla, S.A. Currently, there are two companies operating under Law Number 9, Petaquilla Gold S.A. with a concessioned area of 1,186 ha and Minera Panama, S.A. holding the remainder of the concession, 12,414 ha. Phase II drilling at Molejon continued into 2007 to enable mine planning. The mine was developed and the processing plant constructed. |
| 2008        |                          | Autoridad Nacional del Ambiente (ANAM), environmental authorities in Panama, on November 26, 2008, issued Resolution DIEORA IA-809-2008, approving the Environmental Impact Study Category III, submitted by Petaquilla Gold, S.A., for the implementation of the Molejon Mining Project and other measures mandated by the ANAM.   |
| 2009        |                          | In accordance with Contract Law Number 9 of February 26, 1997, the Ministry of Commerce and Industry of the Government of Panama issued a letter to us dated November 18, 2009, authorizing our subsidiary, Petaquilla Gold, S.A., to initiate commercial production at our Molejon gold mine located in the District of Donoso, Province of Colon, Republic of Panama.   |
| 2010        | Petaquilla Minerals Ltd. | Commercial production commenced on January 8, 2010, when an average of 70% of design capacity was maintained continuously for a period of 30 days with metallurgical recoveries near forecast levels. Ore throughput at the process three-ball mills/carbon-in-pulp processing facility was 1,500 tpd with the operating rate planned at 2,200 tpd for the first year of production. Plans at the time were to increase production to 5,000 tpd with the addition of a SAG mill as the supply of mill feed permits.   |

#### Resource and Reserve Estimates

Resource estimates have been produced at Molejon through the years by different companies including:

- A study completed by SRK Consulting (Canada) Inc. on October 25, 2005
- Subsequent audit of the 2006 drill program by AAT Mining Services released on April 10, 2007
- Updated gold resource estimate by AAT Mining Services based on results obtained through September 2007

The below table shows a summary of historical resources and reserves as reported by different companies.

| <b>Year</b> | <b>Source</b>  | <b>Historical Mineral Resource/Reserve Estimates</b>  |
|-------------|--|---|
| 2005        | Report: Independent Technical Report and Resource Estimate of the Molejon Gold Project, Colon Province, Panama<br>Prepared by: SRK Consulting (Canada) Inc.<br>Date: October 25, 2005    | A National Instrument 43-1010 compliant study completed by SRK Consulting (Canada) Inc. established an <i>Inferred Resource</i> on the Molejon Project of <b>11.2 million tonnes grading 2.48 grams per tonne</b> for total contained resource of 893,000 oz gold using a bottom cut-off grade of 0.5 grams per tonne gold.   |
| 2007        | Report prepared by: AAT Mining Services<br>Date: April 10, 2007  | A National Instrument 43-1010 compliant report released following a subsequent audit of our 2007 drill program by AAT Mining Services, which outlined <b>447,879 ounces of Measured resources, 161,379 ounces of Indicated resources, and 506,294 ounces of Inferred resources.</b>   |
| 2007        | Report: Resource Estimate of the Molejon Gold Deposit through September 2007, Molejon Gold Deposit, Colon Province, Panama<br>Prepared by: AAT Mining Services<br>Date: October 15, 2007 | Updated gold resource estimate based on results obtained through September 2007. AAT Mining Services has estimated a total <b>Measured resource of 593,327 ounces</b> and an <b>Indicated resource of 317,696 ounces</b> at the Molejon Gold deposit. Additionally, an <b>Inferred resource of 458,502 ounces at an average grade of 0.665 grams per tonne above a cutoff of 0.3 grams per tonne</b> was estimated. |

We believe the above noted resource reports to be reliable and an accurate estimate of the resource at the time of their publication.

More recently, in April 2011, Behre Dolbear & Company (USA), Inc. (“Behre Dolbear”) released a report titled, “Molejon Project, NI 43-101 Technical Report, Donoso District, Colon Province, Republic of Panama” (the “April 2011 Behre Dolbear Report”), in which Behre Dolbear determined the potential tonnes and grade of reserves in an optimized pit and generated mine plan. From this work, Behre Dolbear believes that Molejon has reserves that are economically minable. Based on the pre-feasibility level design work, Behre Dolbear believes there are approximately 15.3 million tonnes of reserves that can be produced averaging 1.30 g/t gold and obtaining approximately 643,000 ounces of gold, based on the projected aggregate sales. Behre Dolbear recommends that for the feasibility level analysis the resource and reserve model be updated after further refinement of the database, statistical review of the assays, and evaluation of the estimation methods. Behre Dolbear believes that the mine will be able to produce the projected 643,000 ounces.

The April 2011 Behre Dolbear Report upgraded our measured and indicated resource to a proven and probable reserve of 643,266 contained gold ounces (15.3Mt @ 1.30g/t Au, average metallurgical recovery of 91.1%) as of the October 1, 2010, production cut-off. Prior to October 1, 2010, we mined an additional 99,961 gold ounces (1.39Mt @ 2.22g/t Au) of proven and probable reserves bringing the total proven and probable reserves at our Molejon Gold Project to a total of 743,227 ounces. This represents an increase of 61% over the last calculated reserve as of the October 1, 2010, production cut-off. We also initiated an economic assessment of silver reserves currently contained within the Molejon open pit. In this respect, Behre Dolbear has completed a preliminary assessment showing approximately 1Moz of measured and indicated silver resource ounces at an average grade of 2.4 g/t.

To prepare the April 2011 Behre Dolbear Report, the authors conducted an independent technical review of our Molejón gold project. Several site visits were made to the property during the period 2007 through 2010 and during 2011 by Behre Dolbear’s Qualified Persons, as defined in NI 43-101. These Qualified Persons were:

- H. John Head, Coordinator
- Baltazar Solano-Rico (Geology, Environmental, Coordination)
- Michael D. Martin (Mine Design – Mine Planning)
- Richard S. Kunter (Heap Leach Analysis)
- Robert Archibald (Aggregate Resource Analysis)

The following authors also participated in the development of the report but did not make a site visit.

- Betty Gibbs (Data Review, Resource Estimates)
- Robert Cameron (Reserve/Resource Estimates, Mine Design, Mine Plan)

The authors reviewed technical data, reports, and studies as well as information provided by us, inspected the subject mineral concessions, and reviewed the technical data derived at the properties by us and others during respective tenures of the concessions. The authors affirm the apparent representative nature of the technical data; however, they cannot specifically confirm its accuracy. Their review was conducted on a reasonableness basis and it has been noted in the April 2011 Behre Dolbear Report where such provided information engendered questions. Except for the instances in which questions were noted, the authors have relied upon the information provided as being accurate and suitable for use in the report.

#### *Outlook 2012*

We are focusing on continuing gold production at our Molejon gold project and continuing exploration efforts on our Oro del Norte concession during the fiscal year ending May 31, 2012.

We are also seeking to increase our resource base and to diversify our geopolitical risk by way of acquisitions and have proposed to acquire all of the outstanding shares of Iberian Resources Corp., a private British Columbia company, which owns 100% of the Lomero-Poyatos mine, through its wholly-owned Spanish affiliate Corporacion de Recursos Iberia S.L. The Lomero-Poyatos mine is located about 85 kilometres northeast of Seville, in the northeast part of the Iberian Pyrite Belt. Iberian also owns several other exploration licenses in Iberia, through its wholly-owned Spanish and Portuguese affiliates. This proposed transaction has been unanimously approved by Iberian’s shareholders and currently is subject to the approval of the shareholders of our company at our special meeting to be held on August 31, 2011.

## *Regional and Local Geology*

Panama is underlain by an island arc built upon late Cretaceous oceanic crust and is considered prospective for porphyry copper-gold-molybdenum deposits.

Andesitic tuffs and flows of presumed early to middle Tertiary age cover the majority of the Cerro Petaquilla Concession lying at the southern limit of a 400 square kilometre batholith, dated at 32.6±2 million years, which has intruded the older volcanic sequence. The core of the batholith is composed of quartz monzonite, grading outward to granodiorite and porphyritic granodiorite. The Petaquilla and Botija deposits are centered on porphyritic stocks and dykes lying peripheral to the southern margin of the batholith.

At the Botija deposit, the intrusive is a medium-grained, crowded porphyry composed of 25% plagioclase phenocrysts, 15% hornblende phenocrysts and 5-10% quartz grains in a feldspar rich matrix. At the Petaquilla deposit, the intrusive is more obviously porphyritic, with a generally lower percentage of phenocrysts. Contact phases and dykes at each deposit are finer-grained varieties of the main intrusive. In particular, feldspar, hornblende, quartz porphyry dykes appear to be late stage phases of the granodiorite. Most of these porphyry dykes post-date the mineralization, indicating that they were introduced during the waning stages of hydrothermal alteration and mineralization. The youngest units encountered on the property are the unmineralized basalt and andesite dykes.

Copper-gold-molybdenum porphyry deposits have been identified and partially delineated at the Petaquilla and Botija deposits, which are centred four kilometres apart on an east-west trend within the Cerro Petaquilla Concession. Four types of well-developed alteration have been observed within the various intrusive units: potassic, phyllic, quartz-chloritic and propylitic. Potassic alteration is found near the core of the porphyry system and is not extensive. It is characterized by quartz, potassium feldspar, biotite, sericite and lesser amounts of anhydrite and magnetite. The majority of copper mineralization is hosted in the phyllic altered rock, which is composed of quartz and sericite with minor kaolinite and K-spar. Propylitic alteration, marked by chlorite, pyrite, calcite and epidote, marks the outer extent of alteration in a porphyry system. The phyllic and quartz-chlorite alteration zones are usually found between the potassic core and the peripheral propylitic zone, although either may be missing. Alteration of the andesitic volcanic units, characterized by prograde biotite hornfels and fine grained sulphide mineralization occurs when they are found to be proximal to the intrusive contact or within zones of intrusive dyking.

The Petaquilla deposit is largely hosted by porphyritic granodiorite below its intrusive contact with andesite forming a flat-lying to gently dipping sheet, trending east-west and dipping to the north. It has been drilled for 1,600 metres along strike and remains open along strike to the south, east and west and at depth.

The Valle Grande deposit is hosted dominantly by porphyritic granodiorite and, similar to the Petaquilla deposit, is a flat-lying sheet, trending northwest-southeast and dipping to the north. It has been drilled for 2,400 meters along strike and is considered to have limited expansion potential.

The Botija deposit trends east-west and dips 20-30 degrees to the north or northeast. It has been intersected by drilling along strike for 1,800 metres and up to 600 metres down dip. The Botija deposit remains open near the surface to the south, along strike to the east and the west, and in many places at depth both vertically and down dip to the north.

The general geology of the Molejon epithermal gold target is dominated by volcanic and subvolcanic intrusives, including massive andesite flows, feldspar-porphyritic andesite flows, andesitic tuffs and andesitic agglomerates. This volcanic package has been intruded by feldspar-quartz porphyry and feldspar porphyry units. A northeast trending fault is believed to be the major structural control for the emplacement of the hydrothermally altered quartz-carbonate breccia.

## *Mineralization*

Mineralization at the nearby Petaquilla, Valle Grande and Botija deposits is largely concentrated within potassic or phyllic altered porphyritic intrusives of granodioritic composition. Volcanic-hosted copper mineralization, associated with strong biotite alteration, is widespread at the Petaquilla deposit and contributes significantly to its tonnage. Mineralization in each deposit consists of chalcopyrite and pyrite as disseminations, within quartz veinlets

and filling brittle, irregular fractures. Pyrite content generally decreases with higher grade copper mineralization and increases towards the periphery of the deposits. Chalcopyrite occurs most commonly as very fine disseminations within an altered intrusive matrix or biotite hornfels. It is often associated with magnetite and/or chlorite or biotite altered mafic minerals, most notably in lower-grade sections of propylitic alteration. Stockwork quartz veinlets are best developed within potassic alteration, where they crosscut pervasive silicification. The irregular fracture-filling style of copper mineralization, which locally approaches a sulphide net, is largely confined to biotite-altered andesite at the Petaquilla deposit. This is cut in places by narrow quartz-chalcopyrite veins which have developed bleached selvages of biotite destruction. A fourth style of mineralization, consisting of chalcopyrite and pyrite coatings along steep, widely spaced cooling joints is confined to granodiorite along the eastern periphery of the Botija deposit.

Molybdenite is present mainly in quartz, carbonate, chalcopyrite veinlets hosted by granodiorite within the most intensely altered and mineralized portion of each deposit. Bornite occurs locally with chalcopyrite and contributes significantly to the copper grade in some sections, mainly within hornfelsed andesites in the Petaquilla deposit. Although leaching is widespread throughout the upper 10 to 30 metres of the deposits, supergene copper mineralization is not present in significant amounts. Magnetite is an important accessory in both deposits, disseminated throughout both the porphyritic intrusives and the intruded andesite.

At our Molejon deposit, epithermal gold-silver mineralization occurs within structurally controlled zones of hydrothermal quartz-carbonate breccia and the fractured and altered rocks marginal to the quartz-carbonate breccia. Assay boundaries of gold-silver mineralization are not sharply constrained by geological contacts. Highest grade mineralization usually occurs in the quartz-carbonate breccia but economic mineralization also occurs in feldspar-quartz porphyry, and more rarely in feldspar-porphyritic andesite flows.

*Doing Business in Panama*

The following briefly summarizes our understanding of the economic and political climate in Panama based on research and information compiled by us from various sources that we believe to be reliable.

Democracy was restored in Panama in December 1989, following the invasion of Panama by the U.S. military. In May 1994, Panama held its first democratic elections in almost 30 years. Pursuant to the constitution of Panama, the president of the country holds office for five years. Therefore, elections were subsequently held in May 1999, 2004, and, most recently, in May 2009. On May 3, 2009, Ricardo Martinelli won Panama’s presidential election. He and his right-wing alliance led by his Democratic Change party won 61% of the vote and took office on July 1, 2009. Mr. Martinelli’s business experience impressed voters worried about their livelihoods in a global recession that had stunted Panama’s strong prior economic growth.

Mr. Martinelli remains popular, a reflection of Panama’s solid economic growth prospects, responsible fiscal policies, and favourable government debt dynamics. The government’s current budget proposal, approved by the cabinet on July 26, 2011, and now awaiting approval by the legislature, outlines an increase of close to 16% in spending. This mainly reflects a substantial increase in capital expenditure, on the back of the government’s ambitious five-year economic and social development plan. Over 30% of spending in 2012 is destined for infrastructure investment, up from 28% in 2009, the year the government took office. Over the same period, current spending on government wages and transfers has fallen from 49% to 46% of total expenditure. Total revenue is forecast to rise by 14% compared with 2011. Current revenue growth is forecast to moderate, as the effect of an increase in value-added tax in mid-2010 begins to diminish, but growth is nevertheless expected to remain in double digits as robust economic growth supports consumer spending.

We note the risk assessment ratings for Panama by The Economist Intelligence Unit are in the mid-range, as shown below.

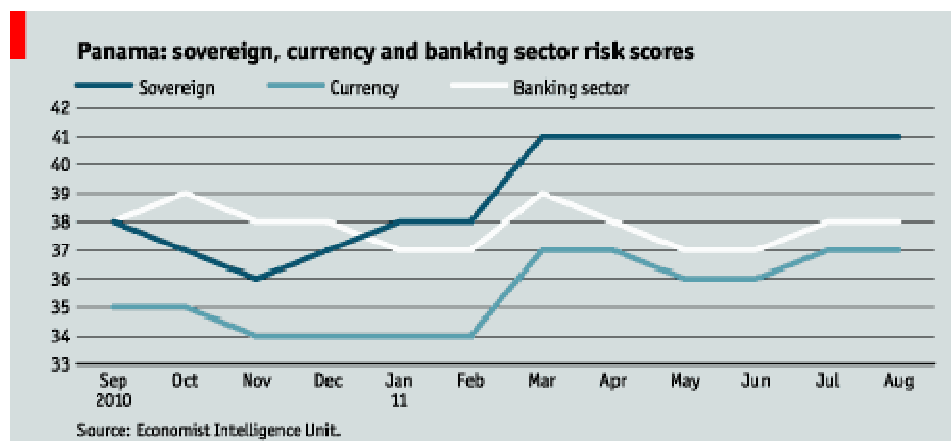
| <b>Credit Risk Overview</b>       |                |               |                     |                |                         |              |
|-----------------------------------|----------------|---------------|---------------------|----------------|-------------------------|--------------|
| <b>Panama Risk Assessment</b>     |                |               |                     |                |                         |              |
| August 2011                       | Sovereign Risk | Currency Risk | Banking Sector Risk | Political Risk | Economic Structure Risk | Country Risk |
|                                   | BBB            | BBB           | BBB                 | BBB            | B                       | BBB          |
| <b>Rating Band Characteristic</b> |                |               |                     |                |                         |              |

|     |   |
|-----|---|
| BBB | Capacity and commitment to honour obligations currently, but somewhat susceptible to changes in economic climate. |
| B   | Capacity and commitment to honour obligations currently, but very susceptible to changes in economic climate.     |

Sovereign risk - Stable. Despite a widening of the fiscal deficit in 2011, strong growth in nominal Gross Domestic Product will result in a gradual fall in the public debt/Gross Domestic Product ratio. The BBB rating also reflects Panama's good access to financing.

Currency risk - Stable. In spite of the mild forecast erosion of Panama's competitiveness vis-à-vis the US, dollarisation is firmly entrenched and will not come under threat.

Banking sector risk - Stable. Low levels of non-performing loans and high capitalization and liquidity levels underpin the banking sector rating.



Political risk - A congressional majority will bolster government reform efforts, but the risk of the break-up of the coalition sustains concerns about medium-term progress.

Economic structure risk - Panama's reliance on trade flows and the export-oriented services sector weigh on the rating. A widening of the current-account deficit mainly reflects investment projects, which will have good access to external financing.

Mining has not historically been a significant factor in the Panamanian economy and, consequently, Panama does not have the infrastructure and trained personnel required for modern mining operations. The government of Panama has, however, included the development of mineral resources in its economic plan to diversify the Panamanian economy and has taken steps to put in place the legislative framework needed to foster development of these resources.

The Code of Mineral Resources of the Republic of Panama has been subject to substantial modifications, among which the most important are Law No. 3 of January 28, 1988, and Law No. 32 of February 9, 1996. The main purpose of such amendments was to simplify the procedure for filing the necessary petitions to obtain concessions, either for conducting mining exploration or mining extraction operations and property rights over the minerals extracted. These amendments grant total exemption from import taxes and customs duties for all equipment, spare parts and materials used in the development of any type of mining operations and there are no export taxes on mineral production.

An exploration concession permits the holder to explore for the minerals specified in the concession. The rental rates payable by the holder to the Government of Panama are \$0.50 per hectare for the first two years, \$1.00 per hectare for the third and fourth years and \$1.50 for the fifth year and thereafter. A 2% gross overriding royalty on the value received for all minerals of higher commercial value (e.g. gold and silver) mined from the concession is payable to the government of Panama. We anticipate that the Government of Panama will be increasing the royalty rate from 2% to 4%, although it has not as of yet implemented the increase.

The holder of an exploration concession has the exclusive right to obtain an exploitation concession for the subject

area upon determining that the minerals covered by the concession may be produced in commercial quantities through a separate request to the Government of Panama. Rental rates for exploitation concessions fluctuate, depending on the mineral concerned and the extraction period, between \$0.75 and \$4.00 per hectare. Rental rates for metallic minerals such as copper, iron, zinc, aluminum and precious metals are \$1.00 per hectare for the first five years, \$2.00 from the sixth to the tenth year and \$3.00 the eleventh year and thereafter. A 2% gross overriding royalty on the value received for all minerals mined from the concession is payable to the Government of Panama. However, this overriding royalty will be 2% for minerals of higher commercial value such as gold and silver.

Exploitation concessions generally permit the holder to carry out additional pre-development exploration, to construct all necessary production facilities and to extract, process, store, transport, market and export the minerals subject to the concession so long as production is ongoing.

In 1995, the Panamanian Tax Reform Law was enacted to simplify the corporate income tax rates applicable to income earned in Panama (Law No. 28 of June 20, 1995). Since June 1995, the corporate income tax rate has been 30%. In addition to corporate income tax, Panamanian law provides for a dividend tax. With the exceptions provided for in the Fiscal Code of the Republic of Panama, all corporations must retain 10% of the amounts they may distribute among their shareholders as dividends or share quotas. In case dividends are not distributed, or the entire amount distributed as dividend or share quota is less than 40% of the net profit of that fiscal period, minus taxes paid by the corporation, the corporation must cover 10% of the remainder.

The Fiscal Code of the Republic of Panama indicates certain expenses which may be deducted from the income tax, applicable to companies conducting mining activities. Additionally, the Code of Mineral Resources establishes certain expenses related to such activities that may be deducted from income tax as well.

There are currently no significant restrictions on repatriation from Panama of earnings to foreign entities other than the income tax and the dividends tax referred to above. There are currently no material currency exchange or foreign investment restrictions.

Based on our understanding of current Panamanian environmental laws and regulations, we do not anticipate that such laws will have an adverse material impact on the operations we may conduct in the future. Based on geochemical analysis and reporting, we anticipate that our Molejon gold project will meet or exceed the effluent and leachate requirements of Panamanian environmental laws and regulations. We use a carbon-in-pulp ("CIP") floatation process, which allows in process cyanide destruction before effluent is discharged. This process is inherently safer and more controllable than traditional acid and cyanide open-air heap leach processing. Any acidity produced at the experimental pH is expected to be buffered by the receiving waters around the Molejon project, which have a pH between 7.4 and 7.8 and total alkalinity between 15 mg/L and 27 mg/L (as CaCO<sub>3</sub>). Results for both tails and waste rock leachate indicate that the Molejon project will have net acid neutralizing potential. The results of the continuous tests showed that the INCO SO<sub>2</sub> cyanide destruction method is an efficient process for decreasing the total cyanide concentrations in our CIP leach pulp.

The foregoing laws of general application apply to our Panamanian mineral properties other than the Cerro Petaquilla Concession which is governed primarily by the Ley Petaquilla. Please refer to "*Item 4 - Information on Our Company - B. Business Overview*".

Panama's currency, the Balboa, is at parity with the U.S. dollar. Exchange transactions are allowed in U.S. dollars and, as a result, foreign currency fluctuations may be material for us to the extent that fluctuations between the Canadian and U.S. dollar are material.

#### **Item 4A. UNRESOLVED STAFF COMMENTS**

None.

### **ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS**

#### **5.A. Operating Results**

We are in the business of the acquisition and exploration of mineral properties, with the primary aim of developing

them to a stage where they can be exploited at a profit. At that stage, our operations would, to a significant extent, be dependent on the prevailing market prices for any of the minerals produced by such operations. We currently have one gold producing mine.

During the year ended May 31, 2011, we were primarily engaged in gold production at our Molejon property in Panama since bringing the Molejon gold project to commercial production on January 8, 2010. Our future mineral exploration and mining activities may be affected in varying degrees by Panama's political stability and government regulation, all of which are beyond our control. Please refer to "*Item 3 - Key Information – 3.D. Risk Factors*".

Historically our fiscal year end was January 31. During the period ended April 30, 2007, we changed our fiscal year end from January 31 to April 30 due to the complexities of the Plan of Arrangement with Copper. We changed our fiscal year end again in 2008 from April 30 to May 31. We made this change because we wanted to demonstrate to the Panamanian government that we had sufficient funds to continue work on the mine.

#### *Year Ended May 31, 2011, Compared to Year Ended May 31, 2010*

Our consolidated financial statements have been prepared in accordance with generally accepted accounting principles in Canada and all amounts are expressed in United States dollars unless otherwise indicated. Our operating results reflect ongoing administrative costs, net of interest and other income, revenue from the sale of gold, production and operating expenses and amortization and depletion. Commercial production at the Molejon Gold mine commenced on January 8, 2010.

Gold sales were \$71,708,685 and cost of sales was \$(39,157,086) during the year ended May 31, 2011.

Amortization of production equipment and depletion of mineral properties were \$(11,335,717) for the year ended May 31, 2011, compared to \$(4,839,420) for the year ended May 31, 2010. During the pre-operating period, which ceased on January 8, 2010, amortization of production equipment was capitalized to mineral properties up until the start of commercial production on January 8, 2010. Depletion of mineral resources commenced on the date of commercial production and is being charged over the life of the mine using the unit-of-production method.

During the year ended May 31, 2011, other income increased by \$18,451,666 to \$1,909,919 compared to \$(16,541,747) for the year ended May 31, 2010. The increase in other income is largely due to a decrease in the mark-to-market loss on convertible and senior secured notes of \$10,066,219. The mark-to-market loss on convertible and senior secured notes was \$(6,023,189) for the year ended May 31, 2011, compared to \$(16,089,408) for the year ended May 31, 2010. There was also a decrease of \$196,571 in interest on long-term debt. Interest on long-term debt was \$(305,003) for the year ended May 31, 2011, compared to \$(501,574) for the year ended May 31, 2010. The decrease in interest on long-term debt is due to the termination of some capital leases during the year ended May 31, 2011. Other income was also impacted by an increase of \$3,153,394 in deferred services. During the year ended May 31, 2011, the agreement for deferred services between us and Minera Panama, S.A. expired, and as a consequence of this termination and subsequent to our receipt of a legal opinion of counsel, the outstanding balance regarding the obligation derived from this contract was recorded as other income. There was also an increase of \$5,243,309 in gain on disposal and dilution derived from the disposal of Vintage Mining Corp. by Azuero Mining Development, S.A.

Expenses for the year ended May 31, 2011, increased by \$7,650,281 to \$(24,555,971) compared to \$(16,905,690) for the year ended May 31, 2010. The increase in expenses is primarily due to an increase of \$2,473,358 in transaction fees on our forward gold sale agreement. Transaction fees on our forward gold sale agreement were \$2,473,358 for the year ended May 31, 2011, compared to \$Nil for the year ended May 31, 2010. This increase was due to the costs associated with our Deutsche Bank Forward Gold Purchase Agreement, which were expensed in accordance with our accounting policy. There was also an increase of \$4,965,003 in exploration and development costs. Exploration and development costs were \$9,269,306 for the year ended May 31, 2011, compared to \$4,304,303 for the year ended May 31, 2010. This increase was due to the increased exploration activity on our Oro del Norte property, located near our Molejon Project. We also incurred an increase in donations and community relations of \$170,961. Donations and community relations for the year ended May 31, 2011, were \$1,411,440 compared to \$1,240,479 for the year ended May 31, 2010. This increase was due to our commitment to fund Fundacion Petaquilla, which promotes a sustainable development culture and administers social programs in the area around our Molejon property. Office administration expenses increased \$811,497. Office administration costs were \$2,421,243 for the year ended May 31, 2011, compared to \$1,609,746 for the year ended May 31, 2010. This increase is mainly due to the fact that all costs incurred by our subsidiary, Panama Desarrollo De Infraestructuras,

S.A. (formerly Petaquilla Hidro S.A.), prior to our commencement of production were capitalized to mineral properties. Consulting fees were \$983,667 for the year ended May 31, 2011, compared to \$663,796 for the year ended May 31, 2010. This increase is mainly due to the engagement of consultants for our projects to transition to International Financial Reporting Standards for our 2012 fiscal year and to optimize processes at our Molejon mine. Lastly, investor relations and shareholder information expenses increased \$365,793. Investor relations and shareholder information expenses were \$843,313 for the year ended May 31, 2011, compared to \$502,690 for the year ended May 31, 2010. This increase is mainly due to filing fees related to our private placement in our 2011 fiscal year and to an increase in investor relationship activities during the year ended May 31, 2011.

Our increase in expenses was partially offset by a decrease in stock based compensation expenses of \$379,898. Stock based compensation expenses were \$971,208 for the year ended May 31, 2011, compared to \$1,351,106 for the year ended May 31, 2010. The decrease was due to a lower amount of stock options issued during fiscal year 2011. Travel expenses also decreased \$249,373. Travel expenses were \$657,616 for the year ended May 31, 2011, compared to \$906,989 for the year ended May 31, 2010. Travel expenses were higher in the prior year due to a significant number of Shareholder and board activities. There was also a decrease in debt issuance costs of \$613,244. Debt issuance costs were \$Nil for the year ended May 31, 2011, compared to \$613,244 for the year ended May 31, 2010. This reduction corresponds to our reduction in debt. Accounting and legal expenses decreased by \$119,678. Accounting and legal expenses totalled \$1,655,679 for the year ended May 31, 2011, compared to \$1,775,357 for the year ended May 31, 2010.

The net loss and comprehensive loss for the year ended May 31, 2011, was \$(3,937,326) or \$(0.03) per basic and diluted share compared to a net loss and comprehensive loss of \$(26,982,082) or \$(0.25) per basic and diluted share for the year ended May 31, 2010.

#### *Year Ended May 31, 2010, Compared to Year Ended May 31, 2009*

Our consolidated financial statements have been prepared in accordance with generally accepted accounting principles in Canada and all amounts are expressed in United States dollars unless otherwise indicated. Our operating results reflect ongoing administrative costs, net of interest and other income, revenue from the sale of gold, production and operating expenses and amortization and depletion. Commercial production at the Molejon Gold mine commenced on January 8, 2010.

Metal sales were \$27,542,935 and cost of sales was \$(16,237,588) during the year ended May 31, 2010. Prior to the attainment of commercial production, all revenue and operating costs associated with the commissioning of the mill were capitalized as part of mineral properties. The revenue and cost of sales recognized in the current year represent operations from January 8, 2010.

Amortization of production equipment and depletion of mineral properties were \$(4,839,420) for the year ended May 31, 2010, compared to \$Nil for the year ended May 31, 2009. During the pre-operating period, amortization of production equipment was capitalized to mineral properties up until the start of commercial production on January 8, 2010. Depletion of mineral resources commenced on the date of commercial production and is being charged over the life of the mine using the unit-of-production method.

During the year ended May 31, 2010, other income decreased by \$21,045,592 to \$(16,541,747) compared to \$4,503,845 for the year ended May 31, 2009. The decrease in other income is largely due to a gain on sale of equity investment of \$Nil during the year ended May 31, 2010, related to the sale of Petaquilla Copper Ltd. ("Copper") shares compared to \$40,604,938 for the year ended May 31, 2009. There was also a dilution gain of \$Nil for the year ended May 31, 2010, compared to \$2,238,492 for the year ended May 31, 2009, related to our investment in Copper. The dilution gain resulted from the difference between our carrying cost of Copper and the amount paid up for each Copper share issued. The decrease in the dilution gain is due to the sale of Copper in the second quarter of fiscal 2009. There was also a mark-to-market loss on senior secured notes of \$(15,849,408) resulting from an increase in the fair value of the senior secured notes ("Notes") due to mark-to-market accounting during the year ended May 31, 2010, compared to \$(14,939,298) for the year ended May 31, 2009. There was also interest on long term debt of \$501,574 for the year ended May 31, 2010, compared to \$37,382 for the year ended May 31, 2009, due to the fact that interest on capital lease obligations was capitalized as part of mineral properties up until the start of commercial production on January 8, 2010.

This decrease in other income was partially offset by a redemption loss on senior secured notes of \$(240,000) for the year ended May 31, 2010, compared to \$(13,130,982) for the year ended May 31, 2009, related to partial early redemption of the senior secured notes during that period. There was also a foreign exchange loss of \$(93,159) for

the year ended May 31, 2010, compared to \$(8,157,720) for the year ended May 31, 2009. This primarily resulted from the significant decrease in the Canadian dollar, impacting the majority of our liabilities which are denominated in United States dollars coupled with a significant increase in U.S. denominated liabilities (senior secured notes) which occurred during fiscal 2009, prior to our adoption of the U.S. dollar as our functional currency. There was also an equity loss of \$Nil for the year ended May 31, 2010, compared to \$(2,396,011) for the year ended May 31, 2009, related to our investment in Copper. The equity loss reflects our portion of the losses that are attributed to our percentage ownership in Copper. The decrease in the equity loss is due to the sale of Copper in the second quarter of fiscal 2009.

Expenses for the year ended May 31, 2010, decreased by \$8,698,021 to \$(16,905,690) compared to \$(25,603,711) for the year ended May 31, 2009. The decrease in expenses is primarily due to a decrease of \$5,785,581 in debt issuance costs. Debt issuance costs were \$613,244 for the year ended May 31, 2010, compared to \$6,398,825 for the year ended May 31, 2009, as less debt was issued during the current period. In addition, there was a decrease of \$3,457,559 in exploration and development costs. Exploration and development costs were \$4,304,303 for the year ended May 31, 2010, compared to \$7,761,862 for the year ended May 31, 2009. This was due to the change in activities from exploration and development of the Molejon property in the prior period to pre-operations, mill commissioning and production during the current period. Approximately 77% of the exploration and development costs incurred in the current fiscal year relate to work performed on the Oro del Norte property, located near Molejon. As well, there was a decrease of \$577,274 in office administration. Office administration costs were \$1,609,746 for the year ended May 31, 2010, compared to \$2,187,020 for the year ended May 31, 2009. This was due to the fact that during the 2010 fiscal year insurance costs and other administrative expenses were capitalized to mineral properties during the pre-operating period and were then included as production costs after the commencement of commercial production.

The decreases in expenses were partially offset by an increase of \$511,855 in wages and benefits. During the year ended May 31, 2010, we incurred \$3,428,470 in wages and benefits compared to \$2,916,615 for the year ended May 31, 2009. The increase is related to termination costs incurred during the current fiscal year as well as additional senior personnel hired to develop our infrastructure business. In addition, there was an increase of \$452,652 in stock-based compensation. Stock-based compensation was \$1,351,106 for the year ended May 31, 2010, compared to \$898,454 for the year ended May 31, 2009, due to a larger number of options, some of which vested immediately, being issued in the current fiscal year. During the current year, 5,365,000 options were granted compared to 1,370,000 granted during the prior fiscal year. There was also an increase of \$291,208 in donations and community relations. Donations and community relations was \$1,240,479 for the year ended May 31, 2010, compared to \$949,271 for the year ended May 31, 2009. This was due to an agreement reached with the government to fund the charity Petaquilla Fundacion by a minimum of \$100,000 per month. There was also an increase of \$293,548 in consulting fees. During the year ended May 31, 2010, we incurred \$663,796 in consulting fees compared to \$370,248 for the year ended May 31, 2009. The increase is largely due to financial consultants hired to facilitate the refinancing of our debt facilities.

The net loss and comprehensive loss for the year ended May 31, 2010, was \$(26,982,082) or \$(0.25) per basic and diluted share compared to a net loss and comprehensive loss of \$(25,748,582) or \$(0.22) per basic and diluted share for the year ended May 31, 2009.

*Year Ended May 31, 2009, Compared to Year Ended May 31, 2008*

**Financial Results for the Year Ended May 31, 2009, and May 31, 2008**

|   | One Month<br>Ended May<br>31,2008 | Year<br>Ended April<br>30,2008 | One Month<br>Ended May<br>31,2007<br><br>(unaudited) | Year<br>Ended May<br>31,2008<br><br>(unaudited) | Year<br>Ended May<br>31, 2009 |
|---|-----------------------------------|--------------------------------|--|---|-------------------------------|
| <b>EXPENSES</b>                                   |                                   |                                |  |   |                               |
| Accounting and legal                              | \$ 15,536                         | \$ 1,306,921                   | \$ 58,159  | \$ 1,264,298                                    | \$ 1,944,302                  |
| Accretion of asset<br>retirement obligation       | 52,098                            | 305,692                        | 25,640   | 332,150   | 331,504                       |
| Consulting fees                                   | 21,170                            | 943,250                        | 90,363   | 874,057   | 370,248                       |
| Filing fees                                       | 280                               | 87,005                         | 6,907  | 80,378  | 115,295                       |
| Investor relations and<br>shareholder information | 54,595                            | 1,012,822                      | 62,249   | 1,005,168                                       | 475,092                       |
| Office administration                             | 213,168                           | 2,711,908                      | 324,369  | 2,600,707                                       | 2,187,020                     |

|   |                |                 |             |                 |                 |
|---|----------------|-----------------|-------------|-----------------|-----------------|
| Rent  | 1,630          | 122,495         | 13,603      | 110,522         | 240,693         |
| Donations and community relations           | -              | -               | -           | -               | 949,271         |
| Exploration and development costs           | 562,237        | 11,690,204      | 723,000     | 11,529,441      | 7,761,862       |
| Stock-based compensation                    | 77,890         | 5,561,247       | 641,848     | 4,997,289       | 898,454         |
| Travel                                      | 121,849        | 857,907         | 79,603      | 900,153         | 1,014,530       |
| Debt issuance costs                         | 3,894,873      | -               | -           | 3,894,873       | 6,398,825       |
| Wages and benefits                          | 177,329        | 1,668,455       | 150,029     | 1,695,755       | 2,916,615       |
| Total expenses                              | (5,192,655)    | (26,267,906)    | (2,175,770) | (29,284,791)    | (25,603,711)    |
| <b>OTHER INCOME (EXPENSE)</b>               |                |                 |             |                 |                 |
| Foreign exchange gain (loss)                | 295,059        | 1,342,442       | (144,621)   | 1,782,122       | (8,157,720)     |
| Interest income                             | 78,658         | 51,926          | 8,542       | 122,042         | 169,366         |
| Asset usage fees                            | (695)          | 126,775         | 59,649      | 66,431          | (4,155)         |
| Gain on sale of equity investment           | -              | 4,347,077       | -           | 4,347,077       | 40,604,938      |
| Interest on long term debt                  | (15,613)       | (68,465)        | -           | (84,078)        | (37,382)        |
| Power and drilling services                 | 70,094         | 76,430          | -           | 146,524         | 156,597         |
| Loss from equity investment                 | (779,846)      | (8,301,371)     | (323,150)   | (8,758,067)     | (2,396,011)     |
| Gain on dilution of equity investment       | -              | 12,582,085      | 2,913,982   | 9,668,103       | 2,238,492       |
| Redemption loss on senior secured notes     | -              | -               | -           | -               | (13,130,982)    |
| Mark-to-market loss on senior secured notes | -              | -               | -           | -               | (14,939,298)    |
|   | (352,343)      | 10,156,899      | 2,514,402   | 7,290,154       | 4,503,845       |
| Net earnings (loss) for the period          | \$ (5,544,998) | \$ (16,111,007) | \$ 338,632  | \$ (21,994,637) | \$ (21,099,866) |

We did not generate revenue from operations during the year ended May 31, 2009, or the year ended May 31, 2008.

Expenses for the year ended May 31, 2009, were \$25,603,711 compared to \$29,284,791 for the year ended May 31, 2008, a decrease of \$3,681,080. The decrease was attributable to a decrease in exploration and development costs due to the change in activities from exploration and development in 2008 to pre-operations and mill commissioning during the second half of fiscal 2009. The decrease was also attributable to a decrease in stock-based compensation due to a fewer number of options vesting in fiscal 2009. These decreases were partially offset by an increase in debt issuance costs as a result of the issuance of the second, third and supplemental tranches of senior secured notes and the issuance of convertible senior secured notes during the current fiscal year. Only one tranche of senior secured notes was issued in the year ended May 31, 2008.

Other income for the year ended May 31, 2009, was \$4,503,845 compared to \$7,290,154 for the year ended May 31, 2008. The decrease in other income is due to the redemption losses and mark-to-market losses on the senior secured notes and the convertible senior secured notes totalling \$28,070,280 which resulted from an increase in the fair value of the senior secured notes ("Notes") due to mark-to-market accounting, a change in the discount rate on the Notes from 26.65% to 20.58% as at February 28, 2009, and the partial redemption of Notes during the year ended May 31, 2009. As the Notes issued in the year ended May 31, 2008, fiscal year were issued close to year end there were no such mark-to-market losses during this comparative period. The decrease in other income was also due to a lower gain on dilution of equity investment as the equity investment was sold in the second quarter of fiscal 2009 and a foreign exchange loss of \$8,157,720 compared to a foreign exchange gain of \$1,782,122 in the prior year. This primarily resulted from the significant decrease in the Canadian dollar, impacting the majority of our liabilities which are denominated in United States dollars coupled with a significant increase in U.S. denominated liabilities (senior secured notes) which occurred during the first nine months of fiscal 2009, prior to the adoption of the U.S. dollar as our functional currency.

The decreases in other income were partially offset by a lower loss from equity investment due to the sale of the equity investment in the second quarter of fiscal 2009 as well as a higher gain on sale of the equity investment.

The net loss for the year ended May 31, 2009, was \$21,099,866 or \$(0.22) per share compared to a net loss of \$21,994,637 or \$(0.24) per share for the year ended May 31, 2008.

## **5.B. Liquidity and Capital Resources**

As at May 31, 2011, our financial situation has improved significantly as compared to May 31, 2010. Cash on hand plus short and long term investments have increased by \$5,279,027 to \$11,905,161 as at May 31, 2011, compared to \$6,626,134 as at May 31, 2010. This represents an increase of 80% in our cash position. In addition, our liquidity ratio as at May 31, 2011, has improved 385% compared to May 31, 2010, resulting in a reduction in working capital deficiency of \$64,490,512. As at May 31, 2011, our working capital deficit was \$22,838,842 compared to \$87,329,354 as at May 31, 2010, representing a reduction of 74% in our working capital deficiency. Working capital is defined as current assets less current liabilities and provides a measure of the Company's ability to settle liabilities that are due within one year with assets that are also expected to be converted to cash within one year.

Our total liabilities as at May 31, 2011, have decreased by \$6,416,140 to \$95,199,170 compared to \$101,615,310 as at May 31, 2010. This represents a 6% decrease in our obligations. Further, as at May 31, 2011, our total assets increased \$35,257,081 to \$115,519,276, compared to \$80,262,195 as at May 31, 2010, representing a 44% increase. Shareholders' equity, as at May 31, 2011, has increased 183% to \$17,812,950 compared to a shareholders' deficiency of \$21,353,115 as at May 31, 2010. This significant improvement in terms of equity was due to the completion of our private placement offering and the exercise of warrants and options during the year ended May 31, 2011, partially offset by the net loss of \$3,937,326 for the year ended May 31, 2011.

As at May 31, 2011, we have accumulated an operating deficit of \$150,694,344 (May 31, 2010 - \$146,757,018). However, during the three months period ended May 31, 2011, we obtained, for the second consecutively time since commercial production, a net income. Our net income of \$5,394,399 represents an increase of \$12,188,339 compared to the net loss for the three months period ended May 31, 2010. This significant achievement was derived mainly from an improvement of \$4,408,789 in our operating profit, due to an increase of 29% in gold sales, and a reduction of \$6,512,494 in the cost of our senior and convertible secured notes.

As at May 31, 2011, we have \$2,906,453 outstanding in senior secured notes ("Notes") and \$3,693,111 outstanding in convertible senior secured notes ("Convertible Notes"). The Notes bear interest at an annual rate of 15% and have maturity dates five years from the dates of issuance (May 21, 2008, July 9, 2008, and October 3, 2008) with a 20% premium on principal to be paid at maturity. The Convertible Notes bear interest at an annual rate of 15% and were originally written to mature two years from the date of issuance (March 25, 2009) at 110% of the principal.

In our 2010 fiscal year, we were unable to meet all of our obligations with respect to scheduled repayments of principal, premium and interest on our Notes and Convertible Notes. As such, under the terms of the Indenture an event of default had occurred and the Notes and Convertible Notes became due on demand at the option of the Note and Convertible Note holders or the Trustee. As of May 31, 2010, the Company had \$26,646,631 in redemption amount of Notes and \$44,837,991 in Convertible Notes outstanding.

The terms of the Indenture were largely suspended, when we entered into a prepaid Forward Gold Purchase Agreement with Deutsche Bank AG ("Deutsche Bank") for \$45,000,000 on September 23, 2010. Upon completion of this transaction, we used proceeds of \$13,952,574 to pay principal, premium and interest on our Notes and \$25,997,426 to pay principal premium and interest on our Convertible Notes. As part of the Forward Gold Purchase Agreement our Note and Convertible Note holders were required to enter into an inter-creditor agreement with us and Deutsche Bank which prevents the Note and Convertible Note holders from taking action as a result of the event of default that occurred, until our obligations under the Forward Gold Purchase Agreement have been satisfied. The Inter-Creditor Agreement on the Notes and Convertible Notes is as follows:

- (a) The security for the Notes and Convertible Notes became subordinated to the security granted under the Forward Gold Purchase Agreement with Deutsche Bank;
- (b) No interest or principal payments are required on the Notes and Convertible Notes until March 22, 2011. After March 22, 2011, we are required only to make scheduled interest payments on the Notes and Convertible Notes as they become due until the Notes and Convertible Notes mature five years and one day after closing of the Forward Gold Purchase Agreement with Deutsche Bank;

- (c) Until our obligations under the Forward Gold Purchase Agreement with Deutsche Bank are satisfied, the holders of the Notes and Convertible Notes are not permitted to take any action as a result of an event of default that has occurred pursuant to the indenture;
- (d) If we are able to negotiate new financing arrangements satisfying certain conditions, the proceeds of such financing will be used to prepay the outstanding balance of principal, premium and interest on the Notes and Convertible Notes.

On February 8, 2011, we redeemed 12,008 Notes at 120% of their principal value plus interest for a total payment of \$12,008,345 and 18,347 Convertible Notes at 110% of their principal value plus interest for a total payment of \$18,347,276. These payments were financed by the private placement completed during the year ended May 31, 2011. On December 30, 2010, January 7, 2011, January 26, 2011, and January 31, 2011, we issued a total of 32,000,000 common shares at a price of CAD\$1.00 per shares, raising gross proceeds of CAD\$32,000,000.

Our operating cash flow and profitability are affected by various factors, including the amount of gold produced and sold, the market price of gold, operating costs, interest rates, environmental costs, the level of exploration activity, labour risk, the risk of business disruption due to environmentalist activities and political risk. We seek to manage the risks associated with our business; however, many of the factors affecting these risks are beyond our control.

On January 8, 2010, we commenced commercial production. If we are unable to generate positive cash flow from production activities, we may have to raise additional funds for further exploration of the surrounding concessions, to meet our operating obligations and to continue operations. We may pursue additional sources of financing and while we have been successful in the past there can be no assurance that we will be able to do so in the future.

Historically, our mineral exploration activities have been funded primarily through sales of common shares and through debt financing and we expect that we will continue to be able to utilize these sources of financing should we not develop sufficient cash flow from our operations. We have not made use of any financial instruments for hedging purposes.

Our management reviews annually the carrying value of our interest in each mineral property and where necessary, properties are written down to the estimated recoverable amount determined on a non-discounted basis after giving effect to any property option agreements and cost recovery agreements. Costs relating to properties abandoned are written off when the decision to abandon is made.

#### *May 31, 2011, Compared with May 31, 2010*

At May 31, 2011, our current assets totaled \$19,125,414 and our working capital deficiency was \$22,838,842 compared with current assets of \$9,066,842 and a working capital deficiency of \$87,329,354 at May 31, 2010, due to the repayment of the majority of our senior secured notes and convertible senior secured notes in fiscal 2011.

At May 31, 2011, total liabilities were \$95,199,170 compared to \$101,615,310 at May 31, 2010. The decrease was due to the repayment of a large portion of the senior secured notes and convertible senior secured notes, but was partially offset by a significant increase in accounts payable and accrued liabilities, as well as the establishment of a deferred revenue obligation.

At May 31, 2011, we had total assets of \$115,519,276 compared to \$80,262,195 at May 31, 2010.

Share capital at May 31, 2011, was \$131,078,574 (176,429,501 shares) compared to \$102,334,997 (125,281,951 shares) at May 31, 2010.

#### *May 31, 2010, Compared with May 31, 2009*

At May 31, 2010, our current assets totaled \$9,066,842 and our working capital deficiency was \$87,329,354 compared with current assets of \$5,350,239 and a working capital deficiency of \$24,386,116 at May 31, 2009, due to the entire amount of the Notes and Convertible Notes being classified as current liabilities, as a result of the anticipated redemption of senior secured notes and convertible senior secured notes in fiscal 2011.

At May 31, 2010, total liabilities were \$101,615,310 compared to \$90,464,111 at May 31, 2009. The increase was

largely due to an increase in accounts payable, from \$8,746,892 in 2009 to \$17,586,683 in 2010.

At May 31, 2010, we had total assets of \$80,262,195 compared to \$81,543,823 at May 31, 2009.

Share capital at May 31, 2010, was \$102,334,997 (125,281,951 shares) compared to \$89,208,668 (96,040,121 shares) at May 31, 2009.

#### *May 31, 2009, Compared with May 31, 2008*

At May 31, 2009, our current assets totaled \$5,350,239 and our working capital deficiency was \$24,386,116 compared with current assets of \$13,611,277 and a working capital deficiency of \$3,714,457 at May 31, 2008, due to expenditures required to complete the construction of the processing mill.

At May 31, 2009, total liabilities were \$90,464,111 compared to \$56,602,043 at May 31, 2008, due to the issue of three additional tranches of Notes and the issue of Convertible Notes in fiscal 2009.

At May 31, 2009, we had total assets of \$81,543,823 compared to \$71,208,177 at May 31, 2008.

Share capital at May 31, 2009, was \$89,208,668 (96,040,121 shares) compared to \$89,002,273 (95,958,641 shares) at May 31, 2008.

The most significant contribution to working capital in the year ended May 31, 2009, came from proceeds of \$43,238,852 from the sale of the equity investment, whereas, in the one month ended May 31, 2008, the most significant contribution to working capital came from the issue of senior secured notes for net proceeds of \$23,517,628.

In June 2008, we closed on a gross amount of \$10,000,000 comprising the second tranche of our \$60 million Notes financing and, in July 2008, we closed on a gross amount of \$17,750,000 comprising the third tranche of our \$60 million Notes financing. The first tranche of \$32,250,000 had been closed on May 21, 2008. The Notes issued with respect to this debt financing bear interest at an annual rate of 15% and mature five years from the date of issuance at 120% of the principal and are guaranteed, on a joint and several basis, by all of our assets and by those of our subsidiaries. After 18 or 24 months from the date of issuance of the Notes, depending upon the agreement reached with the Note holders, the holders of the Notes can give six months' notice to cause us to purchase all of the Notes then outstanding at a price equal to the sum of (a) 120% of the principal amount of such Notes to be purchased and (b) accrued and unpaid interest on the principal amount of the Notes. We have the right to redeem the Notes at any time at 120% of the principal amount plus any accrued or unpaid interest on the Notes. If the Notes are redeemed within one year of issuance, all prepaid interest totalling \$4,162,500 shall be forfeited. As we incurred \$1,050,000 in financing costs and paid \$3,000,000 in prepaid interest with respect to the second tranche, the net amount received by us for the second tranche equalled \$6,000,000. Further, we incurred \$1,850,000 in financing costs and \$2,662,500 in prepaid interest with respect to the third tranche; thereby, the net amount received by us for the third and final tranche equalled \$13,237,500. For additional information, please refer to "*Item 8- Financial Information – 8. B .Significant Changes – Section (v)*".

We initially issued 60,000 Notes with the first, second and third tranche of the Notes financing. Each Note was issued with 382 share purchase warrants. Each warrant entitled the holder to purchase one common share at CAD\$ 2.30 for a period of five years from the date of purchase. On April 17, 2009, we repriced these warrants to entitle the holder to purchase one common share at CAD \$0.65 for the remainder of the warrant period with the provision that, if our closing trading price of our common shares on the TSX is CAD\$ 1.00 or more for a period of 30 consecutive trading days, we have the option to require the earlier exercise of the warrants. The effect of re-pricing the warrants was an increase in the value of the warrants of \$1,781,500 and a decrease to contributed surplus for the same amount.

In September 2008, we sold all 20,418,565 of our common shares of Copper at CAD\$2.20 per share raising \$43,238,852, which we used to retire \$43,238,852 of our outstanding senior secured notes.

In October 2008, we closed a supplemental Notes financing issuing a total of 20,000 Notes and raising gross proceeds of \$20,000,000. The Notes from this supplemental financing bear the same terms as the Notes issued in our previous Notes financing except that no warrants were issued in conjunction with the supplemental financing.

As we incurred \$1,125,000 in financing costs with respect to the supplemental financing and paid \$3,000,000 in prepaid interest, the net amount received by us equalled \$15,875,000.

In March 2009, we closed the Convertible Notes financing issuing a total of 40,000 Convertible Notes and raising gross proceeds of \$40,000,000. Each note in the principal amount of \$1,000 is convertible into common shares at CAD\$2.25 per share. The Convertible Notes bear interest at an annual rate of 15% and mature two years from date of issuance at 110% of the principal amount of such Convertible Notes. We may prepay the Convertible Notes at any time for an amount equal to 110% of the principal amount of such Convertible Notes and accrued and unpaid interest on the principal amount of the Convertible Notes. The indebtedness represented by the Convertible Notes rank pari passu with the previously issued Notes. Holders of the previously issued Notes were offered the opportunity to exchange amounts due upon maturity of their existing Notes and participated pro rata in this Convertible Note financing up to \$24,187,083. Notes representing \$21,000,000 in redemption value participated in exchange for the Convertible Notes. As we incurred \$2,140,000 in financing costs and \$6,000,000 in prepaid interest with respect to the supplemental financing, the net amount received by us less the Notes exchanged equalled \$10,860,000.

### 5.C. Research and Development, Patents and Licenses, etc.

We do not undertake any research or development activities. Please refer to prior Item 5.A. and Item 5.B for a discussion of our exploration expenditures incurred in connection with the exploration of our mineral properties.

### 5.D. Trend Information

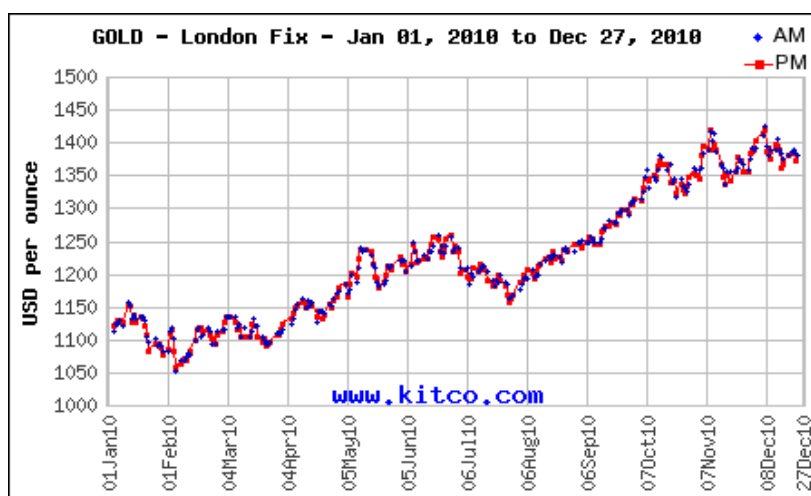
Commercial production at our Molejon gold mine commenced January 8, 2010, when an average of 70% of design capacity was maintained continuously for a period of 30 days with metallurgical recoveries approaching forecast levels. The following table provides production numbers for our two production quarters in fiscal 2010 (combined) as well as each quarter in fiscal 2011:

|  | <b>Q4<br/>2011</b> | <b>Q3<br/>2011</b> | <b>Q2<br/>2011</b> | <b>Q1<br/>2011</b> | <b>Total<br/>2011</b> | <b>Total<br/>2010</b> |
|--|--------------------|--------------------|--------------------|--------------------|-----------------------|-----------------------|
| Gold mined – ounces                        | 25,302             | 18,566             | 24,330             | 17,963             | <b>86,161</b>         | <b>33,832</b>         |
| Gold stockpiled – ounces <sup>(1)</sup>    | 25,088             | 14,618             | 9,803              | 7,216              | <b>25,088</b>         | <b>2,823</b>          |
| Gold poured - ounces                       | 16,735             | 12,825             | 15,268             | 10,738             | <b>55,566</b>         | <b>27,914</b>         |
| Gold sold – ounces                         | 14,608             | 13,880             | 13,166             | 12,211             | <b>53,865</b>         | <b>24,250</b>         |
| Average realized gold price<br>(per ounce) | \$1,413            | \$1,340            | \$1,312            | \$1,210            | <b>\$1,319</b>        | <b>\$1,115</b>        |
| Cash cost per ounce of gold<br>sold        | \$557              | \$610              | \$647              | \$740              | <b>\$634</b>          | <b>\$590</b>          |

<sup>(1)</sup> Total ounces of gold stockpiled as at the end of each period.

The number of gold ounces sold in each quarter has increased steadily and generally unstable global economic conditions, especially in the United States and Europe, have driven the rising global demand for gold.

Monthly average gold prices in calendar 2010 ranged from \$1,095.41/oz to \$1,390.55/oz with a cumulative average of \$1,224.53.



As global economic and other market conditions are uncertain, market experts have forecasted strong gold prices through 2011. Gold reached a record high of \$1,877.50/ounce on August 22, 2011, and some analysts predict gold, given the strong momentum, could reach \$2,000/ounce in the near term; however, there is uncertainty as to how long the trend will continue.

Monthly average gold prices in calendar 2011, thus far, have ranged from \$1,356.40/oz to \$1,749.46/oz with a cumulative average of \$1,498.30.



### 5.E. Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that are material to investors.

### 5.F. Tabular Disclosure of Contractual Obligations

#### Commitments

As at May 31, 2011, we had the following contractual obligations:

|              | Less than 1 Year | 2 Years  | 3 Years | 4 - 5 Years | More than 5 Years | Total     |
|--------------|------------------|----------|---------|-------------|-------------------|-----------|
| Office lease | \$73,900         | \$28,000 | Nil     | Nil         | Nil               | \$101,900 |

|                                  |                    |                    |                    |                     |                     |                     |
|----------------------------------|--------------------|--------------------|--------------------|---------------------|---------------------|---------------------|
| Equipment lease                  | \$1,754,547        | \$1,134,360        | \$1,134,360        | \$2,079,364         | Nil                 | \$6,102,631         |
| Senior secured notes             | \$451,668          | \$455,411          | \$455,411          | \$3,679,473         | Nil                 | \$5,041,963         |
| Convertible senior secured notes | \$573,916          | \$579,672          | \$578,672          | \$4,675,355         | Nil                 | \$6,407,615         |
| Long-term debt                   | \$435,733          | \$465,109          | \$448,377          | \$927,011           | Nil                 | \$2,276,230         |
| Fundacion Petaquilla             | \$1,440,000        | \$1,440,000        | \$1,440,000        | \$2,880,000         | \$1,440,000         | \$8,640,000         |
| Asset retirement obligation      | Nil                | Nil                | Nil                | Nil                 | \$10,218,124        | \$10,218,124        |
| <b>Total</b>                     | <b>\$4,729,764</b> | <b>\$4,102,552</b> | <b>\$4,056,820</b> | <b>\$14,241,203</b> | <b>\$11,658,124</b> | <b>\$38,788,463</b> |

In addition, we have committed to funding of \$120,000 per month to Fundacion Petaquilla for the life of the Molejon mine. Fundacion Petaquilla promotes a sustainable development culture, administering social programs in the area around the Molejon property.

Further, pursuant to the Forward Gold Purchase Agreement effected August 17, 2010, as amended on September 23, 2010, we have an obligation to Deutsche Bank AG, London Branch, to provide them with a specified number of ounces of gold in the future. The following table summarizes our gold delivery requirements on an annual basis:

| <b>Delivery Obligation – 2011 to 2016</b>               | <b>Ounces per month</b> | <b>Total ounces</b> |
|---|-------------------------|---------------------|
| November 2010 - May 2011                                | 500                     | 3,500               |
| <b>Total delivery requirements for fiscal year 2011</b> |                         | <b>3,500</b>        |
| June 2011 - April 2012                                  | 1,110                   | 12,210              |
| May 2012  | 1,485                   | 1,485               |
| <b>Total delivery requirements for fiscal year 2012</b> |                         | <b>13,695</b>       |
| June 2012 - May 2013                                    | 1,485                   | 17,820              |
| <b>Total delivery requirements for fiscal year 2013</b> |                         | <b>17,820</b>       |
| June 2013 - April 2014                                  | 1,485                   | 16,335              |
| May 2014  | 900                     | 900                 |
| <b>Total delivery requirements for fiscal year 2014</b> |                         | <b>17,235</b>       |
| June 2014 - May 2015                                    | 900                     | 10,800              |
| <b>Total delivery requirements for fiscal year 2015</b> |                         | <b>10,800</b>       |
| June 2015 - September 2015                              | 900                     | 3,600               |
| <b>Total delivery requirements for fiscal year 2016</b> |                         | <b>3,600</b>        |
| <b>Total Ounces to be Delivered</b>                     |                         | <b>66,650</b>       |

#### *Capital Lease Obligation*

We entered into four capital lease arrangements with Banco Bilbao Vizcaya Argentaria (Panama) S.A. (“BBVA”)

for the purchase of equipment to advance the Molejon project into production during the thirteen months ended May 31, 2008. The equipment includes but is not restricted to: ball mills, a Metso crushing plant, cranes and an aggregate crushing plant. As a condition of the leases, the equipment will serve as collateral throughout the amortization period and will be registered with the Public Registry of the Republic of Panama. Further, IMN has pledged a term deposit in the amount of \$2,361,098 (May 31, 2010 - \$2,361,098) as additional security.

During the year ended May 31, 2011, a Credit Line Facility with Global Bank from Panama, in amount of \$10 million, was approved for Panama Desarrollo de Infraestructuras, S.A., one of our subsidiaries. This facility for the acquisition of heavy equipment is a lease that accrues interest at 6.25% per annum. As a condition of the leases, the equipment will serve as collateral throughout the amortization period and will be registered with the Public Registry of the Republic of Panama. As at May 31, 2011, leases with a total value of \$4,848,492 had been established under this facility.

Future minimum lease payments on the capital lease obligations are as follows:

|                          | May 31, 2011 | May 31, 2010 |
|--------------------------|--------------|--------------|
| 2011                     | \$ -         | \$4,376,667  |
| 2012                     | 1,754,547    | 447,080      |
| 2013                     | 1,134,360    | -            |
| 2014                     | 1,134,360    | -            |
| 2015                     | 1,134,360    | -            |
| 2016                     | 945,004      | -            |
|                          | 6,102,631    | 4,823,747    |
| Less: imputed interest   | (783,595)    | (247,486)    |
|                          | 5,319,036    | 4,576,261    |
| Less: Current obligation | (1,468,561)  | (4,136,032)  |
| Long - term obligation   | \$3,850,475  | \$440,229    |

#### *Operating Credit Facility*

We have an operating credit line facility with Banco Bilbao Vizcaya Argentaria (Panama) S.A. ("BBVA") up to a maximum of \$13,379,554. The facility is converted to capital leases when the asset purchases are completed. The facility has a fixed rate of 9% on \$11,018,456 and 6% on \$2,361,098, is secured by the assets purchased and is registered with the Public Registry of the Republic of Panama. At May 31, 2010 there is a remaining credit line balance of \$332,511 available upon which the Company may draw.

#### *Long-term debt*

During fiscal year 2010, we arranged bank loan financing of \$115,700 for the purchase of vehicles. The loan is collateralized by the purchased vehicles.

During the year ended May 31, 2011, we arranged bank loan financing of \$25,520 for the leasing of a vehicle and we also we arranged with Global Bank of Panama, a bank loan financing of \$2,210,000 for the payment of advances to suppliers of heavy equipments for our subsidiary, Panama Desarrollo de Infraestructura, S.A. The loan is collateralized by a cash term deposit that earns interest at 5% per annum. The total amount approved for this facility is \$2.5 million.

We have \$2,400,000 in term deposits with an expiration date of longer than one year in order to secure this arrangement. The annual interest rates on these term deposits range from 4.88% to 5%.

The following table summarizes the loans outstanding as at May 31, 2011, and May 31, 2010:

|  | May 31, 2011 | May 31, 2010 |
|--|--------------|--------------|
|--|--------------|--------------|

|   |             |           |
|---|-------------|-----------|
| Vehicle loan, repayable at \$3,733 per month, including interest at 10%, due May 2013             | \$81,087    | \$115,700 |
| Vehicle loan, repayable at \$877 per month, including interest at 8.25%, due April 2014.          | 24,882      | -         |
| Bank loan, repayable at \$42,578 per month, including interest at 6%, due February and April 2016 | 2,170,264   | -         |
|   | 2,276,233   | 115,700   |
| Less: current portion   | (435,733)   | (35,465)  |
|   | \$1,840,500 | \$80,235  |

#### *Asset Retirement Obligation*

Our asset retirement obligation relates to site restoration and cleanup costs for our Molejon gold project located in Panama.

A reconciliation of the provision for asset retirement obligation is as follows:

|   |             |
|---|-------------|
| Balance at May 31, 2008                                   | \$4,333,216 |
| Accretion   | 331,504     |
| Balance at May 31, 2009                                   | 4,664,720   |
| Accretion   | 325,287     |
| Adjustment for change in estimate of timing of cash flows | (291,357)   |
| Balance at May 31, 2010                                   | 4,698,650   |
| Accretion   | 359,448     |
| Adjustment for change in estimate of liability            | 629,138     |
| Balance at May 31, 2011                                   | \$5,687,236 |

The provision for asset retirement obligation is based upon the following assumptions:

- The total undiscounted cash flow required to settle the obligation is approximately \$10,200,000;
- Asset retirement obligation payments are expected to occur mainly between fiscal years 2017 and 2020; and
- A credit adjusted risk-free rate of 10.18% has been used to discount cash flows.

#### **5.G. Safe Harbour**

The safe harbour provided in Section 27A of the Securities Act and Section 21E of the Exchange Act (“statutory safe harbours”) apply to forward-looking information provided pursuant to Item 5.E. and Item 5.F. above.

#### **5.H. Non-GAAP Measures**

We have included the non-GAAP performance measure unit cash cost per ounce sold. This non-GAAP performance measure does not have any standardized meaning prescribed by GAAP and, therefore, may not be comparable to similar measures presented by other companies. We believe that, in addition to conventional measures prepared in accordance with GAAP, certain investors use this information to evaluate our performance. Accordingly, they are intended to provide additional information and should not be considered in isolation or as a substitute for measures of performance prepared using GAAP. More specifically, our management believes that these figures are a useful indicator to investors and management of a mine’s performance as they provide: (i) a measure of the mine’s cash margin per ounce, by comparison of the cash operating costs per ounce to the price of gold, (ii) the trend in costs as the mine matures and, (iii) an internal benchmark of performance to allow for comparison against other mines.

Total cash cost includes mine site operating costs such as mining, processing, administration and royalties but is exclusive of amortization, depletion, reclamation, capital costs, exploration costs and corporate administration costs.

The following table provides a reconciliation of cash costs per ounce to total cost of sales per the consolidated financial statements:

|  | <b>Q4<br/>2011</b> | <b>Q3<br/>2011</b> | <b>Q2<br/>2011</b> | <b>Q1<br/>2011</b> | <b>Total<br/>2011</b> | <b>Total<br/>2010</b> |
|--|--------------------|--------------------|--------------------|--------------------|-----------------------|-----------------------|
| Gold mined – ounces                        | 25,302             | 18,566             | 24,330             | 17,963             | <b>86,161</b>         | <b>33,832</b>         |
| Gold stockpiled – ounces <sup>(1)</sup>    | 25,088             | 14,618             | 9,803              | 7,216              | <b>25,088</b>         | <b>2,823</b>          |
| Gold poured - ounces                       | 16,735             | 12,825             | 15,268             | 10,738             | <b>55,566</b>         | <b>27,914</b>         |
| Gold sold – ounces                         | 14,608             | 13,880             | 13,166             | 12,211             | <b>53,865</b>         | <b>24,250</b>         |
| Average realized gold price<br>(per ounce) | \$1,413            | \$1,340            | \$1,312            | \$1,210            | <b>\$1,319</b>        | <b>\$1,115</b>        |
| Cash cost per ounce of gold<br>sold        | \$557              | \$610              | \$647              | \$740              | <b>\$634</b>          | <b>\$590</b>          |

<sup>(1)</sup> Total ounces of gold stockpiled as at the end of each period.

## **ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES**

### **6.A. Directors and Senior Management**

The following information regarding our directors and members of senior management, including names, business experience, offices held and outside principal business activities, is at May 31, 2011:

#### Rodrigo Esquivel

Mr. Rodrigo Esquivel (born July 5, 1963) was appointed our President on September 1, 2010. Mr. Esquivel is a lawyer with over 20 years of professional practice in Panama. He is a partner in and founder of Esquivel, Fernandez & Associates. Formerly he held such positions as Executive Vice President of Exploraciones Geotecnologicas, S.A., Director and General Manager of Forestal Nacional, S.A., Advisor to the Panamanian Ministry of Finance and Treasury, Deputy Director General of Income Tax (IRS), Director of the Fiscal Lottery, Legal Adviser of the Ministry of Health, Vice Minister of Health, Deputy Director of Social Security and Executive Director of the Water Supply Institute.

#### Raul Ferrer

Mr. Raul Ferrer (born January 8, 1973) was appointed to our board of directors (the “Board of Directors”) on November 6, 2009. Mr. Ferrer is a leading financial advisor to a number of businesses operating in Panama. He is a former financial investments director with the Panamanian equity investment firm, Wall Street Securities.

#### Richard Fifer

Mr. Richard Fifer (born January 23, 1957) is a Panamanian citizen and a U.S.-trained geologist. He has served on our Board of Directors from March 1993 to November 1998, July 2002 to July 2003, and from November 12, 2003, to the present. In addition, he served as our Chief Executive Officer from December 14, 2004, to March 23, 2005, and from April 14, 2007, to September 15, 2009. Since 1994, he has been President of Geoinfo, S.A., a Panamanian company that provides geographic mapping technology and solutions. He was Chairman and President of CODEMIN, Panama’s state mining company, from January 1997 to January 2000. Under the Ministry of Foreign Affairs Panama, he was the President's Plenipotentiary Ambassador-at-large from March 2002 to September 2003. He was also Governor of the Province of Cocolé, Panama, from March 2002 to September 2003. Mr. Fifer holds a B.Sc. in both Geology and Geophysical Engineering and an M.A. in Finance.

#### David Kaplan

Mr. David Kaplan (born April 28, 1970) was appointed to our Board of Directors on November 6, 2009. He is

presently co-head of Lascaux Resource Capital, an asset management company focused on metals and mining. He is a former key member of LIM Advisors LLC, a multi-strategy investment group, where he managed a portfolio of metal and energy futures and securities for a commodity hedge fund. He is also a former Vice-President of Gerald Metals Inc., financial analyst and trader with Glencore Ltd., and graduate of the Wharton School of the University of Pennsylvania.

#### David Levy

Mr. David Levy (born December 22, 1984) was appointed to our Board of Directors on November 6, 2009. He is a member of the private placement group at the investment advising firm of Platinum Management (NY) LLC, where he has participated in over 25 capital raising transactions for public and private corporations. He specializes in structuring and negotiating financings at all levels of the capital structure through extensive industry research financial analysis and modeling. Mr. Levy graduated with honors from Sy Syms School of Business of Yeshiva University.

#### Joao Manuel

Mr. Joao Manuel (born November 6, 1952) was appointed our Chief Executive Officer on November 6, 2009, after having served as our Chief Operating Officer since December 1, 2008. He also served as our President from November 6, 2009, until September 1, 2010. Before joining us, Mr. Manuel held the position of Chief Financial Officer of Copper, which was also a reporting issuer listed on the Toronto Stock Exchange. Mr. Manuel has over 20 years of management experience in large, multinational corporations worldwide, including General Electric Company, ITT Europe Ltd. and Nokia Consumer Electronics. He is a former Managing Director of Inapa France S.A. and Chief Financial Officer and Deputy Chief Executive Officer of the Inapa Group, Europe's fourth largest paper merchant with operations in eight countries.

#### Lazaro Rodriguez

Mr. Lazaro Rodriguez (born March 9, 1971) was appointed our Chief Operating Officer on April 8, 2010, after having served as our Vice President of Security (2007) and Vice President of Operations (2008-2010). Prior to joining us, Mr. Rodriguez was president and general manager of a physical security company and director and general manager of a voice, data, and video wireless network implementation company, both in Panama. He has also served as an external advisor to the National Council for Public Security and National Defense (Panama) responsible for strategy in the areas of public safety and maritime security. This followed Mr. Rodriguez's position as Commander of the Special Operations Unit in Panama's National Maritime Service, where he was responsible for the planning, development and execution of rescue operations, anti-drug trafficking campaigns and research.

#### Ezequiel Sirotinsky

Mr. Ezequiel Sirotinsky (born November 24, 1971), a Certified Public Accountant, was appointed our Chief Financial Officer on November 29, 2010. Mr. Sirotinsky was formerly Director of Finance for Silver Standard Resources, Inc., where he was responsible for the administration and finance aspects of their Mina Pirquitas Project in Argentina, and Administrative and Finance Manager for AngloGold Ashanti Limited's Cerro Vanguardia Project, a gold and silver mine, where, among other responsibilities, he was involved in reporting and accounting management, treasury and cash management, risk management, business planning and strategy development, and tax planning.

One of our current directors, Mr. David Levy holds a position with Platinum Management (NY) LLC ("Platinum"), an investment advisory firm to more than 2/3 of our Senior Secured Note holders and Convertible Note holders (collectively, the Notes Holders) and he became a director of our company due to this relationship. Platinum's clients as Note Holders and, therefore, our creditors, and the interests of Platinum as the investment advisor to the Note Holders, may diverge in certain circumstances with those of the our shareholders.

To the extent that Platinum, as investment advisor to more than 2/3 of our Note Holders, are related to the us, Mr. Levy may have a conflict of interest in negotiating and concluding terms respecting the extent of such participation, which could result in competitive harm to us. In the event that such a conflict of interest arises at a meeting of our directors, a director who has such a conflict will abstain from voting for or against the approval of such participation or such terms. In appropriate cases, we will establish a special committee of independent directors to review a matter in which several directors, or management, may have a conflict. In accordance with the laws of the Province

of British Columbia, our directors are required to act honestly, in good faith and in our best interests.

## 6.B. Compensation

During the fiscal year ended May 31, 2011, we paid cash compensation to our directors and officers as described below. No other funds were set aside or accrued by us during the fiscal year ended May 31, 2011, to provide pension, retirement or similar benefits for our directors or officers pursuant to any existing plan provided or contributed to by us or our subsidiaries under applicable Canadian laws. We are required, under applicable securities legislation in Canada, to disclose to our shareholders details of compensation paid to our directors and executive officers. The following fairly reflects all material information regarding compensation paid to our directors and executive officers and disclosed to our shareholders under applicable Canadian law.

### *Cash and Non-Cash Compensation - Directors and Officers*

The following table sets forth all annual and long-term compensation for services provided to us during the fiscal year ended May 31, 2011, by individuals who were our directors and executive officers as at May 31, 2011:

| Name and Principal Position   | Short Term Compensation |            |                                | Long Term Compensation                  |  |                                |                             |
|---|-------------------------|------------|--------------------------------|---|--|--------------------------------|-----------------------------|
|   | Salary (\$)             | Bonus (\$) | Other Annual Compensation (\$) | Awards                                  | Restricted Shares or Restricted Share Units (\$) | Payouts                        | All Other Compensation (\$) |
|   |                         |            |                                | Common Shares Under Options granted (#) |  | Long-Term Incentive Plans (\$) |                             |
| Raul Ferrer<br>Director   | \$24,800                | nil        | nil                            | 50,000                                  | n/a  | n/a                            | Nil                         |
| Richard Fifer <sup>(1)</sup><br>Director, Executive Chairman<br>of the Board of Directors | \$414,000               | 490,000    | nil                            | 400,000<br>50,000                       | n/a  | n/a                            | nil                         |
| David Kaplan<br>Director, Corporate Secretary   | \$30,000                | nil        | nil                            | 50,000                                  | n/a  | n/a                            | nil                         |
| David Levy<br>Director  | \$30,000                | nil        | nil                            | 50,000                                  | n/a  | n/a                            | nil                         |
| Rodrigo Esquivel <sup>(2)</sup><br>President  | \$135,000               | nil        | nil                            | 50,000                                  | n/a  | n/a                            | nil                         |
| Joao Manuel<br>Chief Executive Officer  | \$480,000               | nil        | nil                            | 50,000                                  | n/a  | n/a                            | nil                         |
| Lazaro Rodriguez<br>Chief Operating Officer   | \$120,000               | nil        | nil                            | nil                                     | n/a  | n/a                            | nil                         |
| Ezequiel Sirotnsky <sup>(3)</sup><br>Chief Financial Officer                              | \$79,500                | nil        | nil                            | 100,000<br>25,000<br>25,000             | n/a  | n/a                            | nil                         |

<sup>(1)</sup> Appointed Executive Chairman of our Board of Directors on September 1, 2010.

<sup>(2)</sup> Appointed President on September 1, 2010.

<sup>(3)</sup> Appointed Chief Financial Officer on November 29, 2010.

<sup>(4)</sup> Amount shown is in Canadian dollars.

### *Option Grants to Directors and Officers During Fiscal Year Ended May 31, 2011*

The table below sets forth stock options granted by us during the year ended May 31, 2011, to our then directors and officers.

| Name                | Common Shares Under Options Granted | % of Total Options Granted in Fiscal Year <sup>(3)</sup> | Exercise Price or Base Price (\$/Share) <sup>(4)</sup> | Market Value of Common Shares Underlying Options on Date of Grant | Expiration Date  |
|---------------------|-------------------------------------|--|--|---|--|
|                     | (#) <sup>(1)</sup>                  |  | (CAD\$)  | (\$/Share)  |  |
| Raul Ferrer         | 50,000                              | 3.86%  | \$1.11   | nil   | December 21, 2015                                      |
| Richard Fifer       | 400,000 <sup>(2)</sup><br>50,000    | 34.75%   | \$0.75<br>\$1.11                                       | nil   | November 1, 2015<br>December 21, 2015                  |
| David Kaplan        | 50,000                              | 3.86%  | \$1.11   | nil   | December 21, 2015                                      |
| David Levy          | 50,000                              | 3.86%  | \$1.11   | nil   | December 21, 2015                                      |
| Rodrigo Esquivel    | 50,000                              | 3.86%  | \$1.11   | nil   | December 21, 2015                                      |
| Joao Manuel         | 50,000                              | 3.86%  | \$1.11   | nil   | December 21, 2015                                      |
| Lazaro Rodriguez    | Nil                                 | nil  | nil  | nil   | n/a  |
| Ezequiel Sirotinsky | 100,000<br>25,000<br>25,000         | 11.58%   | \$0.75<br>\$1.00<br>\$0.93                             | nil   | November 1, 2015<br>November 29, 2015<br>April 6, 2016 |

<sup>(1)</sup> All stock options vest over a period of 21 months with the exception of <sup>(2)</sup>.

<sup>(2)</sup> Stock options subject to immediate vesting upon closing of Forward Gold Purchase Agreement with Deutsche Bank AG, London Branch.

<sup>(3)</sup> Percentage of all stock options granted during the year ended May 31, 2011.

<sup>(4)</sup> The exercise price of stock options is set at not less than the Volume Weighted Average Trading Price for the five trading days immediately preceding the date of the stock option grant.

#### Aggregated Option Exercises in Last Fiscal Year and Fiscal Year-End Option Values

The following table sets forth details of all exercises of stock options during the year ended May 31, 2011, by our directors and executive officers and the value of unexercised options as of May 31, 2011:

| Name             | Common Shares Acquired on Exercise (#) | Aggregate Value Realized <sup>(1)</sup> (CAD\$) | Unexercised Options at Fiscal Year-End (#) <sup>(2) (3)</sup><br>Exercisable/<br>Unexercisable   | Value of Unexercised In-the-Money Options at Fiscal Year-End (\$) <sup>(2) (3)</sup><br>Exercisable/<br>Unexercisable |
|------------------|--|---|--|---|
| Raul Ferrer      | nil                                    | Nil   | 350,000 / 50,000<br>37,500 / 12,500<br>31,250 / 18,750<br>12,500 / 37,500  | 161,000 / 13,800<br>nil / nil<br>3,750 / 2,250<br>nil / nil   |
| Richard Fifer    | nil                                    | Nil   | 118,800 / 0<br>585,000 / 0<br>600,000 / 0<br>75,000 / 25,000<br>62,500 / 37,500<br>350,000 / 0<br>150,000 / 250,000<br>12,500 / 37,500 | 51,084 / 0<br>87,750 / 0<br>276,000 / 0<br>nil / nil<br>7,500 / 4,500<br>56,000 / 0<br>nil / nil<br>nil / nil         |
| David Kaplan     | nil                                    | Nil   | 350,000 / 50,000<br>37,500 / 12,500<br>31,250 / 18,750<br>12,500 / 37,500  | 161,000 / 13,800<br>nil / nil<br>3,750 / 2,250<br>nil / nil   |
| David Levy       | nil                                    | Nil   | 350,000 / 50,000<br>37,500 / 12,500<br>31,250 / 18,750<br>12,500 / 37,500  | 161,000 / 13,800<br>nil / nil<br>3,750 / 2,250<br>nil / nil   |
| Rodrigo Esquivel | nil                                    | Nil   | 48,000 / 0<br>350,000 / 50,000<br>37,500 / 12,500<br>31,250 / 18,750   | nil / nil<br>161,000 / 13,800<br>nil / nil<br>3,750 / 2,250   |

| Name                | Common Shares<br>Acquired on<br>Exercise<br>(#) | Aggregate Value<br>Realized <sup>(1)</sup><br>(CAD\$) | Unexercised Options at<br>Fiscal Year-End<br>(#) <sup>(2) (3)</sup>                      |                               | Value of Unexercised In-the-<br>Money Options at Fiscal<br>Year-End<br>(\$) <sup>(2) (3)</sup> |                               |
|---------------------|---|---|--|-------------------------------|--|-------------------------------|
|                     |   |   | Exercisable/<br>Unexercisable  | Exercisable/<br>Unexercisable | Exercisable/<br>Unexercisable  | Exercisable/<br>Unexercisable |
|                     |   |   | 12,500 / 37,500  |                               | nil / nil  |                               |
| Joao Manuel         | nil<br>50,000                                   | nil<br>26,000   | 300,000 / 0<br>300,000 / 50,000<br>37,500 / 12,500<br>31,250 / 18,750<br>12,500 / 37,500 |                               | 51,000 / 0<br>138,000 / 13,800<br>nil / nil<br>3,750 / 2,250<br>nil / nil                      |                               |
| Lazaro Rodriguez    | nil   | Nil   | 50,000 / 0<br>18,750 / 6,250<br>15,625 / 9,375   |                               | nil / nil<br>nil / nil<br>1,875 / 1,125  |                               |
| Ezequiel Sirotinsky | nil   | Nil   | 0 / 100,000<br>0 / 25,000<br>0 / 25,000  |                               | nil / nil<br>nil / nil<br>nil / nil  |                               |

<sup>(1)</sup> Aggregate value realized calculated using the closing price of our common shares on the Toronto Stock Exchange on date of exercise less exercise price of stock options exercised multiplied by number of options exercised.

<sup>(2)</sup> The figures relate solely to stock options.

<sup>(3)</sup> Value of unexercised in-the-money options calculated using the closing price of our common shares on the Toronto Stock Exchange on May 31, 2011, which was \$0.69, less the exercise price of in-the-money stock options.

#### *Defined Benefit or Actuarial Plan Disclosure*

We do not provide retirement benefits for our directors and officers nor do we provide compensation pursuant to any bonus or profit-sharing plan.

#### *Termination of Employment, Change in Responsibilities and Employment Contracts*

We have entered into formal agreements with our directors, our executive officers and with six key employees that establish financial arrangements that would be in effect in the event of a change of control of our company. Each agreement provides for, in the event of the termination of the engagement of such persons following a change of control of our company, the payment of an amount equal to three times the annual compensation being paid to such person as at the time of the change of control.

#### *Directors*

With the exception of directors whom also serve as officers, we have arrangements in place in which directors are entitled to receive an attendance fee of \$1,000 per attended meeting of our Board of Directors and an attendance fee of \$800 per committee meeting attended during our most recently completed financial year and subsequently up to and including the date of this Annual Report. In addition, directors are entitled to compensation of \$800 per day for technical or professional services performed on behalf of us and directors are also reimbursed for actual expenses incurred in the performance of their duties as directors.

Further, with the exception of directors whom also serve as officers, directors are entitled to an annual retainer of \$24,000.

#### **6.C. Board Practices**

Our Board of Directors is responsible for the stewardship of our business and affairs. Its main role is to oversee corporate performance and to ensure that management has the talent, professionalism and integrity necessary to successfully carry out our strategic plan and achieve our corporate objectives. Directors are elected at each annual meeting of our shareholders and serve until our next annual meeting, at which time directors may stand for re-election, or until their successors are elected or appointed.

During the year ended May 31, 2011, we did not nor did any of our subsidiaries have any arrangement to provide

benefits to our directors upon termination of employment.

From November 6, 2009, to date, our Audit Committee has been comprised of Raul Ferrer, David Kaplan and David Levy. Each Audit Committee member is financially literate and is appointed by our Board of Directors to hold office until removed by the Board of Directors or until our next annual general meeting, at which time the appointments expire and such individuals are eligible for re-appointment. The Audit Committee reviews our interim financial statements and annual audited consolidated financial statements, liaises with our auditors, and recommends to our Board of Directors whether or not to approve such financial statements. Our Audit Committee must convene a meeting to consider any matters our auditor believes should be brought to the attention of the Board of Directors or our shareholders.

Our Audit Committee operates pursuant to a charter adopted by our Board of Directors. Our Audit Committee is responsible primarily for monitoring: (i) the integrity of our financial statements; (ii) compliance with legal and regulatory requirements; and (iii) the independence and performance of our internal and external auditors.

From November 6, 2009, to date, our Compensation Committee has been comprised of Raul Ferrer, Richard Fifer and David Kaplan. The Compensation Committee is appointed by our Board of Directors and is responsible for reviewing and approving annual salaries, bonuses and other forms and items of compensation for board members, committee members and our senior officers. Except for plans that are, in accordance with their terms or as required by law, administered by our board of directors or another particularly designated group, the Compensation Committee also administers and implements all of our stock option and other stock-based and equity-based benefit plans, recommends changes or additions to those plans and reports to our board of directors on compensation matters. Our Chief Executive Officer does not vote upon or participate in the deliberations regarding his compensation.

Since November 6, 2009, our Corporate Governance Committee has been composed of Raul Ferrer, Richard Fifer and David Kaplan with David Kaplan acting as coordinator for meetings of the Corporate Governance Committee. The primary function of our corporate governance committee is to assist our board of directors in developing our approach to corporate governance issues and monitoring performance against the defined approach.

#### **6.D. Employees**

As at May 31, 2011, we had 4 staff, including three permanent employees and one contract staff member working out of our principal office located in Vancouver, Canada, and approximately 1,270 at our various locations in Panama. Our office in Panama City had 32 permanent employees and 9 professional services contracts in force, in the administration, presidency, accounting, investor relations, logistics, legal and IT departments. Our geological exploration team in Petaquilla Minerals, S.A., including administration, digitalization, laboratory, maintenance, etc. staff) contained approximately 149 team members and our Molejon gold plant site had approximately 387 employees. Our infrastructure division, Panama Desarrollo de Infraestructuras, S.A. had 702 employees.

Our subsidiary company, Petaquilla Gold, S.A. has a labour contract with union employees at our Molejon gold plant. A single union, Sindicato de los Trabajadores de las Empresas Mineras Petaquilla, negotiates the labour contract on our workers' behalf. We have not experienced any disruptions of our operations as a result of any labour disagreements to date.

#### **6.E. Share Ownership**

As at August 29, 2011, the following table sets forth the share ownership of those persons listed in subsection 6.B. above and includes the details of all options or warrants to purchase our shares held by such persons:

| Name                | Number of Common Shares Held at August 29, 2011 | Number of Common Shares Subject to Options or Warrants at August 29, 2011 | Beneficial Percentage Ownership <sup>(1)</sup> | Exercise Price (CAD\$) | Expiry Date       |
|---------------------|---|---|--|------------------------|-------------------|
| Raul Ferrer         | nil   | 400,000   | *  | \$0.23                 | November 18, 2014 |
|                     |   | 50,000  |  | \$0.87                 | January 5, 2015   |
|                     |   | 50,000  |  | \$0.57                 | March 25, 2015    |
|                     |   | 50,000  |  | \$1.11                 | December 21, 2015 |
| Richard Fifer       | 4,294,283                                       | 600,000   | 2.43%  | \$0.23                 | November 18, 2014 |
|                     |   | 100,000   |  | \$0.87                 | January 5, 2015   |
|                     |   | 100,000   |  | \$0.57                 | March 25, 2015    |
|                     |   | 350,000   |  | \$0.53                 | April 30, 2015    |
|                     |   | 400,000   |  | \$0.75                 | November 1, 2015  |
| David Kaplan        | nil   | 50,000  | *  | \$1.11                 | December 21, 2015 |
|                     |   | 50,000  |  | \$0.87                 | January 5, 2015   |
|                     |   | 50,000  |  | \$0.57                 | March 25, 2015    |
|                     |   | 50,000  |  | \$1.11                 | December 21, 2015 |
| David Levy          | nil   | 400,000   | *  | \$0.23                 | November 18, 2014 |
|                     |   | 50,000  |  | \$0.87                 | January 5, 2015   |
|                     |   | 50,000  |  | \$0.57                 | March 25, 2015    |
|                     |   | 50,000  |  | \$1.11                 | December 21, 2015 |
| Joao Manuel         | 65,000  | 300,000   | *  | \$0.52                 | December 1, 2013  |
|                     |   | 300,000   |  | \$0.23                 | November 18, 2014 |
|                     |   | 50,000  |  | \$0.87                 | January 5, 2015   |
|                     |   | 50,000  |  | \$0.57                 | March 25, 2015    |
|                     |   | 50,000  |  | \$1.11                 | December 21, 2015 |
| Lazaro Rodriguez    | nil   | 50,000  | *  | \$2.49                 | July 12, 2012     |
|                     |   | 25,000  |  | \$0.87                 | January 5, 2015   |
|                     |   | 25,000  |  | \$0.57                 | March 25, 2015    |
| Ezequiel Sirotinsky | nil   | 100,000   | *  | \$0.75                 | November 1, 2015  |
|                     |   | 25,000  |  | \$1.00                 | November 29, 2015 |
|                     |   | 25,000  |  | \$0.93                 | April 6, 2016     |

\* Indicates less than 1%

<sup>(1)</sup> Beneficial ownership is determined in accordance with the rules of the SEC. In computing the number of shares owned by a person and the percentage ownership of that person, common shares subject to options and warrants held by that person that are currently exercisable or exercisable within 60 days of August 29, 2012, are deemed outstanding. Such shares, however, are not deemed outstanding for the purposes of computing the percentage ownership of any other person. This table has been prepared based on 176,429,501 common shares outstanding as of August 29, 2011.

On June 23, 1994, we adopted a stock option plan (the "Option Plan") which authorized our Board of Directors to grant incentive stock options to our directors, officers and employees or our associated, affiliated, controlled or subsidiary companies, in accordance with the terms of the Option Plan and the rules and policies of the Toronto Stock Exchange. Under the terms of the Option Plan, the aggregate number of our common shares reserved for issuance under the Option Plan at any time could not exceed 4,950,968. The aggregate number of common shares reserved for issuance under the Option Plan to any person may not exceed 5% of the number of our outstanding common shares. On July 24, 2002, our Board of Directors amended the Option Plan to increase the number of shares reserved for issuance thereunder from 4,950,968 to 7,436,158.

On December 8, 2006, we adopted a new stock option plan (the "New Plan") authorizing our Board of Directors to grant incentive stock options to directors, executive officers, employees or consultants of our company or of our

subsidiaries in accordance with the terms of the Option Plan and as may be acceptable pursuant to the policies of the Toronto Stock Exchange. Under the terms of the New Plan, the aggregate number of our common shares reserved for issuance under the New Plan at any time may not exceed 10,000,000. The approval of our disinterested shareholders must be obtained before (a) the number of common shares under option to insiders within any 12-month period; or (b) the number of common shares issuable to insiders at any time, when combined with all of our security-based compensation arrangements, may exceed 10% of our issued and outstanding common shares. The approval of our disinterested shareholders must also be obtained for the reduction in the exercise price, or extension of the term, of options previously granted to insiders.

At our annual general meeting of shareholders held on November 18, 2008, our shareholders approved an amended and restated stock option plan (the "Amended Plan") increasing the maximum number of shares that may be the subject of options at any given time from 10,000,000 to 10,700,000 common shares. The Amended Plan also allows for cashless exercises by option holders in the event of a bona fide takeover offer of our company.

At our annual general meeting of shareholders held on November 29, 2010, our shareholders approved an amended and restated stock option plan (the "2010 Amended Plan") increasing the maximum number of shares that may be the subject of options at any given time from 10,700,000 to 12,500,000 common shares. The 2010 Amended Plan continues to allow for cashless exercises by option holders in the event of a bona fide takeover offer of our company.

The exercise price of options issued under our Amended Plan will not be lower than the "market price" as defined in the Toronto Stock Exchange Company Manual, being the volume weighted average trading price on the Toronto Stock Exchange for the shares for the five trading days immediately preceding the date on which the option is granted. Options granted must be exercised no later than 10 years after the date of grant or such lesser period as may be determined by our Board of Directors. Our Board of Directors may at its discretion in granting any option set a vesting period whereby the option may only be exercisable in pre-determined installments.

## **ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS**

### **7.A. Major Shareholders**

We are a publicly-held corporation with our shares held by residents of Canada, the United States of America and other countries. To the best of our knowledge, as at August 29, 2011, we have two shareholders who may beneficially own, directly or indirectly, or control more than 5% of our common shares, as follows:

- (a) On February 10, 2011, Libra Advisors LLC filed a Schedule 13G report with the SEC stating beneficial ownership of 10,597,320 of our common shares. We believe this information to be current as at July 27, 2011.
- (b) As at July 27, 2011, Walnut Street Capital Management, LLC held 9,539,050 of our common shares.

However, we have no knowledge of their ownership, directly or indirectly, as at August 29, 2011. For these purposes, "beneficial ownership" means the sole or shared power to vote or direct the voting or to dispose or direct the disposition of any security.

As at August 29, 2011, there were 176,479,501 of our common shares issued and outstanding. Based on the records of our registrar and transfer agent, Computershare Trust Company of 510 Burrard Street, Vancouver, British Columbia, Canada, as at July 31, 2011, there were a total of 205 holders of our common shares, of which 45 were resident in Canada holding an aggregate 110,438,863 common shares, 114 were resident in the United States holding an aggregate 65,084,250 common shares and 46 holders holding an aggregate of 906,388 common shares were not resident in either Canada nor the United States. The shareholdings of United States holders represented approximately 36.89% of our total issued and outstanding common shares of 176,429,501 as at July 31, 2011.

To the extent known to our management, we are not directly or indirectly owned or controlled by another corporation(s), by any foreign government or by any other natural or legal person(s) severally or jointly. Further, we do not know of any arrangements that may, at a subsequent date, result in a change of control of our company.

## **7.B. Related Party Transactions**

During the year ended May 31, 2011:

We paid fees for compensation related matters of \$929,000 (year ended May 31, 2010 – \$489,908, year ended May 31, 2009 - \$220,176) to a company controlled by our Chairman.

We paid for goods and services provided to the Molejon mine of \$228,965 (year ended May 31, 2010 - \$166,134, year ended May 31, 2009 - \$155,805) to companies controlled by our Chairman.

We paid fees of \$18,800 (year ended May 31, 2010 – \$Nil, year ended May 31, 2009 - \$Nil) to a company controlled by a Director.

We paid wages of \$Nil (year ended May 31, 2010 – \$Nil, year ended May 31, 2009 - \$32,158) to companies controlled by a former director.

We paid legal fees of \$Nil (year ended May 31, 2010 - \$273,178, year ended May 31, 2009 - \$269,526), and financing costs of \$Nil (year ended May 31, 2010 – \$Nil, year ended May 31, 2009 - \$104,272) to a law firm controlled by a former officer and a law firm controlled by a former director.

Note 10 to our Consolidated Financial Statements for the year ended May 31, 2011, provides a description of the Iberian Resources Corp (“Iberian”) transaction. As noted, Iberian is a related party to us by virtue of common management and directors.

At May 31, 2011, excluding related party Notes and related party Convertible Notes, \$126,858 was owed to related parties.

Other than the above transactions, there were no material transactions in the year ended May 31, 2011, or proposed material transactions between us or any of our subsidiaries and:

enterprises that directly or indirectly through one or more intermediaries, control or are controlled by, or are under common control with, us;

associates;

individuals owning, directly or indirectly, an interest in our voting power that gives them significant influence over us, and close members of any such individual's family;

- a. key management personnel, that is, those persons having authority and responsibility for planning, directing and controlling our activities (or their wholly owned private companies), including directors and senior management of companies and close members of such individuals' families;
- b. enterprises in which a substantial interest in the voting power is owned, directly or indirectly, by any person described in (c) or (d) or over which such a person is able to exercise significant influence including enterprises owned by our directors or major shareholders and enterprises that have a member of key management in common with us.

None of our officers or directors, or any associate of such person, was indebted to us at any time during the year ended May 31, 2011, the year ended May 31, 2010, or the year ended May 31, 2009.

## **7.C. Interests of Experts and Counsel**

Not applicable.

## **ITEM 8. FINANCIAL INFORMATION**

### **8.A. Consolidated Statements and Other Financial Information**

This Annual Report contains our consolidated financial statements for the year ended May 31, 2011, the year ended May 31, 2010, and the year ended May 31, 2009, which contains an Independent Auditor’s Report on Financial

Statements dated August 29, 2011, Consolidated Balance Sheets as at May 31, 2011, and May 31, 2010, Consolidated Statements of Operations and Comprehensive Loss for the Fiscal Periods ended May 31, 2011, May 31, 2010, and May 31, 2009, Consolidated Statements of Shareholders' Deficiency for the years ended May 31, 2011 and 2010, Consolidated Statements of Cash Flows for the Fiscal Periods Ended May 31, 2011, May 31, 2010, and May 31, 2009, and Notes to the Consolidated Financial Statements.

#### Dividend Distributions

The timing, payment, form and amount of dividends paid on our common shares, if and when declared, is determined by our board of directors, based upon considerations such as our cash flow, results of operations and financial condition, the need for funds to finance ongoing operations and such other business matters as our board of directors considers relevant.

### **8.B. Significant Changes**

Subsequent to May 31, 2011, the following events took place:

- (1) On July 19, 2011, we entered into a sublease for corporate office space. The term of the agreement is for thirty-six months commencing on September 1, 2011, at a monthly rate of \$3,052.
- (2) We filed a notice with the Toronto Stock Exchange ("TSX") for, and received its approval to make, a Normal Course Issuer Bid ("NCIB") permitting us to purchase up to 17,000,000 common shares ("Shares"), representing approximately 9.9% of our public float. The average daily trading volume on the TSX for the six months preceding June 1, 2011, was 683,833 Shares. Subject to our ability to make "block" purchases under TSX rules, the daily purchase restriction during the course of the NCIB is 25% of the average daily trading volume, or 170,958 Shares. We may buy back Shares anytime during the 12-month period beginning on July 4, 2011, and ending on July 3, 2012, or on such earlier date as we may complete its purchases pursuant to the NCIB, or provide notice of termination. Any purchase under the NCIB will be made through the facilities of the TSX in compliance with the rules of the TSX. We will pay the market price, up to a maximum of CAD\$1.00 per Share, at the time of acquisition of Shares purchased through the facilities of the TSX, subject to any restrictions under the rules of the TSX. The actual number of Shares which may be purchased, and the timing of any such purchases, will be determined by the Company, in accordance with the rules of the TSX. A total of 285,000 shares were repurchased by the Company, ranging share price from CAD\$0.69 to CAD\$0.80.
- (3) On July 20, 2011, an additional \$1,508,524 was subscribed to from the long term financing with Global Bank of Panama at 6.25% per annum, in addition to the amount of \$2,170,264 that was already subscribed to as at May 31, 2011.
- (4) On July 20, 2011, we announced that a special meeting (the "Meeting") of the holders of common shares of our company (the "Shareholders") will be held on August 31, 2011. At the Meeting, Shareholders will be asked to consider and, if thought fit, to approve with or without variation, an ordinary resolution authorizing the issuance by the Company of such number of common shares in the capital of the Company (the "Shares") as is necessary to complete the proposed acquisition by us of all the outstanding securities of Iberian Resources Corp. (the "Acquisition"); and to transact such other business as may properly come before the Meeting or any adjournment thereof. The Acquisition is subject to receipt of all required regulatory approvals, if any, and to the approval of the Shareholders at the Meeting. Assuming all such approvals are obtained, the Acquisition is expected to be effected on or about September 1, 2011.
- (5) On June 28, 2011, and June 29, 2011, a total of \$1,292,925 was subscribed to by Petaquilla Gold S.A., one of our subsidiaries, from Caterpillar Financial, to supply heavy equipment. The terms of these agreements are an interest rate of 6% per annum, and repayment terms between 48 and 60 months.
- (6) On August 17, 2011, \$175,000 of the \$247,864 lien relating a bank account of Petaquilla Gold S.A., one of our subsidiaries, was cancelled by the Federal Court of Justice of the Republic of Panama.
- (7) 50,000 stock options were exercised.

## ITEM 9. THE OFFER AND LISTING

### 9.A. Offer and Listing Details

The high and low sale prices for our common shares on the Toronto Stock Exchange for each of the preceding six months, each fiscal quarter in each of the last two full financial years and subsequent period and each of the last five full financial years are as follows.

|  | High (CAD\$)  | Low (CAD\$)    |
|--|---------------|----------------|
| July 2011  | \$0.83        | \$0.62         |
| June 2011  | \$0.72        | \$0.59         |
| May 2011   | \$0.88        | \$0.65         |
| April 2011   | \$1.05        | \$0.82         |
| March 2011   | \$1.15        | \$0.81         |
| February 2011  | \$1.31        | \$1.06         |
|  | High (CAD\$)  | Low (CAD\$)    |
| <b>June 1, 2010 – May 31, 2011</b>                     | <b>\$1.36</b> | <b>\$0.30</b>  |
| Fourth Quarter (March 1, 2011 – May 31, 2011)          | \$1.15        | \$0.65         |
| Third Quarter (December 1, 2010 – February 28, 2011)   | \$1.36        | \$0.96         |
| Second Quarter (September 1, 2010 – November 30, 2010) | \$1.22        | \$0.365        |
| First Quarter (June 1, 2010 – August 31, 2010)         | \$0.54        | \$0.30         |
|  | High (CAD\$)  | Low (CAD\$)    |
| <b>June 1, 2009 – May 31, 2010</b>                     | <b>\$0.98</b> | <b>\$0.20</b>  |
| Fourth Quarter (March 1, 2010 – May 31, 2010)          | \$0.70        | \$0.37         |
| Third Quarter (December 1, 2009 – February 28, 2010)   | \$0.98        | \$0.60         |
| Second Quarter (September 1, 2009 – November 30, 2009) | \$0.62        | \$0.20         |
| First Quarter (June 1, 2009 – August 31, 2009)         | \$0.79        | \$0.45         |
|  | High (CAD\$)  | Low (CAD\$)    |
| <b>June 1, 2008 – May 31, 2009</b>                     | <b>\$1.98</b> | <b>\$0.285</b> |
| Fourth Quarter (March 1, 2009 – May 31, 2009)          | \$0.73        | \$0.35         |
| Third Quarter (December 1, 2008 – February 28, 2009)   | \$0.61        | \$0.285        |
| Second Quarter (September 1, 2008 – November 30, 2008) | \$1.30        | \$0.36         |
| First Quarter (June 1, 2008 – August 31, 2009)         | \$1.98        | \$0.93         |
|  | High (CAD\$)  | Low (CAD\$)    |
| <b>May 1, 2008 – May 31, 2008</b>                      | <b>\$2.32</b> | <b>\$1.75</b>  |
|  | High (CAD\$)  | Low (CAD\$)    |
| <b>May 1, 2007 – April 30, 2008</b>                    | <b>\$3.42</b> | <b>\$1.87</b>  |

The closing price of our common shares on the Toronto Stock Exchange on August 29, 2011, was CAD\$0.69.

The high and low sale prices for our common shares on the Over The Counter Bulletin Board for each of the preceding six months, each fiscal quarter in each of the last two full financial years and subsequent period and each of the last five full financial years are as follows:

|            | High     | Low      |
|------------|----------|----------|
| July 2011  | \$0.8847 | \$0.6675 |
| June 2011  | \$0.723  | \$0.62   |
| May 2011   | \$0.90   | \$0.6968 |
| April 2011 | \$1.08   | \$0.8771 |

|  |                 |                 |
|--|-----------------|-----------------|
| March 2011   | \$1.17          | \$0.873         |
| February 2011  | \$1.29          | \$1.16          |
|  | <b>High</b>     | <b>Low</b>      |
| <b>June 1, 2010 – May 31, 2011</b>                     | <b>\$1.29</b>   | <b>\$0.30</b>   |
| Fourth Quarter (March 1, 2011 – May 31, 2011)          | \$1.17          | \$0.6968        |
| Third Quarter (December 1, 2010 – February 28, 2011)   | \$1.29          | \$0.99          |
| Second Quarter (September 1, 2010 – November 30, 2010) | \$1.158         | \$0.37          |
| First Quarter (June 1, 2010 – August 31, 2010)         | \$0.4856        | \$0.30          |
|  |                 |                 |
| <b>June 1, 2009 – May 31, 2010</b>                     | <b>\$0.94</b>   | <b>\$0.2099</b> |
| Fourth Quarter (March 1, 2010 – May 31, 2010)          | \$0.66          | \$0.39          |
| Third Quarter (December 1, 2009 – February 28, 2010)   | \$0.94          | \$0.571         |
| Second Quarter (September 1, 2009 – November 30, 2009) | \$0.54          | \$0.2099        |
| First Quarter (June 1, 2009 – August 31, 2009)         | \$0.715         | \$0.4405        |
|  |                 |                 |
| <b>June 1, 2008 – May 31, 2009</b>                     | <b>\$1.99</b>   | <b>\$0.272</b>  |
| Fourth Quarter (March 1, 2009 – May 31, 2009)          | \$0.629         | \$0.2747        |
| Third Quarter (December 1, 2008 – February 28, 2009)   | \$0.5035        | \$0.272         |
| Second Quarter (September 1, 2008 – November 30, 2008) | \$1.15          | \$0.305         |
| First Quarter (June 1, 2008 – August 31, 2009)         | \$1.99          | \$0.914         |
|  |                 |                 |
| <b>May 1, 2008 – May 31, 2008</b>                      | <b>\$2.30</b>   | <b>\$1.82</b>   |
|  |                 |                 |
| <b>May 1, 2007 – April 30, 2008</b>                    | <b>\$3.3555</b> | <b>\$1.95</b>   |

The closing price of our common shares on the Over the Counter Bulletin Board on August 29, 2011, was \$0.7205.

#### **9.B. Plan of Distribution**

Not applicable.

#### **9.C. Markets**

Our common shares traded on the Vancouver Stock Exchange from March 29, 1988, until August 21, 1998, when they were delisted from trading at our request. Our common shares have traded on the Toronto Stock Exchange since January 28, 1994. We trade our shares on the Toronto Stock Exchange under the trading symbol "PTQ". Our common shares traded on the NASDAQ Small Cap Market from February 5, 1996, until April 12, 1999, when they were delisted for failure to meet minimum bid requirements and began to trade on the Over the Counter Bulletin Board on April 13, 1999. We trade our shares on the Over the Counter Bulletin Board under the trading symbol "PTQMF". We commenced trading on the Frankfurt Stock Exchange under the trading symbol "P7Z" on October 24, 2005.

#### **9.D. Selling Shareholders**

Not applicable.

#### **9.E. Dilution**

Not applicable.

**9.F. Expenses of the Issue**

Not applicable.

**ITEM 10. ADDITIONAL INFORMATION**

**10.A. Share Capital**

Not applicable.

**10.B. Memorandum and Articles of Association**

We were incorporated on October 10, 1985, pursuant to the Company Act (British Columbia), which has been replaced by the Business Corporations Act (British Columbia) (the "Act") and are registered with the Registrar of Companies for British Columbia under incorporation number 298967. We are not limited in our objects and purposes.

With respect to our directors, our Articles provide that a director who is, in any way, directly or indirectly interested in an existing or proposed contract or transaction with us, or who holds any office or possesses any property whereby, directly or indirectly, a duty or interest might be created to conflict with his duty or interest as a director, shall declare the nature and extent of his interest in such contract or transaction or the conflict or potential conflict with his duty and interest as a director, as the case may be, in accordance with the provisions of the Act and shall abstain from voting in respect thereof.

This prohibition does not apply to:

- (i) any such contract or transaction relating to a loan to us, which a director or a specified corporation or a specific firm in which he has an interest has guaranteed or joined in guaranteeing the repayment of the loan or any part of the loan;
- (ii) any contract or transaction made or to be made with, or for the benefit of a holding corporation or a subsidiary corporation of which a director is a director;
- (iii) any contract by a director to subscribe for or underwrite shares or debentures to be issued by us or our subsidiary, or any contract, arrangement or transaction in which a director is, directly or indirectly interested if all the other directors are also, directly or indirectly interested in the contract, arrangement or transaction;
- (iv) determining the remuneration of the directors;
- (v) purchasing and maintaining insurance to cover directors against liability incurred by them as directors; or
- (vi) the indemnification of any director by us.

Our Articles also provide that our directors may from time to time on our behalf borrow such money in such manner and amount, on such security, from such sources and upon such terms and conditions as they think fit; issue bonds, debentures and other debt obligations, either outright or as security for any of our liabilities or obligations, or any other person; and mortgage, charge, whether by way of specific or floating charge, or give other security on the undertaking, or on the whole or any part of our property and assets (both present and future). Variation of these borrowing powers would require an amendment to our Articles which would, in turn, require the approval of our shareholders by way of a Special Resolution, as defined hereinafter. A "Special Resolution" means a resolution cast by a majority of not less than  $\frac{3}{4}$  of the votes cast by our shareholders who, being entitled to do so, vote in person or by proxy at our general meeting of which notice as our Articles provide and not being less than 21 days notice

specifying the intention to propose the resolution as a special resolution, has been duly given (or, if every shareholder entitled to attend and vote at the meeting agrees, at a meeting of which less than 21 days notice has been given), or a resolution consented to in writing by each of our shareholders who would have been entitled to vote in person or by proxy at our general meeting, and a resolution so consented to is deemed to be a special resolution passed at our general meeting.

There is no requirement in our Articles or in the Act requiring retirement or non-retirement of directors under an age limit requirement, nor is there any minimum shareholding required for a director's qualification.

Holders of our common shares are entitled to vote at meetings of shareholders, and a Special Resolution, as described above, is required to effect a change in the rights of shareholders. Holders of common shares are not entitled to pre-emptive rights. Holders of common shares are entitled, ratably, to our remaining property upon our liquidation, dissolution or winding up, and such holders receive dividends if, as, and when, declared by our directors. There are no restrictions on the purchase or redemption of common shares by us while there is an arrearage in the payment of dividends or sinking fund installments. There is no liability on the part of any shareholder to further capital calls by us nor any provision discriminating against any existing or prospective holder of our securities as a result of such shareholder owning a substantial number of common shares. There are no limitations on the rights to own securities, including the rights of non-resident or foreign shareholders to hold or exercise voting rights on the securities imposed by the Act or by our constating documents.

We are required to give our registered shareholders not less than 21 days notice of any general meeting held by us unless all such shareholders consent to reduce or waive the period. In addition, we are obliged to give notice to registrants and intermediaries who hold common shares on behalf of the ultimate beneficial owners no fewer than 35 or more than 60 days prior to the date of the meeting. We then deliver, in bulk, proxy-related materials in amounts specified by the intermediaries. None of our common shares owned by registrants or intermediaries may be voted at our general meeting unless all proxy-related materials are delivered to the ultimate beneficial owners of such common shares. Such ultimate beneficial owner must then deliver a proxy to us within the time limited by us for the deposit of proxies in order to vote the common shares in respect of which such person is the beneficial owner.

There is no provision in our Articles that would have an effect of delaying, deferring or preventing our change in control and that would operate only with respect to a merger, acquisition or corporate restructuring involving us (or any of our subsidiaries) other than a shareholder rights plan adopted by our Board of Directors effective March 7, 2006, and approved by our shareholders at the Annual and Special Meeting held on June 6, 2006, and again at our Annual General Meeting on November 29, 2009 (the "Shareholder Rights Plan").

The Shareholder Rights Plan is designed to ensure that all shareholders receive equal treatment and to maximize shareholder values in the event of a take-over bid or other acquisition that could lead to a change in control of our company. It is not intended to deter take-over bids. Take-over bid contests for corporate control provide a singular opportunity for shareholders to obtain a one-time gain. After the acquisition of effective control, the opportunity for this one-time gain normally does not reoccur. As with most public companies, control of our company can probably be secured through the ownership of much less than 50% of the shares. Without a shareholder rights plan, it would be possible for a bidder to acquire effective control, over a relatively short period of time, through open market and private purchases, using various techniques permitted under the securities legislation in Canada, without making a bid available to all shareholders. Such acquisition of control would probably be an effective deterrent to other potential offerors. The person acquiring control would probably, over a period of time, be able to consolidate and increase its control without the price for control ever being tested through an open market auction. Shareholder rights plans are designed to prevent this occurrence by forcing all acquisitions of control into a public offer mode. A public offer will not necessarily achieve all of the objectives of ensuring the maximum value to shareholders. A take-over bid can be completed in a time period as short as 35 days. This is too short a time period to ensure that the directors can develop other competing alternatives. The Shareholder Rights Plan is intended to provide time to shareholders to properly assess any take-over bid and to provide the Board of Directors with sufficient time to explore and develop alternatives for maximizing shareholder value, including, if considered appropriate, identifying and locating other potential bidders.

Our Shareholder Rights Plan is filed herewith with the SEC as Exhibit 2.A to this Annual Report.

#### **10.C. Material Contracts**

We have entered into formal agreements with our directors, our executive officers and with six key employees that

establish financial arrangements that would be in effect in the event of a change of control of our company. Each agreement provides for, in the event of the termination of the engagement of such persons following a change of control of our company, the payment of an amount equal to three times the annual compensation being paid to such person as at the time of the change of control.

#### **10.D. Exchange Controls**

There are no governmental laws, decrees or regulations in Canada relating to restrictions on the export or import of capital, or affecting the remittance of interest, dividends or other payments to non-resident holders of our common shares. Any remittances of dividends to United States residents are, however, subject to a 15% withholding tax (5% if the shareholder is a corporation owning at least 10% of our outstanding common shares) pursuant to Article X of the reciprocal tax treaty between Canada and the United States. See "*Item 10 – Additional Information – E. Taxation*" below.

Except as provided in the Investment Canada Act (the "Act"), which has provisions which govern the acquisition of a control block of voting shares by non-Canadians of a corporation carrying on a Canadian business, there are no limitations specific to the rights of non-Canadians to hold or vote our common shares under the laws of Canada or the Province of British Columbia or in our charter documents.

Our management considers that the following general summary fairly describes those provisions of the Act pertinent to an investment in us by a person who is not a Canadian resident (a "non-Canadian").

The Act requires a non-Canadian making an investment which would result in the acquisition of control of the Canadian business to notify the Investment Review Division of Industry Canada, the federal agency created by the Act; or in the case of an acquisition of a Canadian business, the gross value of the assets of which exceeds certain threshold levels or the business activity of which is related to Canada's cultural heritage or national identity, to file an application for review with the Investment Review Division.

The notification procedure involves a brief statement of information about the investment on a prescribed form which is required to be filed with Industry Canada by the investor at any time up to 30 days following implementation of the investment. Once the completed notice has been filed, a receipt bearing the certificate date will be issued to the non-Canadian investor. The receipt must advise the investor either that the investment proposal is unconditionally non-reviewable or that the proposal will not be reviewed as long as notice of review is not issued within 21 days of the date certified under the receipt. It is intended that investments requiring only notification will proceed without government intervention unless the investment is in a specific type of business activity related to Canada's cultural heritage and national identity.

If an investment is reviewable under the Act, an order for review must be issued within 21 days after the certified date on which notice of investment was received. An application for review in the form prescribed is required to be filed with Industry Canada prior to the investment taking place. Once the application has been filed, a receipt will be issued to the applicant, certifying the date on which the application was received. For incomplete applications, a deficiency notice will be sent to the applicant, and if not done within 15 days of receipt of application, the application will be deemed to be complete as of the date it was received. Within 45 days after the complete application has been received, the Minister responsible for the Investment Canada Act must notify the potential investor that the Minister is satisfied that the investment is likely to be of net benefit to Canada. If within such 45-day period the Minister is unable to complete the review, the Minister has an additional 30 days to complete the review, unless the applicant agrees to a longer period. Within such additional period, the Minister must advise either that he is satisfied or not satisfied that the investment is likely to be of net benefit to Canada. If the time limits have elapsed, the Minister will be deemed to be satisfied that the investment is likely to be of net benefit to Canada. The investment may not be implemented until the review has been completed and the Minister is satisfied that the investment is likely to be of net benefit to Canada.

If the Minister is not satisfied that the investment is likely to be of net benefit to Canada, the non-Canadian must not implement the investment or, if the investment has been implemented, could be penalized by being required to divest himself of control of the business that is the subject of the investment. To date, the only types of business activities which have been prescribed by regulation as related to Canada's cultural heritage or national identity deal largely with publication, film and music industries. Because our total assets are less than the \$5 million notification threshold, and because our business activities would likely not be deemed related to Canada's cultural heritage or national identity, acquisition of a controlling interest in us by a non-Canadian investor would not be subject to even

the notification requirements under the Investment Canada Act.

The following investments by non-Canadians are subject to notification under the Act:

1. an investment to establish a new Canadian business; and
2. an investment to acquire control of a Canadian business that is not reviewable pursuant to the Act.

The following investments by a non-Canadian are subject to review under the Act:

1. direct acquisition of control of Canadian businesses with assets of \$5 million or more, unless the acquisition is being made by a World Trade Organization ("WTO") member country investor (the United States being a member of the WTO);
2. direct acquisition of control of Canadian businesses with assets of \$250,000,000 or more by a WTO investor;
3. indirect acquisition of control of Canadian business with assets of \$5 million or more if such assets represent more than 50% of the total value of the assets of the entities, the control of which is being acquired, unless the acquisition is being made by a WTO investor, in which case there is no review;
4. indirect acquisition of control of Canadian businesses with assets of \$50 million or more even if such assets represent less than 50% of the total value of the assets of the entities, the control of which is being acquired, unless the acquisition is being made by a WTO investor, in which case there is no review; and
5. an investment subject to notification that would not otherwise be reviewable if the Canadian business engages in the activity of publication, distribution or sale of books, magazines, periodicals, newspapers, film or video recordings, audio or video music recordings or music in print or machine-readable form.

Generally speaking, an acquisition is direct if it involves the acquisition of control of the Canadian business or of its Canadian parent or grandparent and an acquisition is indirect if it involves the acquisition of control of a non-Canadian parent or grandparent of an entity carrying on the Canadian business. Control may be acquired through the acquisition of actual voting control by the acquisition of voting shares of a Canadian corporation or through the acquisition of substantially all of the assets of the Canadian business. No change of voting control will be deemed to have occurred if less than one-third of the voting control of a Canadian corporation is acquired by an investor.

A WTO investor, as defined in the Act, includes an individual who is a national of a member country of the World Trade Organization or who has the right of permanent residence in relation to that WTO member, a government or government agency of a WTO investor-controlled corporation, limited partnership, trust or joint venture and a corporation, limited partnership, trust or joint venture that is neither WTO-investor controlled or Canadian controlled of which two-thirds of its board of directors, general partners or trustees, as the case may be, or any combination of Canadians and WTO investors.

The higher thresholds for WTO investors do not apply if the Canadian business engages in activities in certain sectors such as uranium, financial services, transportation services or communications.

The Act specifically exempts certain transactions from either notification or review. Included among this category of transactions is the acquisition of voting shares or other voting interests by any person in the ordinary course of that person's business as a trader or dealer in securities.

## **10.E. Taxation**

### **Material Canadian Federal Income Tax Consequences**

Through consultation with counsel, our management believes that the following general summary accurately describes all material Canadian federal income tax consequences applicable to a holder of our common shares who is a resident of the United States, that qualifies for benefits under the Canada-United States Convention (1980), as amended (the "Treaty") and who is not a resident of Canada and who does not use or hold, and is not deemed to use or hold, his common shares of us in connection with carrying on a business in Canada (a "non-resident holder").

This summary is based upon the current provisions of the Income Tax Act (Canada) (the "ITA"), the regulations thereunder (the "Regulations"), the current publicly announced administrative and assessing policies of Canada, Customs and Revenue Agency and all specific proposals (the "Tax Proposals") to amend the ITA and Regulations

announced by the Minister of Finance (Canada) prior to the date hereof. This summary assumes that the Tax Proposals will be enacted in their form as of the date of this Annual Report. This description, except for the Tax Proposals, does not take into account or anticipate any changes in law, whether by legislative, government or judicial action, nor does it take into account provincial, territorial, or foreign tax considerations which may differ significantly from those discussed herein.

### *Dividends*

Dividends paid on our common shares to a non-resident holder will be subject to withholding tax. The Treaty provides that the normal 25% withholding tax rate under the ITA is reduced to 15% on dividends paid on shares of a corporation resident in Canada (such as our company) to beneficial owners of the dividends who are residents of the United States, and may also provide for a further reduction of this rate to 5% where the beneficial owner of the dividends is a corporation that is a resident of the United States which owns at least 10% of the voting shares of the corporation paying the dividend.

No dividends have ever been paid by us.

### *Capital Gains*

Under the ITA, a taxpayer's capital gain or capital loss from a disposition of a share of our company is the amount, if any, by which his proceeds of disposition exceed (or are exceeded by) the aggregate of his adjusted cost base of the share and reasonable expenses of disposition. One half of a capital gain (the "taxable capital gain") is included in income, and one half of a capital loss in a year (the "allowable capital loss") is deductible from taxable capital gains realized in the same year. The amount by which a shareholder's allowable capital loss exceeds his taxable capital gains in a year may be deducted from a taxable capital gain realized by the shareholder in the three previous or any subsequent year, subject to certain restrictions in the case of a corporate shareholder.

A non-resident holder is not subject to tax under the ITA in respect of a capital gain realized upon the disposition of a share of a public corporation unless the share represents "taxable Canadian property" to the holder thereof. We are a public corporation for purposes of the ITA and a common share of our company will be taxable Canadian property to a non-resident holder if, at any time during the 60 month period immediately preceding the disposition, the non-resident holder, persons with whom the non-resident holder did not deal at arm's length, or the non-resident holder and persons with whom he did not deal at arm's length together owned not less than 25% of the issued shares of any class of our shares. Our shares may also be taxable Canadian property to a holder if the holder acquired them pursuant to certain tax-deferred "rollover" transactions whereby the holder exchanged property that was taxable Canadian property for our shares.

Where a non-resident holder who is an individual ceased to be resident in Canada, he will be subject to Canadian tax on any capital gain realized on disposition of our shares at that time.

Where a non-resident holder realizes a capital gain on a disposition of our shares that constitute taxable Canadian property, the Treaty relieves the non-resident shareholder from liability for Canadian tax on such capital gains unless:

- (a) the non-resident holder is an individual who was resident in Canada for not less than 120 months during any period of 20 consecutive years preceding, and at any time during the 10 years immediately preceding, the disposition and the shares were owned by him when he ceased to be resident in Canada or are property substituted for property that was owned at that time, or
- (b) the shares formed part of the business property of a "permanent establishment" or pertained to a fixed base used for the purpose of performing independent personal services that the shareholder has or had in Canada within the year preceding the disposition.

### **Material United States Federal Income Tax Consequences**

The following is a discussion of material U.S. federal income tax consequences that may be relevant with respect to the acquisition, ownership and disposition of our common shares by a U.S. Holder (as hereinafter defined). This

discussion does not address all potentially relevant federal income tax matters and it does not address consequences peculiar to persons subject to special provisions of federal income tax law, such as those described below as excluded from the definition of a U.S. Holder. In addition, this discussion does not cover any state, local or foreign tax consequences. Accordingly, holders and prospective holders of our common shares are urged to consult their own tax advisors about the specific federal, state, local and foreign tax consequences to them of acquiring, holding and disposing of our common shares, based upon their individual circumstances.

The following discussion is based upon the sections of the Code, Treasury Regulations, published Internal Revenue Service (“IRS”) rulings, published administrative positions of the IRS and court decisions that are currently applicable, any or all of which could be materially and adversely changed, possibly on a retroactive basis, at any time and which are subject to differing interpretations. This discussion does not consider the potential effects, both adverse and beneficial, of any proposed legislation which, if enacted, could be applied, possibly on a retroactive basis, at any time.

### *U.S. Holders*

As used in this annual report, a “U.S. Holder” means a holder of our common shares who is (i) a citizen or individual resident of the United States, (ii) corporation, or other entity treated as a corporation for U.S. tax purposes, created or organized in or under the laws of the United States or any state thereof (including the District of Columbia), (iii) an estate the income of which is subject to U.S. federal income taxation regardless of its source, or (iv) a trust if such trust was in existence on August 20, 1996 and validly elected to be treated as a United States person for U.S. federal income tax purposes or if (1) a court within the U.S. is able to exercise primary supervision over its administration and (2) one or more U.S. persons have the authority to control all of the substantial decisions of such trust. This summary does not address the tax consequences to, and the term U.S. Holder does not include, persons subject to specific provisions of federal income tax law, such as tax-exempt organizations, qualified retirement plans, individual retirement accounts and other tax-deferred accounts, financial institutions, insurance companies, real estate investment trusts, regulated investment companies, broker-dealers, non-resident alien individuals, persons or entities that have a “functional currency” other than the U.S. dollar, shareholders subject to the alternative minimum tax, shareholders who hold common shares as part of a straddle, hedging or conversion transaction and shareholders who acquired their common shares through the exercise of employee stock options or otherwise as compensation for services. This summary is limited to U.S. Holders who own common shares as capital assets, within the meaning of Section 1221 of the Code, and who own (directly and indirectly, pursuant to applicable rules of constructive ownership) no more than 10% of the value of our total outstanding stock. This summary does not address the consequences to a person of the ownership, exercise or disposition of any options, warrants or other rights to acquire common shares.

If a partnership (or any other entity treated as a partnership for U.S. federal income tax purposes) holds our common shares, the tax treatment of a partner in such partnership will generally depend on the status of the partner and the activities of the partnership. Such a partner should consult its own tax advisors as to the U.S. tax consequences of being a partner in a partnership that acquires, holds, or disposes of our common shares.

### *Distributions on Our Common Shares*

Subject to the discussion below under “*Passive Foreign Investment Company*”, U.S. Holders receiving dividend distributions (including constructive dividends) with respect to our common shares generally are required to include in gross income for U.S. federal income tax purposes the gross amount of such distributions (without reduction of any Canadian income or other tax withheld from such distributions), equal to the U.S. dollar value of such distributions on the date of receipt (based on the exchange rate on such date), to the extent that we have current or accumulated earnings and profits. Such Canadian tax withheld may be credited, subject to certain limitations, against the U.S. Holder’s federal income tax liability or, alternatively, may be deducted in computing the U.S. Holder’s federal taxable income by those who itemize deductions (See more detailed discussion at “*Foreign Tax Credit*” below). Dividends paid on our common shares will not generally be eligible for the dividends received deduction provided to corporations receiving dividends from certain U.S. corporations.

For taxable years beginning before January 1, 2011, dividends received by U.S. Holders that are individuals, estates or trusts from “qualified foreign corporations,” as defined in Section 1(h)(11) of the Code, generally are taxed at the same preferential tax rates applicable to long-term capital gains. Although not free from doubt, it appears that we are a “qualified foreign corporation,” as defined in Section 1(h) (11) of the Code if we are not, and have not been, a PFIC, as described below under “*Passive Foreign Investment Company*.” We have not determined whether or not we meet the definition of a PFIC for the current tax year and any prior tax years. A corporation that is a PFIC, along

with other foreign corporations given special status under the Code, for its taxable year during which it pays a dividend, or for its immediately preceding taxable year, will not be treated as a “qualifying foreign corporation” and dividends received by U.S. Holders that are individuals, estates or trusts generally will be subject to U.S. federal income tax at ordinary income tax rates (and not at the preferential tax rates applicable to long-term capital gains).

In the case of foreign currency received as a dividend that is not converted by the recipient into U.S. dollars on the date of receipt, a U.S. Holder will have a tax basis in the foreign currency equal to its U.S. dollar value on the date of receipt. Generally any gain or loss recognized upon a subsequent sale or other disposition of the foreign currency, including the exchange for U.S. dollars, will be ordinary income or loss.

#### *Disposition of Our Common Shares*

Subject to the discussion below under “Passive Foreign Investment Company,” U.S. Holders will recognize gain or loss upon the sale of our common shares equal to the difference, if any, between (i) the amount of cash plus the fair market value of any property received and (ii) the shareholder’s tax basis in our common shares. Preferential tax rates apply to long-term capital gains of U.S. Holders that are individuals, estates or trusts. In general, gain or loss on the sale of our common shares will be long-term capital gain or loss if our common shares are a capital asset in the hands of the U.S. Holder and are held for more than one year. Deductions for net capital losses are subject to significant limitations.

#### *Passive Foreign Investment Company*

We have not determined whether or not we meet the definition of PFIC, within the meaning of Sections 1291 through 1298 of the Code for the current tax year and any prior tax years. We may or may not qualify as a PFIC in subsequent years due to changes in our assets and business operations. A U.S. Holder who holds stock in a foreign corporation during any year in which such corporation qualifies as a PFIC is subject to numerous special U.S. federal income taxation rules. The following is a discussion of these special rules as they apply to U.S. Holders of our common shares.

Section 1297 of the Code defines a PFIC as a corporation that is not formed in the U.S. if, for any taxable year, either (i) 75% or more of its gross income is “passive income,” which includes interest, dividends and certain rents and royalties or (ii) the average percentage, by fair market value (or, if the corporation is not publicly traded and either is a controlled foreign corporation or makes an election, by adjusted tax basis), of its assets that produce or are held for the production of passive income is 50% or more.

U.S. Holders owning shares of a PFIC are subject to a special tax and to an interest charge based on the value of deferral of U.S. tax attributable to undistributed earnings of a PFIC for the period during which the shares of the PFIC are owned. This special tax would apply to any gain realized on the disposition of shares of a PFIC. In addition, the gain is subject to U.S. federal income tax as ordinary income, taxed at top marginal rates, rather than as capital gain income. The special tax would also be payable on receipt of excess distributions (any distributions received in the current year that are in excess of 125% of the average distributions received during the 3 preceding years or, if shorter, the shareholder’s holding period). However, if the U.S. Holder makes for any tax year a timely election to treat a PFIC as a qualified electing fund (“QEF”) with respect to such shareholder’s interest therein, the above-described rules generally will not apply. Instead, the electing U.S. Holder would include annually in his gross income his pro rata share of the PFIC’s ordinary earnings and any net capital gain regardless of whether such income or gain was actually distributed. Special rules apply to U.S. Holders who own their interests in a PFIC through intermediate entities or persons. Generally, shareholders do not make a QEF election unless they have sufficient information to determine their proportionate share of a corporation’s net capital gain and ordinary earnings. We have not calculated these amounts for any shareholder, and do not anticipate making these calculations in the foreseeable future. **Therefore, U.S. Holders of our common shares should consult their own financial advisor, legal counsel or accountant regarding the QEF election before making this election.**

U.S. Holders who hold, actually or constructively, marketable stock of a foreign corporation that qualifies as a PFIC may elect to mark such stock to the market (a “*mark-to-market election*”). If such an election is made, such U.S. Holder will not be subject to the special taxation rules of PFIC described above for the taxable years for which the mark-to-market election is made. A U.S. Holder who makes such an election will include in income for the taxable year an amount equal to the excess, if any, of the fair market value of our common shares as of the close of such tax year over such U.S. Holder’s adjusted basis in such shares. In addition, the U.S. Holder is allowed a deduction for the lesser of (i) the excess, if any, of such U.S. Holder’s adjusted tax basis in the shares over the fair market value of such shares as of the close of the tax year or (ii) the excess, if any of (A) the mark-to-market gains for our common shares included by such U.S. Holder for prior tax years, including any amount which would have been included for any prior year but for Section 1291 interest on tax deferral rules discussed above with respect to a U.S. Holder, who

has not made a timely QEF election during the year in which he holds (or is deemed to have held) our common shares and we are a PFIC (*“Non-Electing U.S. Holder”*) over (B) the mark-to-market losses for shares that were allowed as deductions for prior tax years. A U.S. Holder’s adjusted tax basis in our common shares will be increased or decreased to reflect the amount included or deducted as a result of mark-to-market election. A mark-to-market election will apply to the tax year for which the election is made and to all later tax years, unless the PFIC stock ceases to be marketable or the IRS consents to the revocation of the election.

The IRS has issued proposed regulations that, subject to certain exceptions, would treat as taxable certain transfers of PFIC stock by a Non-Electing U.S. Holder that are generally not otherwise taxed, such as gifts, exchanges pursuant to corporate reorganizations and transfers at death. Generally, in such cases, the basis of our common shares in the hands of the transferee and the basis of any property received in the exchange for those shares would be increased by the amount of gain recognized. A U.S. Holder who has made a timely QEF election (as discussed above) would not be taxed on certain transfers of PFIC stock, such as gifts, exchanges pursuant to corporate reorganizations and transfers at death. The transferee’s basis in this case will depend on the manner of the transfer. The specific tax effect to the U.S. Holder and the transferee may vary based on the manner in which the common shares are transferred. Each U.S. Holder should consult a tax advisor with respect to how the PFIC rules affect their tax situation.

**The PFIC and QEF election rules are complex. U.S. Holders should consult a tax advisor regarding the availability and procedure for making the QEF election as well as the applicable method for recognizing gains or earnings and profits under the foregoing rules.**

#### *Foreign Tax Credit*

A U.S. Holder who pays (or has withheld from distributions) Canadian or other foreign income tax with respect to the ownership of our common shares may be entitled, at the option of the U.S. Holder, to either receive a deduction or a tax credit for U.S. federal income tax purposes with respect to such foreign tax paid or withheld. Complex limitations apply to the foreign tax credit, including the general limitation that the credit cannot exceed the proportionate share of a U.S. Holder’s U.S. federal income tax liability that such U.S. Holder’s “foreign source” taxable income bears to such U.S. Holder’s worldwide taxable income. In applying this limitation, a U.S. Holder’s various items of income and deduction must be classified, under complex rules, as either “foreign source” or “U.S. source.” In addition, this limitation is calculated separately with respect to specific categories of income including “passive category income” and “general category income.” Gain or loss recognized by a U.S. Holder on the sale or other taxable disposition of our common shares generally will be treated as “U.S. source” for purposes of applying the foreign tax credit rules. Dividends received by U.S. Holders on our common shares generally will be treated as “foreign source” and generally will be categorized as “passive income” for purposes of applying the foreign tax credit rules. **The availability of the foreign tax credit and the application of the limitations with respect to the foreign tax credit are fact specific, and each U.S. Holder of our common shares should consult their own financial advisor, legal counsel or accountant regarding the foreign tax credit rules.**

#### *Controlled Foreign Corporation*

If more than 50% of the total voting power or the total value of our outstanding shares is owned, directly or indirectly, by citizens or residents of the U.S., U.S. partnerships or corporations, or U.S. estates or trusts (as defined by Section 7701(a)(30) of the Code), each of which own, directly or indirectly, 10% or more of the total voting power of the our outstanding shares (each a “10% Shareholder”), we could be treated as a “Controlled Foreign Corporation” (“CFC”) under Section 957 of the Code.

Our classification as a CFC would effect many complex results, including that 10% Shareholders would generally (i) be treated as having received a current distribution of our “Subpart F income” and (ii) would also be subject to current U.S. federal income tax on their pro rata share of our earnings invested in “U.S. property.” The foreign tax credit may reduce the U.S. federal income tax on these amounts for such 10% Shareholders (See more detailed discussion at “Foreign Tax Credit” above). In addition, under Section 1248 of the Code, gain from the sale or other taxable disposition of our common shares by a U.S. Holder that is or was a 10% Shareholder at any time during the five-year period ending with the sale is treated as a dividend to the extent of our earnings and profits attributable to the common shares sold or exchanged.

If we are classified as both a PFIC and a CFC, we generally will not be treated as a PFIC with respect to 10% Shareholders. This rule generally will be effective for taxable years of 10% Shareholders beginning after 1997 and for its taxable years ending with or within such taxable years of 10% Shareholders.

We have not determined whether we meet the definition of a CFC, and there can be no assurance that we will not be considered a CFC for the current or any future taxable year.

The CFC rules are very complicated, and U.S. Holders should consult their own financial advisor, legal counsel or accountant regarding the CFC rules and how these rules may impact their U.S. federal income tax situation.

#### *Information Reporting; Backup Withholding*

Certain information reporting and backup withholding rules may apply with respect to certain payments related to our common shares. In particular, a payor or middleman within the U.S., or in certain cases outside the U.S., will be required to withhold at a current rate of 28% (which rate is scheduled for periodic adjustment) of any payments to a U.S. Holder regarding dividends paid by us, or proceeds from the sale of, such common shares within the U.S., if a U.S. Holder fails to furnish its correct taxpayer identification number (generally on Form W-9) or otherwise fails to comply with, or establish an exemption from, the backup withholding tax requirements. Any amounts withheld under the U.S. backup withholding tax rules will be allowed as a refund or a credit against the U.S. Holder's U.S. federal income tax liability, provided the required information is furnished to the IRS. We do not assume responsibility for the withholding of tax at source. **U.S. Holders should consult their own financial advisor, legal counsel or accountant regarding the information reporting and backup withholding rules applicable to our common shares.**

#### **10.F. Dividends and Paying Agents**

Not applicable.

#### **10.G. Statements by Experts**

Not applicable.

#### **10.H. Documents on Display**

Any documents referred to in this Annual Report may be inspected at our head office located at Suite 410, 475 West Georgia Street, Vancouver, British Columbia, V6B 4M9 Canada, during normal business hours.

#### **10.I. Subsidiary Information**

There is no additional information, which must be provided in Canada and which is not otherwise called for by the body of Canadian GAAP used in preparing our consolidated financial statements, relating to our subsidiaries.

### **ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

#### *Credit risk*

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. Financial instruments that potentially subject the Company to credit risk consist of cash and cash equivalents, restricted cash, and accounts receivable. We have reduced our credit risk by investing our cash and cash equivalents and restricted cash in term deposits with financial institutions that operate globally. There is also minimal risk associated with accounts receivable as the payment for gold sales is received prior to the gold being credited to the customer's account at the refinery.

Therefore, we are not exposed to significant credit risk and overall our credit risk has not changed significantly from the prior year.

#### *Liquidity risk*

Liquidity risk arises from our general and capital financing needs. We have in place a planning and budgeting process to help determine the funds required to ensure we have the appropriate liquidity to meet our operating and growth objectives. We have historically relied on share issuances, senior secured debt, convertible senior secured debt and leasing arrangements to develop the Molejon gold project. We expect to fund operations and capital expenditures in fiscal 2012 via operations as the Molejon gold project has been in commercial production since January 2010.

During our year ended May 31, 2011, we paid a total amount of \$70,413,280 in principal, premium and interest on our Notes and Convertible Notes from the proceeds of our Forward Gold Purchase Agreement with Deutsche Bank AG, London Branch during the second quarter of fiscal year 2011 and a private placement offering which closed on January 31, 2011.

In addition, all of our commitments regarding payments on principal, premium and interest on our Notes and Convertible Notes have been complied with in accordance with the subordination established by our Forward Gold Purchase Agreement with Deutsche Bank AG, London Branch.

#### *Currency risk*

Financial instruments that impact our net earnings or other comprehensive income due to currency fluctuations include: Canadian dollar denominated cash and cash equivalents, restricted cash, accounts receivable and accounts payable. As we conduct the vast majority of our activities in United States dollars, changes in the exchange rate between the Canadian dollar and the United States dollar have a minimal effect on our net earnings and other comprehensive income.

#### *Interest rate risk*

Interest rate risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate due to changes in market interest rates. Cash and cash equivalents and restricted cash bear interest at fixed rates.

Other current financial assets and liabilities are not exposed to interest rate risk because they are non-interest bearing.

The operating credit line facility, capital leases, and long-term debt bear interest at a fixed rate and are also not exposed to interest rate risk.

### **Qualitative Information about Market Risk**

Our objectives of capital management are intended to safeguard our ability to support our normal operating requirements on an ongoing basis, continue the development and exploration of its mineral properties and support any expansionary plans.

The capital structure of the Company consists of long term debt, leases, Notes, Convertible Notes and equity attributable to common shareholders, comprised of issued capital, contributed surplus and deficit. We manage the capital structure and make adjustments in light of changes in economic conditions and the risk characteristics of our assets.

To effectively manage our capital requirements, we have in place a planning and budgeting process to help determine the funds required to ensure we have the appropriate liquidity to meet our operating and growth objectives. We have historically relied on issuance of shares, senior secured debt, convertible senior secured debt and leasing arrangements to develop the project and may require doing so again in the future.

### **ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES**

Not applicable.

## **PART II**

### **ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES**

In our 2010 fiscal year, we were unable to meet all of our obligations with respect to scheduled repayments of principal, premium and interest on our Notes and Convertible Notes. As such, under the terms of the Indenture an event of default had occurred and the Notes and Convertible Notes became due on demand at the option of the Note and Convertible Note holders or the Trustee. However, the terms of the Indenture were largely suspended, when we entered into a prepaid Forward Gold Purchase Agreement with Deutsche Bank on September 23, 2010. As part of

the Forward Gold Purchase Agreement our Note and Convertible Note holders were required to enter into an inter-creditor agreement with us and Deutsche Bank which prevents the Note and Convertible Note holders from taking action as a result of the event of default that occurred, until our obligations under the Forward Gold Purchase Agreement have been satisfied.

There are no payments of dividends by us in arrears, nor has there been any other material delinquency relating to any class of our preference shares.

#### **ITEM 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS**

Effective March 7, 2006, our Board of Directors adopted a shareholder rights plan, which was approved by our shareholders at our Annual and Special Meeting held June 6, 2006, and subsequently at our Annual General Meeting held November 29, 2010.

The Shareholder Rights Plan is designed to ensure that all shareholders receive equal treatment and to maximize shareholder values in the event of a take-over bid or other acquisition that could lead to a change in control of our company. It is not intended to deter take-over bids. Take-over bid contests for corporate control provide a singular opportunity for shareholders to obtain a one-time gain. After the acquisition of effective control, the opportunity for this one-time gain normally does not reoccur. As with most public companies, control of our company can probably be secured through the ownership of much less than 50% of our shares. Without a shareholder rights plan, it would be possible for a bidder to acquire effective control, over a relatively short period of time, through open market and private purchases, using various techniques permitted under the securities legislation in Canada, without making a bid available to all shareholders. Such acquisition of control would probably be an effective deterrent to other potential offerors. The person acquiring control would probably, over a period of time, be able to consolidate and increase its control without the price for control ever being tested through an open market auction. Shareholder rights plans are designed to prevent this occurrence by forcing all acquisitions of control into a public offer mode. A public offer will not necessarily achieve all of the objectives of ensuring the maximum value to shareholders. A take-over bid can be completed in a time period as short as 35 days. This is too short a time period to ensure that the directors can develop other competing alternatives. The Shareholder Rights Plan is intended to provide time to shareholders to properly assess any take-over bid and to provide our Board of Directors with sufficient time to explore and develop alternatives for maximizing shareholder value, including, if considered appropriate, identifying and locating other potential bidders.

Our Shareholder Rights Plan is filed herewith with the SEC as Exhibit 2.A. to this Annual Report.

#### **ITEM 15. CONTROLS AND PROCEDURES**

Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed in our reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in our reports filed under the Exchange Act is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer as appropriate, to allow timely decisions regarding required disclosure.

Under the supervision and with the participation of our Chief Executive Officer (serving as our principal executive officer) and Chief Financial Officer (serving as our principal financial officer), we evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) of the Exchange Act) as of the end of the period covered by this report (the "Evaluation Date"). Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of the Evaluation Date, our disclosure controls and procedures were effective to ensure that information required to be disclosed in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the periods specified in the SEC's rules and forms, and accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

#### *Management's Annual Report on Internal Control over Financial Reporting*

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act. Our internal control system was designed to provide

reasonable assurance to our management and board of directors regarding the preparation and fair presentation of published financial statements.

All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

An internal control material weakness is a deficiency, or aggregation of deficiencies, such that the risk of material misstatements in financial statements will not be prevented or detected on a timely basis by employees in the normal course of their work. An internal control significant deficiency, or aggregation of deficiencies, is one that could result in a misstatement of the financial statements that is more than inconsequential.

The Chief Executive Officer and the Chief Financial Officer evaluated the design and effectiveness of internal controls over financial reporting based on the framework in Internal Control – Integrated Framework issued by the Committee Sponsoring Organizations of the Treadway Commission (“COSO”) as at May 31, 2011. Based on this evaluation, as at May 31, 2011, we believe that our internal controls over financial reporting were designed and operating effectively to provide reasonable, but not absolute, assurance that the objectives of the control system are met.

Ernst & Young LLP, an independent registered public accounting firm, has audited the financial statements for the year ended May 31, 2011, and expressed an unqualified opinion thereon. Ernst & Young LLP has also expressed an unqualified opinion on the Company’s internal control over financial reporting as of May 31, 2011. The report can be found in the “Independent Auditor’s Report on Internal Controls under Standards of the Public Company Accounting Oversight board (United States of America)”.

#### *Attestation Report of our External Auditor*

The effectiveness of our internal control over financial reporting as of May 31, 2011, has been audited by our independent registered chartered accountants, Ernst & Young LLP, which also audited our consolidated financial statements for the year ended May 31, 2011. Ernst & Young LLP have expressed an unqualified opinion on the effectiveness of our internal control over financial reporting as of May 31, 2011, and their report is included on page 86 of this Annual Report.

#### *Changes in Internal Control Over Financial Reporting*

During the period covered by this report, other than the changes discussed under *Management’s Annual Report on Internal Control over Financial Reporting*, there were no changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

#### *Inherent Limitations on Effectiveness of Controls*

Internal control over financial reporting has inherent limitations. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. Internal control over financial reporting also can be circumvented by collusion or improper management override. Because of such limitations, there is a risk that material misstatements will not be prevented or detected on a timely basis by internal control over financial reporting. However, these inherent limitations are known features of the financial reporting process. Therefore, it is possible to design into the process safeguards to reduce, though not eliminate, this risk.

## **ITEM 16. [RESERVED]**

### **16.A. AUDIT COMMITTEE FINANCIAL EXPERT**

We have not identified an Audit Committee Financial Expert among the three directors currently serving on our Audit Committee. Our current Audit Committee members are Raul Ferrer, David Kaplan and David Levy, each of whom, as a result of various professional backgrounds, is financially literate with an understanding of internal controls and procedures.

### **16.B. CODE OF ETHICS**

Effective May 31, 2008, our Board of Directors adopted an updated Code of Business Ethics and Conduct that applies to, among other persons, our President and Chief Executive Officer, being our principal executive officer, and our Chief Financial Officer, being our principal financial officer, and our controller, as well as persons performing similar

functions. As adopted, our Code of Business Ethics and Conduct sets forth written standards that are designed to deter wrongdoing and to promote:

- (1) honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships;
- (2) full, fair, accurate, timely and understandable disclosure in reports and documents that we file with, or submit to, the SEC and in other public communications made by us;
- (3) compliance with applicable governmental laws, rules and regulations;
- (4) the prompt internal reporting of violations of the Code of Business Ethics and Conduct to an appropriate person or persons identified in the Code of Business Ethics and Conduct; and
- (5) accountability for adherence to the Code of Business Ethics and Conduct.

Our Code of Business Ethics and Conduct requires, among other things, that all of our personnel shall be accorded full access to our President and Chief Executive Officer and Chief Financial Officer with respect to any matter which may arise relating to the Code of Business Ethics and Conduct. Further, all of our personnel are to accorded full access to our Board of Directors if any such matter involves an alleged breach of the Code of Business Ethics and Conduct by our President and Chief Executive Officer or Chief Financial Officer.

In addition, our Code of Business Ethics and Conduct emphasizes that all employees, and particularly managers and/or supervisors, have a responsibility for maintaining our financial integrity, consistent with generally accepted accounting principles, and federal, provincial and state securities laws. Any employee who becomes aware of any incidents involving financial or accounting manipulation or other irregularities, whether by witnessing the incident or being told of it, must report it to his or her immediate supervisor or to our Chairman of the Audit Committee or Chief Financial Officer or, if anonymity is preferred, to an independent whistle-blower hotline operated and controlled by a third party. It is against our policy to retaliate against any individual who reports in good faith the violation or potential violation of our Code of Business Ethics and Conduct by another.

Our Code of Business Ethics and Conduct and our Whistle-Blower Policy were filed as Exhibits 11.A and 11.B to our Form 20-F for the period ended May 31, 2008. The full text of our Code of Business Ethics and Conduct and our Whistle-Blower Policy can be viewed on our website at [www.petaquilla.com](http://www.petaquilla.com) and we will provide a copy of each document to any person without charge, upon request. Requests can be sent to: Petaquilla Minerals Ltd., Suite 410 - 475 West Georgia Street, Vancouver, BC, Canada V6B 4M9.

### 16.C. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The aggregate amounts billed by our auditors to us for (i) the period covered by the year ended May 31, 2011, and (ii) the period covered by the year ended May 31, 2010, for audit fees, audit-related fees, tax fees and all other fees are set forth below:

|                                   | Year Ended<br>May 31, 2011<br>(CAD\$) | Year Ended<br>May 31, 2010<br>(CAD\$) |
|-----------------------------------|---------------------------------------|---------------------------------------|
| Audit Fees <sup>(1)</sup>         | \$500,313 <sup>(5)</sup>              | \$711,698                             |
| Audit-Related Fees <sup>(2)</sup> | \$10,500 <sup>(5)</sup>               | \$15,820                              |
| Tax Fees <sup>(3)</sup>           | \$20,873 <sup>(5)</sup>               | \$27,865                              |
| All Other Fees <sup>(4)</sup>     | -                                     | -                                     |
| <b>Totals</b>                     | <b>\$531,686 <sup>(5)</sup></b>       | <b>\$755,383</b>                      |

- (1) "Audit Fees" represent the aggregate fees billed for professional services rendered by our principal accountant for the audit of our annual financial statements or services that are normally provided by our accountant in connection with statutory and regulatory filings or engagements.
- (2) "Audit-Related Fees" represent the aggregate fees billed for assurance and related services by our principal accountant that are reasonably related to the performance of the audit or review of our financial statements and are not reported under "Audit Fees" above.
- (3) "Tax Fees" represent the aggregate fees for professional services rendered by our principal accountant for tax compliance, tax advice and tax planning.
- (4) "All Other Fees" represent the aggregate fees billed for products and services provided by our principal accountant, other than the services reported under "Audit Fees", "Audit-Related Fees" and "Tax Fees" above.
- (5) Fees for the year ended May 31, 2011, are estimated.

The Audit Committee has adopted procedures requiring Audit Committee review and approval in advance of all particular engagements for services provided by our independent auditor. Consistent with applicable laws, the procedures permit limited amounts of services, other than audit, review or attest services, to be approved by one or more members of the Audit Committee pursuant to authority delegated by the Audit Committee, provided the Audit Committee is informed of each particular service. All of the engagements (i.e. 100%) and fees for the year ended May 31, 2011, and the year ended May 31, 2010, were approved by the Audit Committee and all such engagements were completed by our independent auditor with no work performed by persons other than our independent auditor's full-time, permanent employees. The Audit Committee reviews with our auditor whether the non-audit services to be provided are compatible with maintaining the auditor's independence. The Board determined that, starting in the fiscal year ended January 31, 2005, fees paid to our independent auditors for non-audit services in any year would not exceed the fees paid for audit services during the year. Permissible non-audit services are limited to fees for tax services, accounting assistance or audits in connection with acquisitions, and other services specifically related to accounting or audit matters such as audits of employee benefit plans.

**16.D EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES**

Not applicable.

**16.E. PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS**

No purchases were made by us or on our behalf or any "affiliated purchaser", as defined in §240.10b-18(a)(3), of shares or other units of any class of our equity securities that is registered pursuant to Section 12 of the Exchange Act.

**16.F. CHANGE IN REGISTRANT'S CERTIFYING ACCOUNTANT**

Not applicable.

**16.G. CORPORATE GOVERNANCE**

Not applicable.

**PART III**

**ITEM 17. FINANCIAL STATEMENTS**

Please see the Financial Statements and Exhibits listed in Item 19 hereof and filed as part of this Annual Report on Form 20-F. These consolidated financial statements were prepared in accordance with Canadian GAAP and are expressed in United States dollars. Such consolidated financial statements have been reconciled to U.S. GAAP (see Note 27 therein).

**PETAQUILLA MINERALS LTD.**  
**CONSOLIDATED FINANCIAL STATEMENTS**  
**Year Ended May 31, 2011**



## **Management Report on Internal Control over Financial Reporting**

The management of Petaquilla Minerals Ltd. (“Petaquilla” or the “Company”) is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) of the Securities Exchange Act of 1934. Petaquilla’s internal control system was designed to provide reasonable assurance to the Company’s management and board of directors regarding the preparation and fair presentation of published financial statements.

All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

An internal control material weakness is a deficiency, or aggregation of deficiencies, such that the risk of material misstatements in financial statements will not be prevented or detected on a timely basis by employees in the normal course of their work. An internal control significant deficiency, or aggregation of deficiencies, is one that could result in a misstatement of the financial statements that is more than inconsequential.

The Company’s management assessed the effectiveness of Petaquilla’s internal controls over financial reporting as of May 31, 2011.

In making the assessment of internal control over financial reporting, the Company’s management used the criteria issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control—Integrated Framework. Petaquilla’s management believes that, as of May 31, 2011 (“the Evaluation Date”), the Company’s internal control over financial reporting was effective as of the Evaluation Date based on those criteria.

During the period covered by this report, there were no changes in the Company’s internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.

The effectiveness of the Company’s internal control over financial reporting, as of May 31, 2011, has been audited by Ernst & Young LLP, Independent Registered Accountants, who also audited the Company’s consolidated financial statements for the year ended May 31, 2011, as stated in their report which appears on the following page.

### **PETAQUILLA MINERALS LTD.**

By: /s/ Ezequiel Sirotinsky  
\_\_\_\_\_  
Ezequiel Sirotinsky, Chief Financial Officer  
(principal financial and accounting officer)

By: /s/ Joao Manuel  
\_\_\_\_\_  
Joao Manuel, Chief Executive Officer  
(principal executive officer)

**REPORT OF INDEPENDENT REGISTERED  
PUBLIC ACCOUNTING FIRM**

To the Shareholders of  
**Petaquilla Minerals Ltd.**

We have audited **Petaquilla Minerals Ltd.’s** [the “Company”] internal control over financial reporting as of May 31, 2011, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission [the “COSO criteria”]. The Company’s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management’s Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company’s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company’s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company’s internal control over financial reporting includes those policies and procedures that [1] pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; [2] provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and [3] provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company’s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of May 31, 2011, based on the COSO criteria.

We also have audited, in accordance with Canadian generally accepted auditing standards and the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets as at May 31, 2011 and 2010 and the consolidated statements of operations and comprehensive loss, shareholders’ equity and cash flows for each of the years in the three-year period ended May 31, 2011 of the Company and our report dated August 29, 2011 expressed an unqualified opinion thereon.

*Ernst & Young LLP*

Vancouver, Canada,  
August 29, 2011.



A member firm of Ernst & Young Global Limited

## INDEPENDENT AUDITORS' REPORT OF REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders of  
**Petaquilla Minerals Ltd.**

We have audited the accompanying consolidated financial statements of **Petaquilla Minerals Ltd.**, [the "Company"] which comprise the consolidated balance sheets as at May 31, 2011 and 2010, and the consolidated statements of operations and comprehensive loss, shareholders' equity and cash flows for each of the years in the three-year period ended May 31, 2011, 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 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 and the standards of the Public Company Accounting Oversight Board (United States). 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 auditors consider 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. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, 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 **Petaquilla Minerals Ltd.** as at May 31, 2011 and 2010, and the results of its operations and its cash flows for each of the years in the three-year period ended May 31, 2011 in accordance with Canadian generally accepted accounting principles.

### **Other matter**

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), **Petaquilla Minerals Ltd.**'s internal control over financial reporting as of May 31, 2011, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated August 29, 2011 expressed an unqualified opinion on **Petaquilla Minerals Ltd.**'s internal control over financial reporting.

*Ernst & Young LLP*

Vancouver, Canada,  
August 29, 2011.

Chartered Accountants

**PETAQUILLA MINERALS LTD.**  
**CONSOLIDATED BALANCE SHEETS**  
(in United States Dollars)

|   | May 31,<br>2011      | May 31,<br>2010      |
|---|----------------------|----------------------|
| <b>Assets</b> (Note 16)   |                      |                      |
| Current assets  |                      |                      |
| Cash and cash equivalents (Note 25)                                   | \$5,712,792          | \$ 4,625,649         |
| Short term investments (Note 8)                                       | 200,000              | -                    |
| Accounts receivable   | 460,324              | 116,326              |
| Inventory and stockpiled ore (Note 3)                                 | 11,613,321           | 3,634,715            |
| Prepaid expenses  | 1,138,977            | 690,152              |
|   | <u>19,125,414</u>    | <u>9,066,842</u>     |
| Restricted cash (Note 9)  | 255,091              | 566,708              |
| Long term investments (Note 13)                                       | 2,400,000            | -                    |
| Long term stockpiled ore (Note 3)                                     | 2,228,405            | 1,107,316            |
| Advances to suppliers   | 3,509,817            | 816,461              |
| Other assets (Notes 10 and 27)  | 6,616,964            | -                    |
| Property, plant and equipment (Notes 4 and 15)                        | 14,713,518           | 9,916,595            |
| Mineral properties (Note 5)   | 66,670,067           | 58,788,273           |
|   | <u>\$115,519,276</u> | <u>\$ 80,262,195</u> |
| <b>Liabilities</b>  |                      |                      |
| Current liabilities   |                      |                      |
| Current portion of accounts payable and accrued liabilities (Note 11) | \$30,318,558         | \$17,586,683         |
| Current portion of deferred services and materials (Note 14)          | -                    | 3,153,394            |
| Current portion of obligations under capital leases (Note 15)         | 1,468,561            | 4,136,032            |
| Current portion of long-term debt (Note 13)                           | 435,733              | 35,465               |
| Current portion of deferred revenue (Note 27)                         | 9,246,437            | -                    |
| Senior secured notes (Note 16)  | 217,984              | 26,646,631           |
| Convertible senior secured notes (Note 17)                            | 276,983              | 44,837,991           |
|   | <u>41,964,256</u>    | <u>96,396,196</u>    |
| Long term debt (Note 13)  | 1,840,500            | 80,235               |
| Accounts payable and accrued liabilities (Note 11)                    | 1,866,667            | -                    |
| Obligations under capital leases (Note 15)                            | 3,850,475            | 440,229              |
| Senior secured notes (Note 16)  | 2,906,453            | -                    |
| Convertible senior secured notes (Note 17)                            | 3,693,111            | -                    |
| Deferred revenue (Note 27)  | 33,390,472           | -                    |
| Asset retirement obligation (Note 26)                                 | 5,687,236            | 4,698,650            |
|   | <u>95,199,170</u>    | <u>101,615,310</u>   |
| Non-controlling interest (Note 10)                                    | 2,507,156            | -                    |
| Commitments and contingencies (Notes 23 and 28)                       |                      |                      |
| <b>Shareholders' equity</b>   |                      |                      |
| Share capital (Note 18)   | 131,078,574          | 102,334,997          |
| Treasury shares, at cost  | (122,193)            | (122,193)            |
| Warrants (Notes 18 and 20)  | 26,874,201           | 13,209,412           |
| Contributed surplus (Note 18)   | 17,367,137           | 16,219,808           |
| Equity component of convertible senior secured notes (Note 17)        | 42,817               | 495,121              |
| Accumulated comprehensive loss  | (6,733,242)          | (6,733,242)          |
| Deficit   | (150,694,344)        | (146,757,018)        |
|   | <u>17,812,950</u>    | <u>(21,353,115)</u>  |
|   | <u>\$115,519,276</u> | <u>\$ 80,262,195</u> |

On behalf of the Board:

"Richard Fifer" - Director

"David Kaplan" - Director

The accompanying notes are an integral part of these consolidated financial statements.

**PETAQUILLA MINERALS LTD.****CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS**

(in United States dollars)

|   | <b>Year ended<br/>May 31, 2011</b> | <b>Year ended<br/>May 31, 2010</b> | <b>Year ended<br/>May 31, 2009</b> |
|---|------------------------------------|------------------------------------|------------------------------------|
| <b>GOLD SALES</b>   | \$71,708,685                       | \$27,542,363                       | \$ -                               |
| <b>COST OF SALES</b>  | (39,157,086)                       | (16,237,588)                       | -                                  |
| <b>AMORTIZATION AND DEPLETION</b>   | (11,335,717)                       | (4,839,420)                        | -                                  |
| <b>Operating profit</b>   | 21,215,882                         | 6,465,355                          | -                                  |
| <b>EXPENSES</b>   |                                    |                                    |                                    |
| Accounting and legal  | 1,655,679                          | 1,775,357                          | 1,944,302                          |
| Accretion of asset retirement obligation (Note 26)                                    | 359,448                            | 325,287                            | 331,504                            |
| Consulting fees   | 983,667                            | 663,796                            | 370,248                            |
| Filing fees   | 33,821                             | 64,303                             | 115,295                            |
| Investor relations and shareholder information  | 843,313                            | 502,690                            | 475,092                            |
| Office administration   | 2,421,243                          | 1,609,746                          | 2,187,020                          |
| Rent  | 118,010                            | 119,920                            | 240,693                            |
| Donations and community relations   | 1,411,440                          | 1,240,479                          | 949,271                            |
| Exploration and development costs (Note 6)  | 9,269,306                          | 4,304,303                          | 7,761,862                          |
| Stock-based compensation (Note 19)  | 971,208                            | 1,351,106                          | 898,454                            |
| Travel  | 657,616                            | 906,989                            | 1,014,530                          |
| Fees on forward sale agreement (Note 27)  | 2,473,358                          | -                                  | -                                  |
| Debt issuance costs   | -                                  | 613,244                            | 6,398,825                          |
| Wages and benefits (Note 21)  | 3,357,862                          | 3,428,470                          | 2,916,615                          |
| Total expenses  | (24,555,971)                       | (16,905,690)                       | (25,603,711)                       |
| <b>OTHER INCOME (EXPENSE)</b>   |                                    |                                    |                                    |
| Foreign exchange loss   | (72,928)                           | (93,159)                           | (8,157,720)                        |
| Interest income   | 118,835                            | 52,394                             | 169,366                            |
| Interest on long-term debt  | (305,003)                          | (501,574)                          | (37,382)                           |
| Asset usage fees  | -                                  | -                                  | (4,155)                            |
| Gain on sale of equity investment (Note 7)  | -                                  | -                                  | 40,604,938                         |
| Power and drilling services (Note 14)   | -                                  | 90,000                             | 156,597                            |
| Gain on expiry of deferred services contract (Note 14)                                | 3,153,394                          | -                                  | -                                  |
| Gain on disposal and dilution (Notes 7 and 10)  | 5,243,309                          | -                                  | 2,238,492                          |
| Loss from equity investment (Notes 7 and 10)  | (204,499)                          | -                                  | (2,396,011)                        |
| Mark-to-market loss on senior secured notes and convertible senior secured notes      | (6,023,189)                        | (16,089,408)                       | (28,070,280)                       |
| Total other income (expense)  | 1,909,919                          | (16,541,747)                       | 4,503,845                          |
| <b>Loss before non-controlling interests</b>  | (1,430,170)                        | (26,982,082)                       | (21,099,866)                       |
| Non-controlling interests (Note 10)   | (2,507,156)                        | -                                  | -                                  |
| <b>Net loss for the year</b>  | (3,937,326)                        | (26,982,082)                       | (21,099,866)                       |
| <b>Other comprehensive (loss) gain:</b>   |                                    |                                    |                                    |
| Unrealized loss on translating financial statements to U.S. dollar reporting currency | -                                  | -                                  | (4,648,716)                        |
| <b>Net loss and comprehensive loss for the year</b>                                   | \$(3,937,326)                      | \$(26,982,082)                     | \$(25,748,582)                     |
| <b>Basic and diluted loss per share</b>   | \$(0.03)                           | \$(0.25)                           | \$(0.22)                           |
| <b>Weighted average number of common shares outstanding</b>                           | 146,404,334                        | 107,740,441                        | 96,019,488                         |

The accompanying notes are an integral part of these consolidated financial statements.

**PETAQUILLA MINERALS LTD.**  
**CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY**  
(in United States dollars)

|   | Number<br>of Common<br>Shares | Amount of<br>Common Shares | Treasury Shares<br>(1) | Warrants     | Contributed<br>Surplus | Accumulated<br>Other<br>Comprehensive<br>Loss | Accumulated<br>Deficit |
|---|-------------------------------|----------------------------|------------------------|--------------|------------------------|---|------------------------|
| Balance as at May 31, 2008  | 95,958,641                    | \$89,002,273               | \$(122,193)            | \$11,771,374 | \$14,714,276           | \$(2,084,526)                                 | \$(98,675,070)         |
| Exercise of stock options   | 81,480                        | 206,395                    | -                      | -            | (168,732)              | -   | -                      |
| Stock-based compensation  | -                             | -                          | -                      | -            | 869,890                | -   | -                      |
| Senior secured notes finders warrants   | -                             | -                          | -                      | 215,230      | -                      | -   | -                      |
| Senior secured notes warrants   | -                             | -                          | -                      | 706,802      | -                      | -   | -                      |
| Expiration of warrants  | -                             | -                          | -                      | (263,263)    | 263,263                | -   | -                      |
| Warrant issue costs   | -                             | -                          | -                      | (102,546)    | -                      | -   | -                      |
| Repricing of senior secured note warrants   | -                             | -                          | -                      | 1,781,500    | (1,781,500)            | -   | -                      |
| Net loss  | -                             | -                          | -                      | -            | -                      | -   | (21,099,866)           |
| Exchange difference from translation of financial statements to US reporting currency | -                             | -                          | -                      | -            | -                      | (4,648,716)                                   | -                      |
| Balance as at May 31, 2009  | 96,040,121                    | \$89,208,668               | \$(122,193)            | \$14,109,097 | \$13,897,197           | \$(6,733,242)                                 | \$(119,774,936)        |
| Non-brokered private placements, net of finders' fees                                 | 28,000,080                    | 12,226,321                 | -                      | 319,736      | -                      | -   | -                      |
| Exercise of stock options   | 768,750                       | 542,201                    | -                      | -            | (187,487)              | -   | -                      |
| Stock-based compensation  | -                             | -                          | -                      | -            | 1,351,106              | -   | -                      |
| Expiration of warrants  | -                             | -                          | -                      | (1,158,992)  | 1,158,992              | -   | -                      |
| Exercise of warrants  | 473,000                       | 357,807                    | -                      | (60,429)     | -                      | -   | -                      |
| Net loss  | -                             | -                          | -                      | -            | -                      | -   | (26,982,082)           |
| Balance as at May 31, 2010  | 125,281,951                   | \$102,334,997              | \$(122,193)            | \$13,209,412 | \$16,219,808           | \$(6,733,242)                                 | \$(146,757,018)        |
| Non-brokered private placement, net of finders' fees                                  | 32,000,000                    | 31,633,563                 | -                      | (1,715,805)  | -                      | -   | -                      |
| Private placement warrants issued   | -                             | (19,360,365)               | -                      | 19,360,365   | -                      | -   | -                      |
| Exercise of warrants  | 18,553,800                    | 11,988,810                 | -                      | (3,979,771)  | -                      | -   | -                      |
| Costs of warrants exercised   | -                             | 3,979,771                  | -                      | -            | -                      | -   | -                      |
| Exercise of stock options   | 593,750                       | 501,798                    | -                      | -            | (276,184)              | -   | -                      |
| Stock-based compensation  | -                             | -                          | -                      | -            | 971,208                | -   | -                      |
| Equity component of convertible senior secured notes                                  | -                             | -                          | -                      | -            | 452,305                | -   | -                      |
| Net loss  | -                             | -                          | -                      | -            | -                      | -   | \$(3,937,326)          |
| Balance as at May 31, 2011  | 176,429,501                   | \$131,078,574              | \$(122,193)            | \$26,874,201 | \$17,367,137           | \$(6,733,242)                                 | \$(150,694,344)        |

(1) 44,200 common shares (Note 29)

The accompanying notes are an integral part of these consolidated financial statements.

**PETAQUILLA MINERALS LTD.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(in United States dollars)

|  | Year ended<br>May 31, 2011 | Year ended<br>May 31, 2010 | Year ended<br>May 31, 2009 |
|--|----------------------------|----------------------------|----------------------------|
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>                                      |                            |                            |                            |
| Loss for the year  | \$(3,937,326)              | \$(26,982,082)             | \$(21,099,866)             |
| Accretion of asset retirement obligation   | 359,448                    | 325,287                    | 331,504                    |
| Gain on disposal and dilution  | (5,243,309)                | -                          | (2,238,492)                |
| Non cash non-controlling interest  | 2,507,156                  | -                          | -                          |
| Gain on sale of equity investment  | -                          | -                          | (40,604,938)               |
| Loss from equity investment  | 204,499                    | -                          | 2,396,011                  |
| Amortization and depletion   | 11,335,717                 | 4,839,420                  | -                          |
| Amortization included in administration expense                                  | 345,889                    | 361,198                    | 336,602                    |
| Stock-based compensation   | 971,208                    | 1,351,106                  | 898,454                    |
| Stock-based compensation included in exploration and development expenses        | -                          | -                          | (28,564)                   |
| Amortization included in exploration and development expenses                    | -                          | -                          | 4,033,720                  |
| Non-cash gain on expiry of deferred services contract                            | (3,153,394)                | -                          | -                          |
| Debt issuance costs  | -                          | 613,244                    | 6,398,825                  |
| Redemption loss on senior secured notes  | 7,448,537                  | 240,000                    | 13,130,982                 |
| Mark-to-market loss on senior secured notes and convertible senior secured notes | (1,425,348)                | 15,849,408                 | 14,939,298                 |
| Interest paid on senior secured notes and convertible senior secured notes       | (7,451,584)                | (2,526,291)                | -                          |
| Unrealized foreign exchange losses   | -                          | -                          | 8,651,025                  |
| Changes in non-cash working capital items:                                       |                            |                            |                            |
| (Increase) Decrease in receivables   | (343,998)                  | 27,899                     | 306,660                    |
| (Increase) in prepaid expenses   | (448,825)                  | (98,305)                   | (281,592)                  |
| (Increase) in other assets   | (1,580,451)                | -                          | -                          |
| (Increase) in inventory  | (8,827,361)                | (3,274,719)                | (1,038,999)                |
| (Decrease) in Deferred services and materials                                    | -                          | (90,000)                   | (156,597)                  |
| Increase (Decrease) in accounts payable and accrued liabilities                  | 10,730,203                 | 9,864,681                  | (1,984,118)                |
| Increase in deferred revenue   | 42,636,909                 | -                          | -                          |
| Net cash provided by (used in) operating activities                              | 44,127,970                 | 500,846                    | (16,010,085)               |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>                                      |                            |                            |                            |
| Net proceeds from exercise of warrants and options                               | 12,214,428                 | 652,092                    | 37,662                     |
| Proceeds from issue of shares  | 31,976,036                 | 13,216,313                 | -                          |
| Share issuance costs   | (2,054,030)                | (670,256)                  | -                          |
| Repayment of bank overdraft  | -                          | -                          | (2,100,000)                |
| Payment of capital lease obligations   | (4,105,717)                | (4,869,894)                | (2,824,140)                |
| Debt issuance costs  | -                          | (613,244)                  | (6,286,138)                |
| Repayment of long-term debt  | (74,987)                   | (160,993)                  | (436,230)                  |
| Proceeds of long term debt   | 2,235,520                  | -                          | -                          |
| Proceeds from senior secured notes   | -                          | -                          | 40,587,500                 |
| Proceeds from convertible senior secured notes                                   | -                          | -                          | 34,000,000                 |
| Repayment of senior secured notes and convertible senior secured notes           | (62,961,696)               | (1,200,000)                | (64,238,852)               |
| Proceeds from bridge financing   | -                          | 4,788,826                  | -                          |
| Repayment of bridge financing  | -                          | (4,788,826)                | -                          |

|   |              |           |             |
|---|--------------|-----------|-------------|
| Net cash (used in) provided by financing activities | (22,770,446) | 6,354,018 | (1,260,198) |
|---|--------------|-----------|-------------|

**CASH FLOWS FROM INVESTING ACTIVITIES**

|   |              |              |              |
|---|--------------|--------------|--------------|
| Decrease in restricted cash   | 311,617      | 140,772      | -            |
| (Increase) in short term investments                                | (200,000)    | -            | -            |
| (Increase) in long term investments                                 | (2,400,000)  | -            | -            |
| Acquisition of property and equipment                               | (1,774,349)  | (1,138,477)  | (1,631,883)  |
| Pre-production revenue credited to mineral properties               | -            | 22,779,059   | 653,941      |
| Pre-production cost of sales included in mineral properties         | -            | (24,275,977) | (1,260,127)  |
| Deposit on equipment  | -            | -            | (1,762,945)  |
| Advances to suppliers   | (2,693,356)  | -            | -            |
| Investment in mineral properties                                    | (13,514,811) | (3,310,056)  | (31,073,461) |
| Proceeds from sale of equity investment                             | -            | -            | 43,238,852   |
| Net cash (used in) provided by investing activities                 | (20,270,899) | (5,804,679)  | 8,164,377    |
| <b>Impact of exchange rate changes on cash and cash equivalents</b> | 518          | 296          | (169,063)    |
| <b>Change in cash and cash equivalents</b>                          | 1,087,143    | 1,050,481    | (9,274,969)  |
| <b>Cash and cash equivalents, beginning of year</b>                 | 4,625,649    | 3,575,168    | 12,850,137   |
| <b>Cash and cash equivalents, end of year</b>                       | \$5,712,792  | \$4,625,649  | \$3,575,168  |

Supplemental disclosure with respect to cash flows (Note 25)

The accompanying notes are an integral part of these consolidated financial statements.

## **1. NATURE OF OPERATIONS**

Petaquilla Minerals Ltd. (“the Company” or “Petaquilla”) was incorporated in the Province of British Columbia.

The Company is engaged in the mining and mineral exploration of gold-bearing mineral properties in Panama and operates under the rules and regulations of Ley Petaquilla No. 9 of February 26, 1997 which is a contractual arrangement between the Company and the Government of Panama. In accordance with Ley Petaquilla, the Ministry of Commerce and Industry of the Government of Panama issued a letter to the Company dated November 18, 2009, authorizing Petaquilla’s subsidiary, Petaquilla Gold, S.A., to initiate commercial production at its Molejon gold mine. Commercial production was subsequently achieved on January 8, 2010. The Company is also pursuing exploration activities centered on its 842 square kilometres of concessions in the Province of Colon, Panama.

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles on a going concern basis which assumes that the Company will be able to realize its assets and discharge its liabilities in the normal course of business for the foreseeable future. The Board of Directors of the Company believes that the operational results obtained during the first complete fiscal year of commercial production created the basis that will support the sustainability of the Company’s business.

The operating cash flow and profitability of the Company are affected by various factors including the amount of gold produced and sold, the market price of gold, operating costs, interest rates, environmental costs, and the level of exploration activity, labour risk, risk of business disruption due to environmentalist activities, and political risk. The Company seeks to manage the risks associated with its business; however, many of the factors affecting these risks are beyond the Company’s control.

## **2. SIGNIFICANT ACCOUNTING POLICIES AND BASIS OF PRESENTATION**

These consolidated financial statements and accompanying notes have been prepared in conformity with Canadian Generally Accepted Accounting Principles (“GAAP”). For a description of the differences between Canadian GAAP and United States GAAP for the Company, see note 30.

These consolidated financial statements include the accounts of the Company, its wholly-owned subsidiaries Adrian Resources (BVI) Ltd. (a British Virgin Island corporation), Petaquilla Minerals, S.A. (a Panama corporation), Instituto Petaquilla, S.A. (a Panama corporation), Petaquilla Gold, S.A. (a Panama corporation), Brigadas Verdes, S.A. (a Panama corporation), Aqua Azure, S.A. (a Panama corporation), Petaquilla Infraestructura Ltd. (a British Virgin Island corporation), Panama Desarrollo De Infraestructuras, S.A. (formerly Petaquilla Hidro, S.A.) (a Panama corporation), Panama Central Electrica, S.A. (a Panama corporation), Panamanian Development and Infrastructure Ltd. (a British Columbia corporation) and a 50.2% interest in Petaquilla Infraestructura, S.A. (a Panama corporation). The Company proportionately consolidates its 69% interest in a joint venture investment, Compania Minera Belencillo, S.A. (“Belencillo”) (a Panama corporation).

Variable interest entities (“VIEs”), which include, but are not limited to, special purpose entities, trusts, partnerships, and other legal structures, as defined by the Accounting Standards Board in Accounting Guideline (“AcG”) 15, Consolidation of Variable Interest Entities (“AcG 15”) are entities in which equity investors do not have the characteristics of a “controlling financial interest” or there is not sufficient equity at risk for the entity to finance its activities without additional subordinated financial support. VIEs are subject to consolidation by the primary beneficiary who will absorb the majority of the entities’ expected losses and/or expected residual returns. The Company has determined that it is the primary beneficiary of its 49% owned subsidiary Azuero Mining Development, S.A. (“Azuero”) (a Panama corporation) and this VIE is consolidated with the accounts of the Company in these consolidated financial statements.

**2. SIGNIFICANT ACCOUNTING POLICIES AND BASIS OF PRESENTATION (continued)**

All inter-company transactions and balances have been eliminated upon consolidation.

**Use of estimates**

The preparation of consolidated financial statements in accordance with Canadian GAAP requires management to make estimates and assumptions that affect the reported amount of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the amount of revenues and expenses reported during the year. Actual results could differ from these estimates.

Significant estimates used in the preparation of the consolidated financial statements include, but are not limited to, the estimated recoverable tones of ore from the mine and the estimated tones of waste material to be mined, the expected economic life of the mine, the estimated future operating results and net cash flows from the mine, the anticipated costs of reclamation and mine closure obligations, the useful life of property, plant and equipment, the amount and likelihood of contingencies, the discount rate and expected redemption date used for valuation of senior secured and convertible senior secured notes, the valuation allowance for future income tax assets and the accounting for stock-based compensation and warrants.

**Cash and cash equivalents**

Cash and cash equivalents are classified as held for trading and include short-term, highly liquid investments with original maturities of three months or less that are readily convertible to known amounts of cash and which are subject to an insignificant risk of change in value. The Company places its deposits with financial institutions with high credit standings. The Company regularly maintains cash balances in financial institutions in excess of insured limits.

**Inventories and stockpiled ore**

Finished goods, work-in-process, and stockpiled ore are valued at the lower of average production cost and net realizable value. Production costs include the cost of raw materials, direct labor, mine-site overhead expenses, royalties and amortization and depletion of mining assets. Supplies are valued at the lower of average cost or replacement cost.

**Property, plant and equipment**

Equipment is recorded at cost less accumulated amortization, which is provided on the declining balance basis at rates as follows:

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|                               |     |
|-------------------------------|-----|
| Furniture and fixtures        | 20% |
| Computer equipment            | 30% |
| Equipment under capital lease | 30% |
| Equipment                     | 30% |
| Vehicles                      | 30% |
| Computer software             | 50% |
| Buildings                     | 4%  |

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**2. SIGNIFICANT ACCOUNTING POLICIES AND BASIS OF PRESENTATION (continued)**

Plant (including tailings ponds) is depleted on a unit-of-production basis over the estimated economic life of the mine to which it relates.

**Mineral properties**

Exploration and development costs are expensed in the year in which they are incurred, except where these costs relate to specific properties for which resources, as defined under National Instrument 43-101, exist and it is expected that the expenditure can be recovered by future exploitation or sale, in which case they are capitalized. Acquisition costs of mineral properties and tangible development costs incurred there on are deferred until the property to which they relate is placed into production, sold or abandoned. The carrying values of mineral properties are, where necessary, written down to fair value if carrying value is not recoverable. Costs relating to properties abandoned are written off when the decision to abandon is made.

Prior to the attainment of commercial production, all revenues from metal sales and all production and selling costs related to those sales were capitalized as part of mineral properties. After the start of commercial production, all revenue and applicable costs are recorded in the consolidated statement of operations. The start of commercial production is defined as the point in time when 70% of the designed production capability is achieved and this is maintained for thirty consecutive days. The Company achieved these conditions on January 8, 2010.

The Company follows the cost reduction method of accounting for the receipt of property option and similar payments. Cash and other property payments received from the Company's exploration partners are credited to the respective property until all capitalized costs are recovered; thereafter, such payments are included in income. Option payments are exercisable at the discretion of the optionee and are only recognized when received.

The Company has capitalized operational expenses incurred at Molejon Project regarding to pre-stripping activities. These operational expenses are capitalized as pre-stripping within Mineral Properties and they are amortized based on the reserves of gold contained in the ore body for which the pre-stripping activity is being performed, once the ore body is ready for development and mine. As of May 31, 2011, \$6,370,240 has been capitalized within Mineral Properties. During the last quarter of year ended May 31, 2011 pre-stripping costs incurred during stages 1 thru 3 of a total of five stages have been started to depreciated. Net residual value of pre-stripping costs as of May 31, 2011 is in amount of \$5,699,087.

**Restricted cash**

The Company has elected to classify restricted cash as held for trading.

**Receivables**

Receivables are classified as loans and receivables and are measured at amortized costs. Receivables consist of refundable government value added taxes, amounts receivable from Deutsche Bank, AG and travel advances.

**2. SIGNIFICANT ACCOUNTING POLICIES AND BASIS OF PRESENTATION (continued)**

**Asset retirement obligation**

An asset retirement obligation is a legal obligation associated with the retirement of tangible long-lived assets that the Company is required to settle. The Company recognizes the fair value of a liability for an asset retirement obligation in the period in which it is incurred when a reasonable estimate of fair value can be made. The carrying amount of the related long-lived asset is increased by the same amount as the liability. Subsequently, these capitalized asset retirement costs is amortized to expense over the life of the related assets using the unit-of-production method. At the end of each period, the liability is increased to reflect the passage of time (accretion expense) and adjusted for changes in the estimated future cash flows underlying any initial fair value measurements (an increase or decrease in asset retirement costs).

**Impairment of long-lived assets**

A long-lived asset which includes property and related costs and equipment is tested for recoverability whenever events or changes in circumstances indicate that its carrying amount may not be recoverable. An impairment loss is recognized when the carrying amount of a long-lived asset exceeds its fair value. For purposes of recognition and measurement of an impairment loss, a long-lived asset is grouped with other assets and liabilities to form an asset group, at the lowest level for which identifiable cash flows are largely independent of the cash flows of other assets and liabilities. Estimates of future cash flows used to test recoverability of a long-lived asset include only the future cash flows that are directly associated with, and that are expected to arise as a direct result of its use and eventual disposition.

**Foreign currency translation**

It has been determined the United States dollar is the reporting and measurement currency of the Company's operations and therefore these operations have been translated using the temporal method. Under this method, foreign currency monetary assets and liabilities are translated into United States dollars at the exchange rates prevailing at the balance sheet date; non-monetary assets denominated in foreign currencies are translated using the rate of exchange at the transaction date; and foreign exchange gains and losses are included in the determination of earnings.

**Revenue recognition**

Revenue from the sale of metals is recognized in the accounts when persuasive evidence of an arrangement exists, title and risk passes to the buyer, collection is reasonably assured and the price is reasonably determinable. During the pre-operating period, revenues and related expenses are recognized as a reduction / increase to mineral properties.

**Debt issuance costs**

Debt issuance costs, which include legal fees, trustee fees, due diligence fees, finders' fees, and finders' warrants, are expensed in the year that they are incurred.

**Capitalized interest**

Interest cost is considered an element of the historical cost of an asset when a period of time is necessary to prepare it for its intended use. The Company capitalized interest costs in fiscal 2010 up until the time the Molejon mine achieved commercial production.

**2. SIGNIFICANT ACCOUNTING POLICIES AND BASIS OF PRESENTATION (continued)**

**Loss per share**

The Company uses the treasury stock method to compute the dilutive effect of options, warrants and similar instruments. Under this method, the dilutive effect on loss per share is recognized as a result of the use of the proceeds that could be obtained upon exercise of options, warrants and similar instruments. It assumes that the proceeds would be used to purchase common shares at the average market price during the period. For all periods presented, all outstanding options and warrants were anti-dilutive since the proceeds to be received would be below the market value of the Company's shares, and the Company incurred a net loss for all periods presented.

**Stock-based compensation**

The Company accounts for all stock-based payments and awards using the fair value-based method. Under the fair value-based method, stock-based payments to non-employees are measured at the fair value of the goods or services received, or the fair value of the equity instruments issued, whichever is more reliably measurable. The fair value of stock-based payments to non-employees is periodically re-measured until counterparty performance is complete, and any change therein is recognized over the vesting period of the award and in the same manner as if the Company had paid cash instead of paying with or using equity instruments. The cost of stock-based payments to non-employees that are fully vested and non-forfeitable at the grant date is measured and recognized at that date. Compensation cost attributable to awards to employees is measured at fair value at the grant date and recognized over the vesting period.

**Income taxes**

Future income taxes are recorded using the liability method under which future tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Future tax assets and liabilities are measured using the enacted or substantively enacted tax rates expected to apply when the asset is realized or the liability settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income or loss in the period that substantive enactment or enactment occurs. To the extent that the Company does not consider it more likely than not that a future tax asset will be recovered, it provides a valuation allowance against the excess.

**Accounting Policies to be Implemented Effective June 1, 2011**

The Accounting Standards Board (AcSB) adopted International Financial Reporting Standards (IFRS) as Canadian GAAP for publicly accountable enterprises for fiscal years beginning on or after January 1, 2011. The Company will report its first consolidated financial statements in accordance with IFRS for the three months ending August 31, 2011, with comparative figures for the corresponding period for 2010. In addition, the adoption will require the restatement, for comparative purposes, of amounts reported by the Company for its year ended May 31, 2011, and restatement of the opening balance sheet as at June 1, 2010.

**3. INVENTORY AND STOCKPILED ORE**

|  | May 31, 2011        | May 31, 2010       |
|--|---------------------|--------------------|
| Supplies   | \$3,170,929         | \$1,505,310        |
| Ore stockpiles   | 8,498,801           | 1,398,074          |
| Work in process  | 356,066             | 404,870            |
| Finished goods   | 1,815,930           | 1,433,777          |
|  | 13,841,726          | 4,742,031          |
| Less: Ore stockpiles which will not be consumed for more than one year | (2,228,405)         | (1,107,316)        |
|  | <u>\$11,613,321</u> | <u>\$3,634,715</u> |

The cost of inventory sold in the period reflects all components capitalized to inventory, except that, for presentation purposes, the component of inventory cost relating to amortization of property, plant and equipment, and depletion of mineral properties are classified in the Consolidated Statements of Operations and Comprehensive Loss under "amortization and depletion".

**4. PROPERTY, PLANT AND EQUIPMENT**

|                                | May 31,<br>2011     |                             |                     | May 31,<br>2010     |                             |                    |
|--------------------------------|---------------------|-----------------------------|---------------------|---------------------|-----------------------------|--------------------|
|                                | Cost                | Accumulated<br>Amortization | Net<br>Book Value   | Cost                | Accumulated<br>Amortization | Net<br>Book Value  |
| Equipment under capital leases | \$15,656,567        | \$8,176,527                 | \$7,480,040         | \$10,808,073        | \$6,011,701                 | \$4,796,372        |
| Equipment                      | 11,785,283          | 6,887,421                   | 4,897,862           | 9,294,346           | 5,322,109                   | 3,972,237          |
| Buildings                      | 472,529             | 57,175                      | 415,354             | 472,530             | 39,160                      | 433,370            |
| Vehicles                       | 438,994             | 207,296                     | 231,698             | 433,348             | 109,208                     | 324,140            |
| Computer equipment             | 349,358             | 176,752                     | 172,606             | 262,105             | 121,475                     | 140,630            |
| Computer software              | 216,632             | 192,085                     | 24,547              | 214,132             | 168,788                     | 45,344             |
| Land                           | 196,783             | -                           | 196,783             | 188,533             | -                           | 188,533            |
| Furniture and fixtures         | 110,142             | 23,711                      | 86,431              | 28,302              | 12,333                      | 15,969             |
| Spare parts                    | 1,208,197           | -                           | 1,208,197           | -                   | -                           | -                  |
|                                | <u>\$30,434,485</u> | <u>\$15,720,967</u>         | <u>\$14,713,518</u> | <u>\$21,701,369</u> | <u>\$11,784,774</u>         | <u>\$9,916,595</u> |

**5. MINERAL PROPERTIES**

As at May 31, 2011, the Company has capitalized \$78,292,958 net of revenue of \$27,908,659, in mineral property costs. A total of \$62,408,006, net of revenue of \$27,908,659 was capitalized in mineral property costs as at May 31, 2010.

|                                       | May 31, 2011         | May 31, 2010        |
|---------------------------------------|----------------------|---------------------|
| Plant                                 | \$50,297,224         | \$46,876,372        |
| Plant equipment                       | 2,973,133            | 2,973,133           |
| Camp                                  | 5,560,803            | 5,553,824           |
| Tailings ponds                        | 5,059,722            | 1,599,202           |
| Pre-stripping                         | 6,370,240            | -                   |
| Site improvements under construction  | 2,235,957            | 238,734             |
| Asset retirement obligation (Note 26) | 3,796,085            | 3,166,947           |
| Capitalized interest expense          | 1,999,794            | 1,999,794           |
| Depletion                             | (11,622,891)         | (3,619,733)         |
|                                       | <u>\$ 66,670,067</u> | <u>\$58,788,273</u> |

**5. MINERAL PROPERTIES (continued)**

*Molejon Property – Panama*

The Molejon Property is located in the District of Donoso, Province of Colon, Panama. The project forms part of the Petaquilla Concession. The Company, through Petaquilla Gold, S.A., owns a 100% interest in the Molejon gold deposit, as well as all other gold and precious metal mineral deposits that might be developed within the Petaquilla Concession, subject to a graduated 5% - 7% net smelter return, based on the gold price at the time of production. A phased Mine Development Plan was approved by Ministerial Resolution of the Government of Panama in September 2005. The Company proceeded with the development of the property and construction of the processing mill and commercial production was achieved on January 8, 2010.

**6. EXPLORATION AND DEVELOPMENT COSTS**

Exploration and development costs incurred to develop the Company's Molejon property and for exploration of the Oro del Norte property are detailed below

|                                     | Year ended May 31, 2011 | Year ended May 31, 2010 | Year ended May 31, 2009 |
|-------------------------------------|-------------------------|-------------------------|-------------------------|
| Temporary camp costs                | \$2,697,776             | \$1,182,676             | \$ -                    |
| Engineering and geologists          | 1,695,532               | 769,598                 | 1,180,721               |
| Trenching                           | 2,891,032               | 637,277                 | 78,024                  |
| Drilling costs                      | 375,439                 | 486,291                 | 1,603,544               |
| Environment                         | 167,978                 | 60,009                  | 162,859                 |
| Logistics                           | 374,904                 | 264,593                 | 153,229                 |
| Assaying                            | 618,098                 | 186,941                 | -                       |
| Transportation                      | 148,941                 | 161,666                 | -                       |
| Engineering and design              | -                       | 123,053                 | 145,285                 |
| Communications                      | 58,470                  | 96,372                  | 49,396                  |
| Administration                      | 134,698                 | 74,004                  | -                       |
| Topography                          | 106,438                 | 202,893                 | 7,599                   |
| Property permits                    | -                       | 20,111                  | -                       |
| Bridges and roads                   | -                       | 38,819                  | 376,049                 |
| Amortization on operating equipment | -                       | -                       | 4,033,720               |
| Stock-based compensation            | -                       | -                       | (28,564)                |
|                                     | <b>\$9,269,306</b>      | <b>\$4,304,303</b>      | <b>\$7,761,862</b>      |

**7. INVESTMENT IN PETAQUILLA COPPER LTD.**

The Company initially owned 22,233,634 of the issued shares of Petaquilla Copper Ltd. ("Copper") at a cost of \$439,367 (CAD\$ 500,000). Subsequent to the spin out of Copper, the Company accounted for Copper on an equity basis. Under the equity method, the Company recorded the percentage of net income (loss) that would be attributed to the investment by adjusting the carrying value of the investment. If the percentage of loss from the investee was greater than the carrying cost, the amount was not reduced below zero. Dilution gains arose whenever Copper issued equity at a price greater than the carrying value of the equity investment.

**7. INVESTMENT IN PETAQUILLA COPPER LTD. (continued)**

On September 19, 2008, the Company disposed of its 20,418,565 common shares of Copper to a wholly-owned subsidiary of Inmet Mining Corporation at a price of CAD\$ 2.20 per common share, for proceeds of \$43,238,852 (CAD\$ 44,920,843). The Company did not incur any transaction costs in disposing of the shares.

**8. SHORT TERM INVESTMENTS**

The Company has \$200,000 in term deposits with an expiration date of longer than 90 days but shorter than one year. The annual interest rate on these term deposits is 2.75%.

**9. RESTRICTED CASH**

The Company has \$255,091 in bank accounts and term deposits (May 31, 2010 - \$566,708) which is being held to guarantee credit cards, a union lien in Panama and a supplier lien. Annual interest rate on these deposits is 0.75%.

**10. INVESTMENT IN IBERIAN RESOURCES CORP.**

The Company announced on April 6, 2011 that it had entered into a binding letter of intent (“LOI”) with Iberian Resources Corp. (“Iberian”) pursuant to which the Company proposes to acquire all of the outstanding shares of Iberian (the “Proposed Transaction”). The Company and Iberian have certain directors, officers and shareholders in common and accordingly the Proposed Transaction is considered to be related party transaction. In connection with the Proposed Transaction the Company will issue 44,635,255 common shares of the Company as well as warrants to purchase 1,640,240 common shares at prices ranging from US\$0.14 to US\$0.60 and options to purchase 3,357,313 common shares at prices ranging from CAD\$0.10 to US\$0.60. The Company estimates transaction costs will be \$700,000 of which approximately \$318,000 had been incurred and included in prepaid expenses by May 31, 2011. The TSX provided its conditional listing approval for the acquisition on April 19, 2011. As the transaction will result in the issuance of more than 25% of the Company’s outstanding non-diluted securities, the Company’s shareholders are needed to approve the Proposed Transaction. The special meeting of the Company’s shareholders will be held in Vancouver, Canada on August 31, 2011.

Iberian is a private British Columbia company that owns 100% of the Lomero Poyatos mine through its wholly-owned Spanish affiliate; Corporacion de Recursos Iberia S.L. Lomero Poyatos is located about 85 kilometres northeast of Seville, in the northeast part of the Iberian Pyrite Belt. Iberian also owns several other exploration licenses in Iberia through its wholly-owned Spanish and Portuguese affiliates including Sulfuros Complejos Andalucia Mining S.L. (“SCA”) and Almada Mining S.A. (“Almada”).

There were some transactions which occurred during the Company’s fourth quarter of fiscal 2012 related to SCA and Almada, which were owned by Azuero as at February 28, 2011, which impacted the consolidated financial statements of the Company:

a) Azuero a 49% owned subsidiary of the Company that owns SCA and Almada via Vintage Mining Corp. (“Vintage Canada”). Azuero is consolidated in Petaquilla’s consolidated financial statements as a Variable Interest Entity (“VIE”). The remaining 51% of Azuero is owned by Fundacion CC (Panama) and Fundacion Celina (Panama) (together “51% ownership”) which are considered related parties to the Company. Island Investments Holdings Ltd. (“Island”) on March 15, 2011 subscribed for \$600,000 of common shares of Vintage Canada. This transaction resulted in a dilution gain of \$346,907.

**10. INVESTMENT IN IBERIAN RESOURCES CORP. (continued)**

b) On April 12, 2011, Iberian, pursuant to a share exchange agreement dated March 18, 2011, completed the purchase of all of the issued and outstanding shares of Vintage Canada. As consideration, Iberian issued 12,721,362 common shares to the former shareholders of Vintage Canada and 1,272,138 stock options to the former option holders of Vintage Canada exercisable into one common share at an exercise price of CAD\$0.10 per common share for a period expiring on February 28, 2016 of which Azuero received 8,523,312 shares of Iberian. Accordingly, Azuero deconsolidated Vintage Canada on April 12, 2011 and recorded its investment in Iberian of \$5,113,987 (included in "other assets" on the balance sheet) and a gain on disposal of Vintage Canada of \$4,793,737. The Company also recorded non-controlling interest of \$2,507,156 relating to the 51% ownership of Azuero.

At May 31, 2011, the Company's investment in Iberian is \$4,911,488. The Company considers Iberian an investment for which it can exert significant influence and accordingly, has an equity account for this investment. The equity loss incurred from the period of April 12, 2011 to May 31, 2011 was \$204,499.

**11. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES**

The following table summarizes the accounts payables and accrued liabilities as at May 31, 2011 and May 31, 2010:

|                         | May 31, 2011        | May 31, 2010        |
|-------------------------|---------------------|---------------------|
| Accounts payable        | \$24,571,129        | 15,078,122          |
| Accrued liabilities     | 876,720             | 310,126             |
| Royalties payable       | 6,484,013           | 1,949,972           |
| Miscellaneous           | 253,363             | 248,463             |
|                         | 32,185,225          | 17,586,683          |
| Less: long term portion | (1,866,667)         | -                   |
|                         | <u>\$30,318,558</u> | <u>\$17,586,683</u> |

**12. OPERATING CREDIT LINE FACILITY**

The Company has an operating credit line facility with Banco Bilbao Vizcaya Argentaria (Panama) S.A. ("BBVA") up to a maximum of \$13,379,554. The facility is converted to capital leases when the asset purchases are completed. The facility has a fixed rate of 9% on \$11,018,456 and 6% on \$2,361,098, is collateralized by the assets purchased and is registered with the Public Registry of the Republic of Panama. At May 31, 2011 there is a remaining credit line balance of \$332,511 available upon which the Company may draw.

**13. LONG-TERM DEBT**

During fiscal year 2010, the Company arranged a bank loan financing \$115,700 for the purchase of vehicles. The loan is collateralized by the purchased vehicles.

During the year ended May 31, 2011, the Company arranged a bank loan financing \$25,520 for the leasing of a vehicle.

During the year ended May 31, 2011, the Company arranged with Global Bank of Panama, a bank loan financing of \$2,210,000 for the payment of advances to suppliers of heavy equipments for its subsidiary Panama Desarrollo de Infraestructura, S.A. The loan is collateralized by a cash term deposit that earns interest at 5% per annum. The total amount approved for this facility is \$2.5 million.

**13. LONG-TERM DEBT (continued)**

The Company has \$2,400,000 in term deposits with an expiration date of longer than one year in order to secure this arrangement. The annual interest rates on these term deposits range from 4.88% to 5%.

The following table summarizes the loans outstanding as at May 31, 2011 and May 31, 2010:

|   | May 31, 2011       | May 31, 2010    |
|---|--------------------|-----------------|
| Vehicle loan, repayable at \$3,733 per month, including interest at 10%, due May 2013             | \$81,087           | \$115,700       |
| Vehicle loan, repayable at \$877 per month, including interest at 8.25%, due April 2014.          | 24,882             | -               |
| Bank loan, repayable at \$42,578 per month, including interest at 6%, due February and April 2016 | 2,170,264          | -               |
|   | <u>2,276,233</u>   | <u>115,700</u>  |
| Less: current portion   | <u>(435,733)</u>   | <u>(35,465)</u> |
|   | <u>\$1,840,500</u> | <u>\$80,235</u> |

**14. DEFERRED SERVICES AND MATERIALS PROVIDED TO IMN RESOURCES INC.**

On September 30, 2007, Petaquilla Gold S.A. (“Gold”), a subsidiary of the Company entered into a Service Agreement with Minera Panama S.A. (“MPSA”) (formerly Petaquilla Copper S.A.) to provide electric generation, aggregate for construction and the rental of a drill machine (collectively, the “services”) for a 3-year period. In return for receiving certain benefits and assurances, payment for services was assumed and prepaid by IMN Resources Inc. (“IMN”) (formerly Petaquilla Copper Ltd.), a wholly owned subsidiary of Inmet Mining Corporation, in the amount of \$4,404,000. Services provided to date include the rental of a drill and the generation of electricity.

During the year ended May 31, 2011, the Service Agreement between Gold and MPSA expired with no further obligations. As a result, the Company derecognized the liability and in doing so recognized a gain of \$3,153,394 during the year ended May 31, 2011.

**15. CAPITAL LEASE OBLIGATIONS**

The Company entered into four capital lease arrangements with Banco Bilbao Vizcaya Argentaria (Panama) S.A. (“BBVA”) for the purchase of equipment to advance the Molejon project into production during the thirteen months ended May 31, 2008. The equipment includes but is not limited to: ball mills, a Metso crushing plant, cranes and an aggregate crushing plant. As a condition of the leases, the equipment will serve as collateral throughout the amortization period and will be registered with the Public Registry of the Republic of Panama. Further, IMN has pledged a term deposit in the amount of \$2,361,098 (May 31, 2010 - \$2,361,098) as additional security.

During the year ended May 31, 2011 a Credit Line Facility with Global Bank from Panama, in amount of \$10 million, has been approved for the Company. This facility for the acquisition of heavy equipment by Panama Desarrollo de Infraestructuras, S.A. is a lease that accrues interest at 6.25% per annum. As a condition of the leases, the equipment will serve as collateral throughout the amortization period and will be registered with the Public Registry of the Republic of Panama. As at May 31, 2011, leases with a total value of \$4,848,492 had been established under this facility.

**15. CAPITAL LEASE OBLIGATIONS (continued)**

Future minimum lease payments on the capital lease obligations are as follows:

|                          | May 31, 2011 | May 31, 2010 |
|--------------------------|--------------|--------------|
| 2011                     | \$ -         | \$4,376,667  |
| 2012                     | 1,754,547    | 447,080      |
| 2013                     | 1,134,360    | -            |
| 2014                     | 1,134,360    | -            |
| 2015                     | 1,134,360    | -            |
| 2016                     | 945,004      | -            |
|                          | 6,102,631    | 4,823,747    |
| Less: imputed interest   | (783,595)    | (247,486)    |
|                          | 5,319,036    | 4,576,261    |
| Less: Current obligation | (1,468,561)  | (4,136,032)  |
| Long - term obligation   | \$3,850,475  | \$440,229    |

**16. SENIOR SECURED NOTES**

|   | May 31, 2011 | May 31, 2010 |
|---|--------------|--------------|
| Senior secured notes due to related parties | \$3,124,437  | \$20,672,235 |
| Senior secured notes due to third parties   | -            | 5,974,396    |
|   | 3,124,437    | 26,646,631   |
| Less estimated current portion              | (217,984)    | (26,646,631) |
|   | \$2,906,453  | \$ -         |

The Notes bear interest at an annual rate of 15%.

The Notes have a maturity date of five years from date of issuance with a 20% premium on principal to be paid at maturity. The Company has the right to redeem the Notes at any time at 120% of the principal amount plus any accrued or unpaid interest on the Notes.

The Company initially issued 60,000 Notes. Each Note was issued with 382 share purchase warrants. Each warrant entitled the holder to purchase one common share at CAD\$ 2.30 for a period of five years from the date of purchase. On April 17, 2009, the Company re-priced these warrants to entitle the holder to purchase one common share at CAD \$0.65 for the remainder of the warrant period with the provision that, if the closing trading price of the Company's common shares on the TSX is CAD\$ 1.00 or more for a period of 30 consecutive trading days, the Company has the option to require the earlier exercise of the warrants. The effect of re-pricing the warrants was an increase in the value of the warrants of \$1,781,500 and a decrease in contributed surplus for the same amount.

The Notes contain an embedded derivative as a result of the call and put options. The Company is unable to fair value the embedded derivative component separately and thus has classified the combined contract as a financial liability that is held for trading.

On September 30, 2008 the Company redeemed 36,032,376 Notes at 120% of their principal value for a total payment of \$43,238,852, resulting in a loss of \$10,983,735.

On October 1, 2008, the Company issued an additional 20,000 Notes under the \$60 million senior secured notes indenture for net proceeds of \$15,874,958. These Notes contain the same terms and conditions as the previous issue under the indenture with the exception of the 382 share purchase warrants. These Notes did not include any warrants.

**16. SENIOR SECURED NOTES (continued)**

On March 25, 2009, the Company redeemed 17,500 Notes at 120% of their principal value for a total payment of \$21,000,000, resulting in a loss of \$2,147,247.

On September 15, 2009 the Company redeemed 5,000 Notes at 120% of their principal value plus interest for a total payment of \$6,208,844. This payment was financed in part by a \$5,129,600 prepayment on forward gold sales of 5,600 ounces at a net price of \$916 per ounce.

There were two additional scheduled repayments of principal, premium and interest totalling \$9,443,405 that were due in March 2010 and May 2010. Of the amounts due, the Company paid out \$857,594. Under the terms of the Indenture an event of default occurred and the Notes became due on demand at the option of the Note holders or the Trustee.

On September 23, 2010, the Company paid \$13,952,574 in principal, premium and interest on the Notes from the proceeds of a Forward Gold Purchase Agreement, entered with Deutsche Bank as is described in note 27. As part of the Forward Gold Purchase Agreement, the Note holders were required to enter into an inter-creditor agreement with the Company which prevents the Note holders from taking action as a result of the event of default that occurred, until the Company's obligations under the Forward Gold Purchase Agreement have been satisfied. The impact of the Inter-Creditor Agreement on the Notes is as follows:

- a) The security for the Notes became subordinated to the security granted under the Forward Gold Purchase Agreement with Deutsche Bank;
- b) No interest or principal payments are required on the Notes until March 22, 2011. After March 22, 2011, the Company is only required to make scheduled interest payments on the Notes as they become due until the Notes mature five years and one day after closing of the Forward Gold Purchase Agreement with Deutsche Bank;
- c) Until the Company's obligations under the Forward Gold Purchase Agreement with Deutsche Bank are satisfied, the holder of the Notes are not permitted to take any action as a result of an event of default that has occurred pursuant to the indenture;
- d) If the Company is able to negotiate new financing arrangements satisfying certain conditions, the proceeds of such financing will be used to prepay the outstanding balance of principal, premium and interest on the Notes.

On February 8, 2011, the Company redeemed 12,008 Notes at 120% of their principal value plus interest for a total payment of \$12,008,345. This payment was financed by the private placement that closed on January 31, 2011, as is explained in note 18.

At May 31, 2011 the Notes have been adjusted to their fair market value of \$3,124,437 using a discount rate of 10.18%.

The Notes are guaranteed, on a joint and several basis, by all of the assets of the Company and of the Company's subsidiaries. The security for the Notes is subordinated to the security granted under the Forward Gold Purchase Agreement with Deutsche Bank.

**17. CONVERTIBLE SENIOR SECURED NOTES**

|  | May 31, 2011       | May 31, 2010        |
|--|--------------------|---------------------|
| Convertible notes due to related parties | \$3,970,094        | \$44,397,509        |
| Convertible notes due to third parties   | -                  | 440,482             |
|  | <u>3,970,094</u>   | <u>44,837,991</u>   |
| Less estimated current portion           | <u>(276,983)</u>   | <u>(44,837,991)</u> |
|  | <u>\$3,693,111</u> | <u>\$ -</u>         |

On March 25, 2009 the Company closed \$40,000,000 of a convertible senior secured note (“Convertible Notes”) financing. The Convertible Notes bear interest at an annual rate of 15%, of which the first year is prepaid. The Convertible Notes had an original maturity after two years from the date of issuance at 110% of the principal. The Company has the right to redeem the Convertible Notes at any time at 110% of the principal amount plus any accrued or unpaid interest. Each Convertible Note in the principal amount of \$1,000 is convertible into common shares at CAD\$ 2.25 per share.

The Convertible Notes contained an embedded derivate as a result of the call option. The Company is unable to fair value the embedded derivative component separately and thus has classified the combined contract as a financial liability that is held for trading.

Interest of \$829,545 on the Convertible Notes was due on May 15, 2010. Of this amount the Company paid \$342,406. Under the terms of the Indenture an event of default occurred and the Convertible Notes became due on demand at the option of the Convertible Note holders or the Trustee.

On September 23, 2010, the Company paid \$25,997,426 in principal, premium and interest on the Convertible Notes from the proceeds of a Forward Gold Purchase Agreement entered with Deutsche Bank as is described in note 27. As part of the Forward Gold Purchase Agreement, the Convertible Note holders were required to enter into an inter-creditor agreement with the Company which prevents the Convertible Note holders from taking action as a result of the event of default that occurred, until the Company’s obligations under the Forward Gold Purchase Agreement have been satisfied. The Inter-Creditor Agreement on the Convertible Notes is as follows:

- a) The security for the Convertible Notes became subordinated to the security granted under the Forward Gold Purchase Agreement with Deutsche Bank;
- b) No interest or principal payments are required on the Convertible Notes until March 22, 2011. After March 22, 2011, the Company is only required to make scheduled interest payments on the Convertible Notes as they become due until the Convertible Notes mature five years and one day after closing of the Forward Gold Purchase Agreement with Deutsche Bank;
- c) Until the Company’s obligations under the Forward Gold Purchase Agreement with Deutsche Bank are satisfied, the holder of the Convertible Notes are not permitted to take any action as a result of an event of default that has occurred pursuant to the indenture;
- d) If the Company is able to negotiate new financing arrangements satisfying certain conditions, the proceeds of such financing will be used to prepay the outstanding balance of principal, premium and interest on the Convertible Notes.

On February 8, 2011, the Company redeemed 18,347 Notes at 110% of their principal value plus interest for a total payment of \$18,347,276. The total amount of interest paid was \$1,212,746. This payment was financed by the private placement that closed on January 31, 2011, as is explained in note 18.

**17. CONVERTIBLE SENIOR SECURED NOTES (continued)**

At May 31, 2011, the Convertible Notes were adjusted to their fair market value of \$3,970,094 using a 10.18% discount rate.

The Convertible Notes are guaranteed, on a joint and several basis, by all of the assets of the Company and of the Company's subsidiaries. The security for the Convertible Notes is subordinated to the security granted under the Forward Gold Purchase Agreement with Deutsche Bank.

**18. SHARE CAPITAL, WARRANTS AND CONTRIBUTED SURPLUS**

At May 31, 2011, the Company had unlimited authorized common shares without par value and unlimited authorized preferred shares without par value. The Board of Directors will assign the rights and privileges to each series of preference shares upon issue.

In December 2009, the Company closed a non-brokered private placement of 24,000,000 common shares at a price of CAD \$0.50 per share, raising gross proceeds of \$11,328,236. In connection with the closing of the private placement, the Company has paid finders' fees in the amount of \$566,412.

In May 2010, the Company issued 4,000,080 units at a price of CAD\$ 0.50 per unit, raising gross proceeds of \$1,888,077. Each unit consisted of one common share and one-half of one common share purchase warrant. Each warrant entitles the holder to purchase one additional common share of the Company for a period of two years at an exercise price of CAD\$ 0.85 per share. The Company paid finders' fees of \$103,844 plus 100,002 warrants exercisable for a period of two years at an exercise price of CAD\$ 0.85 per share. The fair value of the finders' warrants was \$15,225.

On December 30, 2010, January 7, 2011, January 26, 2011 and January 31, 2011, the Company issued a total of 32,000,000 common shares at a price of CAD \$1.00 per shares, raising gross proceeds of \$32,000,000 Canadian. Each unit consisted of one common share and one common share purchase warrant. Each warrant entitles the holder to purchase one additional common share of the Company for a period of three years at an exercise price of CAD \$1.45 per share. The fair value of the warrants issued was \$18,329,132. The Company paid finders' fees of CAD \$2,054,330. In addition, the Company granted to finders a total of 1,568,748 stock options according to the following breakdown:

| Number of shares | Exercise Price<br>(CAD\$) | Expiry Date       |
|------------------|---------------------------|-------------------|
| 1,169,970        | 1.00                      | December 30, 2013 |
| 273,778          | 1.00                      | January 7, 2014   |
| 125,000          | 1.00                      | January 26, 2014  |
| <u>1,568,748</u> |                           |                   |

Each finder option is exercisable into one common share and one common share purchase warrant, which shall bear an exercise price of CAD\$1.45. These warrants are callable by the Company if the volume weighted average trading price of the Company's common share on the Toronto Stock Exchange, or any other stock exchange on which the Company's common share are then listed, is at a price equal to or greater than CAD\$2.00 for a period of 30 consecutive trading days. In such event, the Company is entitled to accelerate the expiry date of the warrants by providing written notice to the holders of the warrants that the warrants will expire on the date that is not less than 30 days from the date of such notice. The fair value of the options issued was \$1,031,233.

**19. STOCK OPTIONS**

On November 18, 2008, the Company received approval for its stock option plan which authorizes the Board of Directors to grant incentive stock options to directors, officers and employees. The maximum number of shares reserved for issuance under the Company's Plan was 10,700,000.

On October 18, 2010, the Company's plan was amended. The Company received approval for its stock option plan which authorizes the Board of Directors to grant incentive stock options to directors, officers and employees. The maximum number of shares reserved for issuance under the Company's Plan is 12,500,000.

The aggregate number of common shares reserved for issuance to any person may not exceed 5% of the number of outstanding common shares. The exercise price of the options will be determined by the five day volume weighted average price of the Company's shares prior to the date of the grant. Options granted must be exercised no later than 10 years after the date of grant or such lesser period as may be determined by the Board. The Board may at its discretion in any granting of an option set a vesting period whereby the option may only be exercisable in pre-determined instalments.

Stock option transactions are summarized as follows:

|                                     | Number<br>of Shares | Weighted Average<br>Exercise Price (CAD\$) |
|-------------------------------------|---------------------|--|
| Balance at May 31, 2009             | 8,435,853           | 1.64                                       |
| Granted                             | 5,365,000           | 0.37                                       |
| Exercised                           | (768,750)           | 0.48                                       |
| Cancelled                           | (3,245,080)         | 2.08                                       |
| Forfeited                           | (1,532,653)         | 1.65                                       |
| Expired                             | (30,000)            | 0.26                                       |
| Balance at May 31, 2010             | 8,224,370           | 0.75                                       |
| Granted                             | 1,295,000           | 0.91                                       |
| Exercised                           | (593,750)           | 0.38                                       |
| Cancelled                           | -                   | -  |
| Forfeited                           | (743,350)           | 0.50                                       |
| Expired                             | (786,000)           | 0.54                                       |
| Balance at May 31, 2011             | 7,396,270           | 0.74                                       |
| Number of stock options exercisable | 5,870,645           | 0.74                                       |

As at May 31, 2011, the following stock options were outstanding as follows:

**19. STOCK OPTIONS (continued)**

| Number of Shares<br>Outstanding | Exercise Price<br>(CAD\$) | Expiry Date       |
|---------------------------------|---------------------------|-------------------|
| 118,800                         | 0.26                      | July 11, 2011     |
| 762,262                         | 1.05                      | January 15, 2012  |
| 755,208                         | 2.01                      | January 15, 2012  |
| 100,000                         | 2.25                      | June 20, 2012     |
| 50,000                          | 2.49                      | July 12, 2012     |
| 300,000                         | 0.52                      | December 1, 2013  |
| 2,750,000                       | 0.23                      | November 18, 2014 |
| 425,000                         | 0.87                      | January 5, 2015   |
| 425,000                         | 0.57                      | March 25, 2015    |
| 350,000                         | 0.53                      | April 30, 2015    |
| 65,000                          | 0.48                      | May 13, 2015      |
| 685,000                         | 0.75                      | November 1, 2015  |
| 75,000                          | 1.00                      | November 29, 2015 |
| 510,000                         | 1.11                      | December 21, 2015 |
| 25,000                          | 0.93                      | April 6, 2016     |
| <b>7,396,270</b>                |                           |                   |

During the year ended May 31, 2011, 762,262 options priced at \$2.01 CAD and expiring on January 15, 2012 were repriced to \$1.05. The increased stock based compensation expense associated with this change was \$104,540.

The weighted average fair value of stock options granted is estimated to be CAD \$0.53 for the year ended May 31, 2011 (year ended May 31, 2010 – CAD \$0.35) by using the Black-Scholes options pricing model with the following weighted average assumptions:

|                                 | Year ended May 31, 2011 | Year ended May 31, 2010 |
|---------------------------------|-------------------------|-------------------------|
| Risk-free interest rate         | 1.52%                   | 1.88 %                  |
| Expected dividend yield         | -                       | -                       |
| Expected stock price volatility | 100%                    | 82%                     |
| Expected option life in years   | 2.0                     | 3.00                    |

**20. SHARE PURCHASE WARRANTS**

Share purchase warrant transactions are summarized as follows:

**20. SHARE PURCHASE WARRANTS (continued)**

|                         | Number<br>of Shares | Weighted<br>Average<br>Exercise<br>Price (CAD\$) |
|-------------------------|---------------------|--|
| Balance at May 31, 2009 | 34,953,280          | 1.03   |
| Issued                  | 2,100,042           | 0.85   |
| Exercised               | (473,000)           | 0.65   |
| Expired                 | (1,691,875)         | 3.50   |
| Balance at May 31, 2010 | 34,888,447          | 0.90   |
| Issued                  | 32,000,000          | 1.45   |
| Exercised               | (18,553,800)        | 0.65   |
| Expired                 | -                   | -  |
| Balance at May 31, 2011 | 48,334,647          | 1.36   |

In December 2009, the Company closed a non-brokered private placement of 24,000,000 common shares at a price of CAD \$0.50 per share, raising gross proceeds of \$11,328,236. In connection with the closing of the private placement, the Company has paid finders' fees in the amount of \$566,412.

On May 21, 2010, the Company issued 4,000,080 units at a price of CAD\$ 0.50 per unit, raising gross proceeds of \$1,888,077. Each unit consisted of one common share and one-half of one common share purchase warrant. Each warrant entitles the holder to purchase one additional common share of the Company for a period of two years at an exercise price of CAD\$ 0.85 per share. The Company paid finders' fees of \$103,844 plus 100,002 warrants exercisable for a period of two years at an exercise price of CAD\$ 0.85 per share. The fair value of the finders' warrants was \$15,225.

On December 30, 2010, January 7, 2011, January 26, 2011 and January 31, 2011, the Company issued a total of 32,000,000 common shares at a price of CAD \$1.00 per share, raising gross proceeds of \$31,976,036. Each unit consisted of one common share and one common share purchase warrant. Each warrant entitles the holder to purchase one additional common share of the Company for a period of three years at an exercise price of CAD \$1.45 per share. The Company paid finders' fees of CAD \$1,763,236.

At May 31, 2011, the following warrants were outstanding as follows:

| Number of Warrants<br>Outstanding | Exercise<br>Price (CAD\$) | Expiry Date       |
|-----------------------------------|---------------------------|-------------------|
| 250,000                           | 1.54                      | October 4, 2011   |
| 9,174,605                         | 1.54                      | October 17, 2011  |
| 3,964,000                         | 0.65                      | May 21, 2013      |
| 846,000                           | 0.65                      | June 4, 2013      |
| 2,100,042                         | 0.85                      | May 21, 2012      |
| 23,399,402                        | 1.45                      | December 30, 2013 |
| 6,100,598                         | 1.45                      | January 7, 2014   |
| 2,500,000                         | 1.45                      | January 26, 2014  |
| 48,334,647                        |                           |                   |

**21. RELATED PARTY TRANSACTIONS**

Related party transactions are measured at the exchange amount, which is the amount of consideration established and agreed to by the transacting parties.

During the year ended May 31, 2011:

- a) The Company paid fees for compensation related matters of \$929,000 to a company controlled by the Chairman (year ended May 31, 2010 – \$489,908, year ended May 31, 2009 – \$220,176).
- b) The Company paid for goods and services provided to the Molejon mine of \$228,965 (year ended May 31, 2010- \$166,134, year ended May 31, 2009 - \$155,805) to companies controlled by the Chairman.
- c) The Company paid fees of \$18,800 (year ended May 31, 2010 – nil, year ended May 31, 2009 - nil) to a company controlled by a Director.
- d) The Company paid wages of nil (year ended May 31, 2010 – nil, year ended May 31, 2009 - \$32,158) to companies controlled by a former director.
- e) The Company paid legal fees of nil (year ended May 31, 2010 - \$273,178, year ended May 31, 2009 - \$269,526), and financing costs of nil (year ended May 31, 2010 – nil, year ended May 31, 2009 - \$104,272) to a law firm controlled by a former officer and a law firm controlled by a former director.
- f) Note 10 provides a description of the Iberian Resources Corp (“Iberian”) transaction. As noted, Iberian is a related party to the Company by virtue of common management and directors.

At May 31, 2011, excluding related party Notes and related party Convertible Notes (Notes 16 and 17), \$126,858 was owed to related parties.

**22. INCOME TAXES**

A reconciliation of income taxes at statutory rates with the reported taxes is as follows.

|   | Year ended<br>May 31, 2011 | Year ended<br>May 31, 2010 | Year ended<br>May 31, 2009 |
|---|----------------------------|----------------------------|----------------------------|
| Statutory tax rate                                    | 27.67%                     | 29.38%                     | 30.38%                     |
| (Loss) for the period                                 | \$(3,937,323)              | \$(26,982,082)             | \$(21,099,866)             |
| Income tax recovery                                   | (1,089,457)                | (7,925,987)                | (6,409,084)                |
| Permanent differences                                 | (770,813)                  | (199,709)                  | (4,746,965)                |
| Share issue costs                                     | (586,739)                  | -                          | -                          |
| Income tax rate change and differential               | (1,847,117)                | 2,608,282                  | 5,551,802                  |
| Foreign exchange                                      | 630,607                    | 522,046                    | (1,131,760)                |
| Cost of previously unrecognized tax pools             | -                          | -                          | 1,480,781                  |
| Change in functional currency foreign exchange impact | -                          | -                          | 4,010,847                  |
| Other   | 28,814                     | (2,142,158)                | -                          |
| Change in valuation allowance                         | 3,634,705                  | 7,137,526                  | 1,244,379                  |
| Income tax recovery                                   | -                          | -                          | -                          |

**22. INCOME TAXES (continued)**

The significant components of the Company's future income tax assets (liabilities) are as follows:

|   | May 31, 2011  | May 31, 2010 |
|---|---------------|--------------|
| Future income tax assets (liabilities)    |               |              |
| Non-capital and other loss carry-forwards | \$ 14,200,672 | \$9,684,260  |
| Equipment and exploration properties      | 63,530        | 51,814       |
| Deferred financing costs                  | 2,243,377     | 1,951,713    |
| Foreign exchange gain on notes            | -             | -            |
| Senior secured notes                      | 147,860       | 1,333,938    |
| Other                                     | 13,843        | 12,852       |
| Total future income tax assets            | \$16,669,282  | \$13,034,577 |
| Valuation allowance                       | (16,669,282)  | (13,034,577) |
| Net future income tax assets              | -             | -            |

The Company has non-capital losses of \$56,802,689 for deduction against future years' taxable income in Canada. If unutilized, these losses will expire, beginning in 2014, as follows:

|      |              |
|------|--------------|
| 2014 | \$433,802    |
| 2015 | 910,470      |
| 2026 | 1,994,647    |
| 2027 | 5,339,864    |
| 2028 | 4,182,831    |
| 2029 | 6,285,866    |
| 2030 | 23,010,780   |
| 2031 | 14,644,429   |
|      | \$56,802,689 |

The Company will not be subject to any income taxes in Panama until all of the debt incurred by all of the affiliated / subsidiary companies has been repaid in full, the timing of which cannot be estimated due to the uncertainty inherent in the future price of gold. At that time the Company will be able to claim accelerated write-offs for all Panamanian subsidiaries.

**23. COMMITMENTS**

|                                  | <b>Less than 1<br/>Year</b> | <b>2 Years</b>     | <b>3 Years</b>     | <b>4-5 Years</b>    | <b>More than 5<br/>Years</b> |
|----------------------------------|-----------------------------|--------------------|--------------------|---------------------|------------------------------|
| Office lease                     | \$ 73,900                   | \$28,000           | Nil                | Nil                 | Nil                          |
| Equipment lease                  | \$ 1,754,547                | \$1,134,360        | \$1,134,360        | \$2,079,364         | Nil                          |
| Senior secured notes             | \$ 451,668                  | \$455,411          | \$455,411          | \$3,679,473         | Nil                          |
| Convertible senior secured notes | \$ 573,916                  | \$578,672          | \$578,672          | \$4,675,355         | Nil                          |
| Long term debt                   | \$435,733                   | \$ 465,109         | \$448,377          | \$927,011           | Nil                          |
| Fundacion Petaquilla             | \$1,440,000                 | \$1,440,000        | \$1,440,000        | \$2,880,000         | \$1,440,000                  |
| Asset retirement obligation      | Nil                         | Nil                | Nil                | Nil                 | \$10,218,124                 |
| <b>Total</b>                     | <b>\$4,729,764</b>          | <b>\$4,101,552</b> | <b>\$4,056,820</b> | <b>\$14,241,203</b> | <b>\$11,658,124</b>          |

The Company has committed funding of \$120,000 per month to Fundacion Petaquilla for the life of the Molejon mine. Fundacion Petaquilla promotes a sustainable development culture, administering social programs in the area around the Molejon property.

As it is described in note 27, the Company has an obligation to the Deutsche Bank, AG for a certain amount of ounces of gold in the future.

**24. FINANCIAL INSTRUMENTS AND CAPITAL MANAGEMENT**

The Company thoroughly examines the various financial instrument risks to which it is exposed and assesses the impact and likelihood of those risks. These risks may include credit risk, liquidity risk, currency risk, and interest rate risk. Where material, these risks are reviewed and monitored by the Board of Directors.

**(a) Fair Values**

The fair value of the Company's current assets and liabilities including cash and cash equivalents, receivables, restricted cash and accounts payable and accrued liabilities approximates their carrying values due to the immediate or short-term maturity of these financial instruments. The carrying amounts of the Company's long term debt and obligations under capital leases approximate fair value due to their interest rates being in line with market rates.

The Company's Notes and Convertible Notes are measured on initial recognition using the residual method. Subsequent fair value measurement is based on a discounted cash flow model using a discount rate of 10.18% at May 31, 2011 (May 31, 2010 – 12.0%) and estimated principal, premium and interest date of September 15, 2011 and the assumption mentioned in Notes 16 and 17.

**24. FINANCIAL INSTRUMENTS AND CAPITAL MANAGEMENT (continued)**

The amendments to Section 3862 introduce a fair value hierarchy that reflects the significance of inputs used in making fair value measurements as follows:

Level 1 – quoted prices in active markets for identical assets or liabilities;

Level 2 – inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e. as prices of) or indirectly (i.e. derived from prices); and

Level 3 – inputs for the asset or liability that are not based on observable market data.

At May 31, 2011, the levels in the fair value hierarchy into which the Company's financial assets and liabilities measured and recognized in the balance sheet at fair value are categorized as follows:

|                                  | Level 1 | Level 2 | Level 3     |
|----------------------------------|---------|---------|-------------|
| Senior secured notes             | -       | -       | \$3,124,437 |
| Convertible senior secured notes | -       | -       | 3,970,094   |

An analysis of these notes including related gains and losses during the year is as follows:

|  | Year ended<br>May 31, 2011 | Year ended<br>May 31, 2010 |
|--|----------------------------|----------------------------|
| Balance at beginning of the year                                       |                            |                            |
| Senior secured notes   | \$26,646,631               | \$29,407,502               |
| Convertible senior secured notes                                       | 44,837,991                 | 34,794,455                 |
|  | <u>71,484,622</u>          | <u>64,201,957</u>          |
| Repayment of senior secured notes and convertible senior secured notes | (70,413,280)               | (8,806,743)                |
| Mark-to-market losses (gain) included in net income (expense)          | <u>6,023,189</u>           | <u>16,089,408</u>          |
| Balance at end of the year   | <u>\$7,094,531</u>         | <u>\$71,484,622</u>        |

**(b) Financial Instrument Risk Exposure**

***Credit risk***

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. Financial instruments that potentially subject the Company to credit risk consist of cash and cash equivalents, restricted cash, and accounts receivable. The Company has reduced its credit risk by investing its cash and cash equivalents and restricted cash in term deposits with financial institutions that operate globally. There is also minimal risk associated with accounts receivable as the payment for gold sales is received prior to the gold being credited to the customer's account at the refinery.

Therefore, the Company is not exposed to significant credit risk and overall the Company's credit risk has not changed significantly from the prior year.

**24. FINANCIAL INSTRUMENTS AND CAPITAL MANAGEMENT (continued)**

***Liquidity risk***

Liquidity risk arises from the Company's general and capital financing needs. The Company has in place a planning and budgeting process to help determine the funds required to ensure the Company has the appropriate liquidity to meet its operating and growth objectives. The Company has historically relied on issuance of shares, senior secured debt, convertible senior secured debt and leasing arrangements to develop the Molejon gold project. The Company expects to fund operations and capital expenditures in fiscal 2012 via operations as the Molejon gold project has been in commercial production since January 2010.

***Market risk***

***(i) Currency risk***

Financial instruments that impact the Company's net earnings or other comprehensive income due to currency fluctuations include: Canadian dollar denominated cash and cash equivalents, restricted cash, accounts receivable and accounts payable. As the Company conducts the vast majority of its activities in United States dollars, changes in the exchange rate between the Canadian dollar and the United States dollar have a minimal effect on the Company's net earnings and other comprehensive income.

***(ii) Interest rate risk***

Interest rate risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate due to changes in market interest rates. Cash and cash equivalents and restricted cash bear interest at fixed rates.

Other current financial assets and liabilities are not exposed to interest rate risk because they are non-interest bearing.

The operating credit line facility, capital leases, and long-term debt bear interest at a fixed rate and are also not exposed to interest rate risk.

***(c) Capital Management***

The Company's objectives of capital management are intended to safeguard the entity's ability to support the Company's normal operating requirements on an ongoing basis, continue the development and exploration of its mineral properties and support any expansionary plans.

The capital structure of the Company consists of long term debt (Note 13), leases (Note 15), Notes (Note 16), Convertible Notes (Note 17), advances from Deutsche Bank in connection with future production of gold (Note 27) and equity attributable to common shareholders, comprised of issued capital, contributed surplus and deficit. The Company manages the capital structure and makes adjustments in light of changes in economic conditions and the risk characteristics of the Company's assets.

To effectively manage the entity's capital requirements, the Company has in place a planning and budgeting process to help determine the funds required to ensure the Company has the appropriate liquidity to meet its operating and growth objectives. The Company has historically relied on issuance of shares, senior secured debt, convertible senior secured debt and leasing arrangements to develop the project and may require doing so again in the future.

The Company is monitoring market conditions to secure funding at the lowest cost of capital. The Company is exposed to various funding and market risks which could curtail its access to funds.

**25. SUPPLEMENTAL DISCLOSURE WITH RESPECT TO CASH FLOWS**

|   | Year ended<br>May 31, 2011 | Year ended<br>May 31, 2010 | Year ended<br>May 31, 2009 |
|---|----------------------------|----------------------------|----------------------------|
| <b>Non-cash investing and financing activities</b>                                |                            |                            |                            |
| Finder's fees   | \$1,763,236                | \$15,226                   | \$ -                       |
| Share issue costs   | (1,763,236)                | (15,226)                   | -                          |
| Share capital warrants exercised  | 3,979,771                  | 60,429                     | -                          |
| Warrants exercised  | (3,979,771)                | (60,429)                   | (112,686)                  |
| Share capital warrants issued in private placement                                | (19,360,365)               | (304,511)                  | -                          |
| Warrants granted in private placement   | 19,360,365                 | 304,511                    | -                          |
| Share capital broker warrants issued  | 1,715,805                  | -                          | -                          |
| Broker warrants issued  | (1,715,805)                | -                          | -                          |
| Mineral properties  | 629,138                    | (291,357)                  | -                          |
| Asset retirement obligation   | (629,138)                  | 291,357                    | -                          |
| Share capital options exercised   | 276,180                    | 187,488                    | -                          |
| Contributed surplus options exercised   | (276,180)                  | (187,488)                  | -                          |
| Senior secured note repayment through forward sales agreement                     | -                          | (5,129,600)                | -                          |
| Deposits on equipment transferred to capital assets                               | -                          | 946,484                    | -                          |
| Mineral properties financed through payables                                      | 7,000,000                  | 5,242,659                  | 5,147,462                  |
| Property and equipment financed through payables                                  | 2,110,998                  | -                          | 1,071,255                  |
| Property and equipment acquired through credit line facility and capital leases   | 4,848,492                  | 115,700                    | 2,058,197                  |
| Amortization capitalized to mineral properties                                    | -                          | 1,825,067                  | -                          |
| Amortization allocated to ending inventory  | 173,226                    | 146,696                    | -                          |
| Depletion allocated to ending inventory   | 527,421                    | 281,617                    | -                          |
| Deferred services and materials financed by a reduction in amounts payable to IMN | -                          | 90,000                     | 156,597                    |
| Interest paid in cash   | \$7,758,123                | \$4,165,274                | \$14,224,440               |
| Income taxes paid in cash   | -                          | -                          | -                          |
|   | May 31, 2011               | May 31, 2010               |                            |
| Cash and cash equivalents consist of:   |                            |                            |                            |
| Cash  | \$5,712,792                | \$4,625,649                |                            |
|   | \$5,712,792                | \$4,625,649                |                            |

**26. ASSET RETIREMENT OBLIGATION**

The Company's asset retirement obligation relates to site restoration and cleanup costs for its Molejon gold project located in Panama.

A reconciliation of the provision for asset retirement obligation is as follows:

|   |             |
|---|-------------|
| Balance at May 31, 2008                                   | \$4,333,216 |
| Accretion   | 331,504     |
| Balance at May 31, 2009                                   | 4,664,720   |
| Accretion   | 325,287     |
| Adjustment for change in estimate of timing of cash flows | (291,357)   |
| Balance at May 31, 2010                                   | 4,698,650   |
| Accretion   | 359,448     |
| Adjustment for change in estimate of liability            | 629,138     |
| Balance at May 31, 2011                                   | \$5,687,236 |

**26. ASSET RETIREMENT OBLIGATION (continued)**

The provision for asset retirement obligation is based upon the following assumptions:

- a) The total undiscounted cash flow required to settle the obligation is approximately \$10,200,000;
- b) Asset retirement obligation payments are expected to occur mainly between fiscal years 2017 and 2020;
- c) A credit adjusted risk-free rate of 10.18% has been used to discount cash flows.

**27. DEFERRED REVENUE**

On September 22, 2010, the Company entered into a Forward Gold Purchase Agreement (“the Agreement”) with Deutsche Bank, AG (“Deutsche Bank”), in an amount of \$45,000,000. Under the terms of the Agreement, the Company has sold to Deutsche Bank, a Contract Quantity of Gold being 66,650 ounces.

For any shortfall in the number of gold ounces the Company is required to deliver, the Company is required to pay the amount in US dollars equal to the shortfall in gold ounces required to be delivered multiplied by the gold price on the scheduled delivery date. Interest will be charged on the shortfall at the LIBOR rate plus 2% per annum (based on 360 days/year) and is due on demand. However, under the Agreement the Company may deliver the monthly shortfall in gold, plus interest, if it can do so within 30 days of the monthly delivery date. The Company is only allowed to exercise this right no more frequently than twice in total during the term of the Agreement and no more frequently than once during any six month period.

The following table summarizes the above noted delivery requirements on an annual basis:

| <b>Delivery Obligation – 2011 to 2016</b>        | <b>Ounces per month</b> | <b>Total ounces</b> |
|--|-------------------------|---------------------|
| November 2010 - May 2011                         | 500                     | 3,500               |
| Total delivery requirements for fiscal year 2011 |                         | 3,500               |
| June 2011 - April 2012                           | 1,110                   | 12,210              |
| May 2012   | 1,485                   | 1,485               |
| Total delivery requirements for fiscal year 2012 |                         | 13,695              |
| June 2012 - May 2013                             | 1,485                   | 17,820              |
| Total delivery requirements for fiscal year 2013 |                         | 17,820              |
| June 2013 - April 2014                           | 1,485                   | 16,335              |
| May 2014   | 900                     | 900                 |
| Total delivery requirements for fiscal year 2014 |                         | 17,235              |
| June 2014 - May 2015                             | 900                     | 10,800              |
| Total delivery requirements for fiscal year 2015 |                         | 10,800              |
| June 2015 - September 2015                       | 900                     | 3,600               |
| Total delivery requirements for fiscal year 2016 |                         | 3,600               |
| <b>Total Ounces to be Delivered</b>              |                         | <b>66,650</b>       |

**27. DEFERRED REVENUE (continued)**

As of May 31, 2011, the Company has delivered 3,500 ounces under the terms of the Agreement and has an obligation to deliver 63,150 ounces in future periods in accordance with the table above. The current portion of deferred revenue represents the revenue expected to be recognized in the following year in respect of gold to be delivered pursuant to this Agreement. As at May 31, 2011, \$9.2 million and \$33.4 million represent the current and long-term remaining ounces, respectively, to be delivered under the Agreement.

The Company incurred \$3.9 million of fees to parties involved in the Agreement, of which \$2.1 million was expensed as transaction costs and \$1.8 million paid to the Deutsche Bank was deferred. As of May 31, 2011, the mentioned amount of the costs was deferred based on their direct relationship with the revenue expected to be recognized in future periods. This transaction fee is being amortized based on the ounces to be delivered under the Agreement. As of May 31, 2011 net book value of this deferred fee was \$1,705,476.

In addition, should the gold price be in excess of \$875 per ounce, the Company will receive from Deutsche Bank, an additional payment amount equal to the product of the monthly quantity of gold delivered in that month and the amount by which the gold price exceeds \$875 per ounce, limited to \$415 per ounce.

If on any business day on or after September 1, 2010 and on or prior to December 31, 2013, the gold price is less than \$1,000 per ounce, then Deutsche Bank may, by notice to the Company, require that the Company enter into, on commercially reasonable terms, a fixed-for-floating swap or any combination of gold derivative instruments that would have the net effect of reducing the Company's exposure to movements in the gold price. The mandatory hedging which the Deutsche Bank may require pursuant to this shall be restrictive to the period commencing on the Notice Date and ending on December 31, 2013.

**28. CONTINGENCIES**

- 1) On November 13, 2008 the Autoridad Nacional del Ambiente ("ANAM"), the environmental agency of the Government of the Republic of Panama, issued a Resolution purporting to fine the Company and its present and former affiliates \$1,000,000 for alleged violations of environmental laws that took place on the main Petaquilla Copper Concession in 2005 and an additional \$934,695 for damages. On November 26, 2008, ANAM, by Resolution, approved the Company's Environmental Impact Study ("EIS") Category III submitted in July 2007 for the Molejon Gold Project. The Resolution sets out a number of conditions to be satisfied before the Company can attain full commercial production. Based on the approval of the EIS, the Company filed for reconsideration by ANAM to have the fines reduced to nil. In January 2009, the Company was advised that ANAM had not accepted the Company's request for reconsideration that the amount of the financial sanctions purportedly levied against the Company and its present and former affiliates be reduced to nil. On March 10, 2009, the Supreme Court of the Republic of Panama suspended the imposition of ANAM's fine until the matter of the Company's appeal is resolved. On February 14, 2011, the Supreme Court of the Republic of Panama declared that the fine imposed by ANAM on the Company rendered ineffective. The Company has accepted the Government of the Republic of Panama's position, and therefore, no fine has been recorded.
- 2) On February 11, 2011, the Government of Panama made an amendment to the Mineral Resources Code of Panama. However, after this decision the Government of Panama formally requested to the National Assembly to revoke Law No. 8 of February 11, 2011, which amended the Mineral Resources Code of Panama in its entirety. The primary focus of the Law No. 8 amendments was to allow foreign sovereign funds to invest in Panamanian resources. In addition, an increase in royalties' rate by 2% was included in such amendments. The effect of increasing royalties by 2% on the Company's operations and financial position for the current year would have been an increase in cost of sales of \$1,441,287 should the legislation be enacted and applied retroactively.

**28. CONTINGENCIES (continued)**

- 3) During the year ending May 31, 2008, the Company was served with a claim by a former officer in the amount of \$250,000. This matter will be going to mediation in fiscal 2012. The Company believes that the claim is without merit and has not recorded a liability as the outcome is uncertain.
- 4) On October 6, 2010 Pro-Con Industries, Inc. filed a claim in the Los Angeles Superior Court against Petaquilla Minerals S.A. for breach of written contract, fraud, intentional interference with economic relationship and negligent interference with economic relationship. The claim seeks damages in excess of \$600,000 in addition to punitive damages and attorney fees. The case was dismissed on January 10, 2011, as the plaintiff failed to effect service.
- 5) The Company is engaged in certain other legal actions in the ordinary course of business and believes that the ultimate outcome of these actions will not have a material adverse effect on its operating results, liquidity or financial position.

**29. SUBSEQUENT EVENTS**

Subsequent to May 31, 2011 the following events took place:

- 1) On July 19, 2011, the Company entered into a sublease for corporate office space. The term of the agreement is for thirty six months commencing on September 1, 2011, at a monthly rate of \$3,052.
- 2) The Company has filed a notice with the Toronto Stock Exchange (“TSX”) for, and received its approval to make, a Normal Course Issuer Bid (“NCIB”) permitting the Company to purchase up to 17,000,000 common shares (“Shares”), representing approximately 9.9% of its public float. The average daily trading volume on the TSX for the six months preceding June 1, 2011, was 683,833 Shares. Subject to the Company’s ability to make “block” purchases under TSX rules, the daily purchase restriction during the course of the NCIB is 25% of the average daily trading volume, or 170,958 Shares. The Company may buy back Shares anytime during the 12-month period beginning on July 4, 2011, and ending on July 3, 2012, or on such earlier date as the Company may complete its purchases pursuant to the NCIB, or provide notice of termination. Any purchase under the NCIB will be made through the facilities of the TSX in compliance with the rules of the TSX. The Company will pay the market price, up to a maximum of CAD\$1.00 per Share, at the time of acquisition of Shares purchased through the facilities of the TSX, subject to any restrictions under the rules of the TSX. The actual number of Shares which may be purchased, and the timing of any such purchases, will be determined by the Company, in accordance with the rules of the TSX. A total of 285,000 shares were repurchased by the Company, ranging share price from CAD\$0.69 to CAD\$0.80.
- 3) On July 20, 2011, an additional \$1,508,524 was subscribed to from the long term financing with Global Bank of Panama at 6.25% per annum, in addition to the amount of \$2,170,264 that was already subscribed to as at May 31, 2011, according to terms detailed in note 13.
- 4) On July 20, 2011, the Company announced that a special meeting (the “Meeting”) of the holders of common shares of Petaquilla (the “Shareholders”) will be held on August 31, 2011. At the Meeting, Shareholders will be asked to consider and, if thought fit, to approve with or without variation, an ordinary resolution authorizing the issuance by the Company of such number of common shares in the capital of the Company (the “Shares”) as is necessary to complete the proposed acquisition by the Company of all the outstanding securities of Iberian Resources Corp. (the “Acquisition”); and to transact such other business as may properly come before the Meeting or any adjournment thereof. The Acquisition is subject to receipt of all required regulatory approvals, if any, and to the approval of the Shareholders at the Meeting. Assuming all such approvals are obtained, the Acquisition is expected to be effected on or about September 1, 2011.

**29. SUBSEQUENT EVENTS (continued)**

- 5) On June 28, 2011 and June 29, 2011, a total of \$1,292,925 was subscribed to by Petaquilla Gold S.A., a subsidiary of the Company from Caterpillar Financial, to supply heavy equipment. The terms of these agreements are an interest rate of 6% per annum, and repayment terms between 48 and 60 months.
- 6) On August 17, 2011, \$175,000 of the \$247,864 lien relating a bank account of Petaquilla Gold S.A., a subsidiary of the Company, was cancelled by the Federal Court of Justice of the Republic of Panama.
- 7) 50,000 stock options were exercised.

**30. DIFFERENCES BETWEEN CANADIAN AND UNITED STATES GENERALLY ACCEPTED ACCOUNTING PRINCIPLES**

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("Canadian GAAP"). Material variations in the accounting principles, practices and methods used in preparing these financial statements from United States Generally Accepted Accounting Principles ("U.S. GAAP") are described and quantified below.

| <b>Loss for the years</b>  | <b>Year ended<br/>May 31, 2011</b> | <b>Year ended<br/>May 31, 2010</b> | <b>Year ended<br/>May 31, 2009</b> |
|--|------------------------------------|------------------------------------|------------------------------------|
| Loss for the year – Canadian GAAP  | \$(3,937,326)                      | \$(26,982,082)                     | \$(21,099,866)                     |
| Gain on dilution of equity investment (a)  | (453,775)                          | -                                  | (2,238,492)                        |
| Mineral properties expensed under U.S. GAAP (b)  | (15,371,440)                       | (3,411,935)                        | (17,562,548)                       |
| Revenue recognized (i)   | -                                  | 27,948,475                         | 653,941                            |
| Cost of goods sold (i)   | (231,896)                          | (24,275,977)                       | (1,260,127)                        |
| Amortization (i)   | -                                  | (1,825,067)                        | (640,425)                          |
| Amortization of ball mills included in mineral properties under U.S. GAAP (i)                                      | (419,345)                          | (419,345)                          | -                                  |
| Depletion of mineral properties under Canadian GAAP (i)  | 7,489,645                          | 3,338,116                          | -                                  |
| Loss of variable interest entity under US GAAP (k)   | -                                  | 69,765                             | -                                  |
| Expensing of opening inventory reclassified in prior year  | -                                  | (2,868,999)                        | -                                  |
| Write down of inventory in finished goods and work in progress   | -                                  | -                                  | (2,404,695)                        |
| Foreign exchange on difference in mineral properties expensed under U.S. GAAP                                      | -                                  | -                                  | (9,639,262)                        |
| Foreign exchange on difference in senior secured notes under U.S. GAAP   | -                                  | -                                  | 3,180,313                          |
| Additional loss relating to redemption and modification of senior secured note agreement under U.S. GAAP (f and g) | 177,778                            | -                                  | (18,712,488)                       |
| Share issue costs relating to warrants expensed under U.S. GAAP  | (357,395)                          | -                                  | -                                  |
| Change in fair value of warrants denominated in Canadian dollars under U.S. GAAP (j)                               | (8,420,089)                        | 1,692,320                          | 22,871,582                         |
| Change in fair value of share capital issued with warrants denominated in Canadian dollars under U.S. GAAP (j)     | -                                  | 58,824                             | -                                  |
| Net gain (loss) – U.S. GAAP  | \$(21,523,843)                     | \$(26,675,905)                     | \$(46,852,067)                     |
| Other comprehensive (loss) gain  |                                    |                                    |                                    |
| Unrealized loss on translating financial statements to US reporting currency                                       | -                                  | -                                  | (4,648,716)                        |
| Foreign exchange on difference in mineral properties expensed under U.S. GAAP                                      | -                                  | -                                  | 9,639,262                          |
| Foreign exchange on difference in senior secured notes under U.S. GAAP   | -                                  | -                                  | (3,180,313)                        |
| Comprehensive gain (loss) for the year   | \$(20,414,977)                     | \$(26,675,905)                     | \$(45,041,834)                     |
| Basic and diluted gain (loss) per share – U.S. GAAP  | \$(0.15)                           | \$(0.25)                           | \$(0.49)                           |

**PETAQUILLA MINERALS LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
(in United States Dollars)  
Year ended May 31, 2011, May 31, 2010 and May 31, 2009

**30. DIFFERENCES BETWEEN CANADIAN AND UNITED STATES GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (continued)**

| <b>Mineral Properties</b>  | <b>May 31, 2011</b> | <b>May 31, 2010</b> |
|--|---------------------|---------------------|
| Mineral properties – Canadian GAAP   | \$66,670,067        | \$58,788,273        |
| Amortization (h)   | (2,465,492)         | (2,465,492)         |
| Revenue recognized under U.S. GAAP (i)   | 28,602,416          | 28,602,416          |
| Cost of goods sold (i)   | (25,536,104)        | (25,536,104)        |
| Depletion of mineral properties under Canadian GAAP (i)  | 11,622,891          | 3,619,733           |
| Amortization of ball mills included in mineral properties under U.S. GAAP (i)  | (838,690)           | (419,345)           |
| Mineral properties expensed under U.S. GAAP (b)  | (75,920,645)        | (60,036,692)        |
| Mineral properties – U.S. GAAP   | \$2,134,443         | \$2,552,789         |
| <b>Balance Sheets</b>  |                     |                     |
|  | <b>May 31 2011</b>  | <b>May 31 2010</b>  |
| Total assets – Canadian GAAP   | \$115,519,276       | \$80,262,195        |
| Depletion of mineral properties added to ending inventory (i)  | (513,513)           | (281,617)           |
| Mineral properties expensed or charged to cost of sales and revenue under U.S. GAAP (a)(i)                                   | (64,535,624)        | (56,235,484)        |
| Total assets – U.S. GAAP   | \$50,470,139        | \$23,745,094        |
| Liabilities – Canadian GAAP  | \$95,199,170        | \$101,615,310       |
| Derivative liability – warrants (j)  | 11,578,581          | 4,965,589           |
| Equity component of convertible debt treated as a liability under U.S. GAAP (g)  | -                   | 177,778             |
| Liabilities – U.S. GAAP  | \$106,777,751       | \$106,758,677       |
| Non-controlling interest – Canadian GAAP   | \$ 2,507,156        | \$ -                |
| Equity adjustment (a)  | (2,507,156)         | -                   |
| Non-controlling interest – U.S. GAAP   | \$ -                | \$ -                |
| Shareholders' equity (deficit) - Canadian GAAP   | \$17,812,950        | \$(21,353,115)      |
| Mineral properties expensed or charged to cost of sales and revenue under U.S. GAAP (b)(i)                                   | (64,536,624)        | (56,235,484)        |
| Exercise of warrants denominated in Canadian dollars under U.S. GAAP (j)   | 13,478,944          | 272,000             |
| Depletion added to ending inventory  | (513,513)           | (281,617)           |
| (Decrease) increase in retained earnings due to translation of prior year mineral property expenses and senior secured notes | (4,564,949)         | (4,564,949)         |
| Difference in accumulated other comprehensive income   | 4,564,949           | 4,564,949           |
| Increase in net income due to the change in fair value of warrants denominated in Canadian dollars under U.S. GAAP (j)       | 14,463,183          | 22,883,272          |
| Decrease in warrants due to fair value of warrants denominated in Canadian dollars under U.S. GAAP (j)                       | (38,489,476)        | (28,120,861)        |
| Decrease in warrants due to the fair value of finders' warrants (j)  | (1,031,232)         | -                   |
| Additional loss relating to redemption and modification of senior secured note agreement under U.S. GAAP (f)                 | (14,591,713)        | (14,591,713)        |
| Allocation of fair value of senior secured notes under U.S. GAAP (f)   | 14,591,713          | 14,591,713          |
| Equity adjustment of non-controlling interest (a)  | 2,507,156           | -                   |
| Equity component of convertible debenture treated as a liability under U.S. GAAP (g)   | -                   | (177,778)           |
| Shareholders' equity (deficit) – U.S. GAAP   | \$(56,308,612)      | \$(83,013,583)      |

**30. DIFFERENCES BETWEEN CANADIAN AND UNITED STATES GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (continued)**

| Statement of Cash Flows   | Year ended<br>May 31, 2011 | Year ended<br>May 31, 2010 | Year ended<br>May 31, 2009 |
|---|----------------------------|----------------------------|----------------------------|
| Cash provided by (used in) operating activities – Canadian GAAP         | \$44,127,970               | \$500,846                  | \$(16,010,085)             |
| Revenues and expenses charged to mineral properties under Canadian GAAP | -                          | 3,672,498                  | -                          |
| Expenditures on mineral properties                                      | (13,514,509)               | (3,411,935)                | (27,201,810)               |
| Cash provided by (used in) operating activities – U.S. GAAP             | \$30,613,461               | \$761,409                  | \$(43,211,895)             |
| Cash provided by (used in) financing activities – Canadian GAAP         | \$(22,770,446)             | \$6,354,018                | \$(1,260,198)              |
| Cash provided by (used in) financing activities – U.S. GAAP             | \$(22,770,446)             | \$6,354,018                | \$(1,260,198)              |
| Cash provided by (used in) investing activities – Canadian GAAP         | \$(20,270,899)             | \$(5,804,679)              | \$8,164,377                |
| Revenues and expenses charged to mineral properties under Canadian GAAP | -                          | (3,672,498)                | -                          |
| Expenditures on mineral properties                                      | 13,514,509                 | 3,411,935                  | 27,201,810                 |
| Cash provided by (used in) investing activities – U.S. GAAP             | \$(6,756,390)              | \$(6,065,242)              | \$35,366,187               |
| Cash and cash equivalents, end of year – Canadian GAAP                  | \$5,712,792                | \$4,625,649                | \$3,575,168                |
| Cash and cash equivalents, end of year – U.S. GAAP                      | \$5,712,792                | \$4,625,649                | \$3,575,168                |

a) Equity investment

Under U.S. GAAP, changes in the parent company's proportionate share of equity resulting from the additional equity raised by an entity subject to significant influence in the development stage are accounted for as an equity transaction on consolidation. Under Canadian GAAP, these gains have been credited to income. In the current year, under Canadian GAAP, the Company recorded a dilution gain related to a variable interest entity. The non-controlling interest portion of this equity investment has been recorded as a U.S. GAAP adjustment of \$2,507,156 in the current year.

b) Mineral properties and deferred costs

Mineral property costs and related exploration expenditures are accounted for in accordance with Canadian GAAP as disclosed in Note 2. For U.S. GAAP purposes, the Company expenses, as incurred, the exploration costs related to unproven mineral properties. When proven and probable reserves are determined for a property and a feasibility study is prepared, then subsequent exploration and development costs of the property would be capitalized. The capitalized costs of such properties are measured periodically for recoverability of carrying values.

c) Development stage company

Pursuant to U.S. GAAP, the Company would be subject to the disclosure requirements applicable to a development stage enterprise as the Company is devoting its efforts to establishing commercially viable mineral properties. However, the identification of the Company as such for accounting purposes does not impact the measurement principles applied to these consolidated financial statements.

**30. DIFFERENCES BETWEEN CANADIAN AND UNITED STATES GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (continued)**

d) Income taxes

Under Canadian GAAP, future tax assets and liabilities are recorded at substantively enacted tax rates. Under U.S. GAAP, deferred tax assets and liabilities are recorded at enacted rates. There were no significant differences between enacted and substantively enacted rates for the periods presented.

e) Accounting for uncertainty in income taxes

U.S. GAAP provides guidance on the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return and prescribes a recognition threshold and measurement of a tax position taken or expected to be taken in a tax return.

Effective May 1, 2007 the Company adopted the U.S. GAAP guidance in accounting for uncertainty in income taxes. The adoption did not result in any adjustment to opening retained earnings under U.S. GAAP. As a result of the implementation of this guidance, the Company did not recognize any liabilities for unrecognized tax benefits. In the event that the Company recognizes accrued interest related to unrecognized tax benefits, it will be recorded in interest expense. Any penalties will be recorded in general and administrative expenses.

The Company is subject to taxation in Canada and various other foreign jurisdictions. The Company is currently open to audit under the statute of limitations by the Canada Revenue Agency for years ended April 30, 2006 through May 31, 2011.

f) Senior secured notes

Under Canadian GAAP, compound financial instruments can be accounted for using the residual method when allocating between the liability and the equity component of the instrument. Under U.S. GAAP, compound financial instruments are accounted for using the fair value method when allocating between the liability and the equity component. On the modification of the senior secured note agreement on March 25, 2009, the senior secured notes were required to be marked- to-market and the Company recognized additional losses relating to redemption and inception losses in the amount of \$14,903,816. This resulted in harmonizing both Canadian GAAP and U.S. GAAP with no differences going forward.

g) Convertible senior secured notes

Under U.S. GAAP, convertible debt instruments are classified as debt until converted to equity, whereas under Canadian GAAP, the proceeds of the convertible debt instrument are allocated to both debt and equity components, with the debt component being accreted over time to its face value and accretion charged to earnings. Under U.S. GAAP, a value is assigned to the conversion feature only if the effective conversion rate is less than the market price of the common stock at the commitment date. No value would be assigned under U.S. GAAP to the conversion feature and thus, the entire value of the convertible notes is classified as debt. This difference resulted in liabilities being increased by \$177,778 and shareholders' equity being decreased by \$177,778.

**30. DIFFERENCES BETWEEN CANADIAN AND UNITED STATES GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (continued)**

h) Deferred financing costs

U.S. GAAP requires that debt issuance costs be reported in the balance sheet as deferred charges and amortized over the term of the debt. Upon issuance, the Company reduced the carrying value of the senior secured notes by debt issuance costs. On modification of the senior secured note agreement as stated above in (f), an inception loss wrote off all deferred financing costs. No differences exist for the period ended May 31, 2011.

i) Commencement of production

Under Canadian GAAP, the Company uses specific criteria to assess the point at which an operation commences commercial production (Note 2). Under U.S. GAAP, commercial production is considered to have commenced when saleable minerals are extracted (produced) from an ore body, regardless of the level of production. However, commercial production does not commence with the removal of de minimum saleable mineral material that occurs in conjunction with the removal of overburden or waste material for the purpose of obtaining access to an ore body. For the year ended May 31, 2011, there were no Canadian/U.S. GAAP differences with respect to the determination of commercial production as the Company was in commercial production during the entire fiscal year.

Under Canadian GAAP, up until January 7, 2010, the Molejon gold mine was at a pre-commercial production phase whereas for U.S. GAAP purposes, commercial production commenced on the date on which revenue was earned from the sale of gold. For U.S. GAAP purposes, the impact of this difference was to increase revenues, cost of sales and amortization and decrease depletion for the year ended May 31, 2010 by \$27,948,475, \$24,275,977, \$1,825,067 and \$3,338,116 respectively, and increase mineral properties and net earnings for the year ended May 31, 2010 by \$8,054,546, and \$5,185,547, respectfully. For the year ended May 31, 2011, there were no Canadian/U.S. GAAP differences as the Company was in commercial production during the entire fiscal year.

j) Warrants

Under Canadian GAAP share purchase warrants are accounted for as equity. Under US GAAP, as required by the Financial Accounting Standards Board ("FASB") issued ASC Topic 815 (formerly, SFAS 133 "Accounting for Derivative Instruments and Hedging Activities"), as amended, and EITF 07-5 "Determining Whether an Instrument (or Embedded Feature) is Indexed to an Entity's Own Stock", share purchase warrants denominated in a currency that is not the functional currency of the Company are accounted for as a liability, with the change in fair value recorded in the statement of operations.

For the year ended May 31, 2011, under U.S. GAAP, other income was decreased by \$8,420,089 arising from an increase in fair value of the warrants granted in which the exercise price denominated currency is different from the Company's functional currency. As of May 31, 2011, the liability relating to warrants granted for which the exercise price denominated currency is different from the Company's functional currency was \$11,578,581 and the warrant account was reduced by \$38,489,476 as a result of the reclassification of the warrants to liabilities pursuant to U.S. GAAP.

k) Under Canadian GAAP, the financial position and results of operations of a variable interest entity are consolidated with those of the Company designated as the primary beneficiary of the entity even though the Company may not hold the controlling interest in the entity. Under ASC 810, non-controlling interests are classified as a separate component of shareholders' equity. Under ASC 810, accumulated losses attributable to non-controlling interests are not limited to the original carrying amount, and therefore non-controlling interests could have a negative carrying amount.

**30. DIFFERENCES BETWEEN CANADIAN AND UNITED STATES GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (continued)**

l) Transition to International Financial Reporting Standards

The Company will report consolidated financial statements in accordance with International Financial Reporting Standards (“IFRS”) for Fiscal 2012. As such the Company will not be presenting reconciliation to US GAAP in future periods as allowed under SEC regulations.

**ITEM 18. FINANCIAL STATEMENTS**

Please refer to “Item 17 — Financial Statements”.

**ITEM 19. EXHIBITS****(a) Financial Statements****Description of Document**

Cover Sheet

Management Report on Internal Controls over Financial Reporting

Report of Independent Registered Public Accounting Firm dated August 29, 2011

Independent Auditors’ Report of Registered Public Accounting Firm dated August 29, 2011

Balance Sheets as at May 31, 2011 and May 31, 2010

Consolidated Statements of Operations and Deficit for Year Ended May 31, 2011, Year Ended May 31, 2010, and Year Ended May 31, 2009

Consolidated Statements of Shareholders’ Equity

Consolidated Statements of Cash Flows for Year Ended May 31, 2011, Year Ended May 31, 2010, and Year Ended May 31, 2009

Notes to the Consolidated Financial Statements

**(b) Exhibits**

| <b>Exhibit Number</b> | <b>Description of Document</b>  |
|-----------------------|---|
| *1.A.                 | Memorandum of Incorporation and Articles of Petaquilla Minerals Ltd.  |
| 2.A.                  | Shareholder Rights Plan   |
| *2.B.                 | Amended and Restated Senior Secured Notes Indenture between Petaquilla Minerals Ltd. and Computershare Trust Company of Canada made as of March 25, 2009                                    |
| *3.B.                 | Special Resolution dated June 8, 1995, increasing the authorized share capital of Petaquilla Minerals Ltd.  |
| *4.F.                 | Option Agreement dated August 10, 1993, between Petaquilla Minerals, S.A., Madison Enterprises Corp. and Madison Enterprises (Latin America), S.A. with respect to the Belencillo Property. |
| *4.G.                 | Association Agreement dated September 23, 1994, as amended, between Petaquilla Minerals, S.A. and Madison Enterprises (Latin America), S.A., with respect to the Belencillo Property        |
| *4.I.                 | Option Agreement dated February 17, 1994, between Petaquilla Minerals, S.A. and Arlo Resources Ltd. with respect to the Oro del Norte Property  |
| *4.J.                 | Option Agreement dated February 17, 1994, between Petaquilla Minerals, S.A. and Arlo Resources Ltd. with respect to the Santa Lucia Property  |
| *4.K.                 | Option Agreement dated January 27, 1994, between Petaquilla Minerals, S.A. and Silverstone Resources Ltd. with respect to the La Esperanza Property   |
| *4.L.                 | Option Agreement dated November 7, 1994, between Petaquilla Minerals, S.A., Arlo Resources Ltd. and Arlo Resources (Panama), S.A. with respect to the Iglesias Property                     |

|        |  |
|--------|--|
| *4.O.  | Petaquilla Shareholders Agreement dated February 21, 1997, between Petaquilla Minerals Ltd., Teck Corporation, Inmet Mining Corporation, Georecursos Internacional, S.A. and Minera Petaquilla, S.A. |
| *4.S.  | Assignment dated May 23, 2000, between Adrian Resources (Colorado) Ltd. and Hyperion Resources (Colorado) Ltd. respecting the Baca Ranch Property  |
| *4.T.  | Molejon Gold Project Agreement dated June 2, 2005, among Petaquilla Minerals Ltd., Teck Cominco Limited, Inmet Mining Corporation and Minera Petaquilla, S.A.  |
| *4.V.  | Law No. 9, dated February 26, 1997, of the Legislative Assembly of Panama (original Spanish version)   |
| *4.W.  | Law No. 9, dated February 26, 1997, of the Legislative Assembly of Panama (English translation of original Spanish version)  |
| *8     | Subsidiaries of Petaquilla Minerals Ltd.   |
| *11.A. | Code of Business Ethics and Conduct dated May 31, 2008   |
| *11.B. | Whistle-Blower Policy dated May 31, 2008   |
| 12.A.  | Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act 2002  |
| 12.B.  | Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act 2002  |
| 13.A.  | Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002   |
| 13.B.  | Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002   |

\* *These exhibits were previously filed with Petaquilla Minerals Ltd.'s Registration Statement or a previous Annual Report on Form 20-F (file no. 000-26296).*

## SIGNATURES

Pursuant to the requirements of Section 12 of the Securities Exchange Act of 1934, the Registrant certifies that it meets all of the requirements for filing on Form 20-F and has duly caused this Annual Report to be signed on its behalf by the undersigned, hereunto duly authorized.

Dated at Vancouver, British Columbia, this 29<sup>th</sup> day of August, 2011.

### **PETAQUILLA MINERALS LTD.**

By: /s/ Joao Manuel

\_\_\_\_\_  
Joao Manuel, Chief Executive Officer  
(principal executive officer)

By: /s/ Ezequiel Sirotinsky

\_\_\_\_\_  
Ezequiel Sirotinsky, Chief Financial Officer  
(principal financial and accounting officer)

**SHAREHOLDER RIGHTS PLAN AGREEMENT**

**PETAQUILLA MINERALS LTD.**

**(the "Corporation")**

**AND**

**COMPUTERSHARE INVESTOR SERVICES INC.**

**(the "Rights Agent")**

**October 18, 2010**

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## SHAREHOLDER RIGHTS PLAN AGREEMENT

THIS SHAREHOLDER RIGHTS PLAN AGREEMENT dated for reference October 18, 2010,

BETWEEN:

**PETAQUILLA MINERALS LTD.**, a corporation incorporated under the laws of the Province of British Columbia and having its head office at #410 – 475 West Georgia Street, Vancouver, BC V6B 4M9

(the "**Corporation**")

OF THE FIRST PART

AND:

**COMPUTERSHARE INVESTOR SERVICES INC.**, a company under the laws of Canada and having an office at 2nd Floor, 510 Burrard Street, Vancouver, BC, V6C 3B9

(the "**Rights Agent**")

OF THE SECOND PART

### WHEREAS:

A. The Board of Directors of the Corporation has determined that it is in the best interests of the Corporation to adopt a shareholder rights plan to ensure, to the extent possible, that all shareholders of the Corporation are treated fairly in connection with any take-over bid for the Corporation.

B. In order to implement the adoption of a shareholder rights plan as established by this Agreement the Board of Directors of the Corporation has:

(1) authorized the issuance, effective at 12:01 a.m. (Vancouver time) on the Effective Date, of one Right in respect of each Common Share outstanding as of 12:01 a.m. (Vancouver time) on the Effective Date (the "**Record Time**"); and

(2) authorized the issue of one Right in respect of each Common Share issued after the Record Time and prior to the earlier of the Separation Time and the Expiration Time.

C. Each Right entitles the holder thereof, after the Separation Time, to purchase securities of the Corporation pursuant to the terms and subject to the conditions set forth in this Agreement.

D. The Corporation wishes to appoint the Rights Agent to act on behalf of the Corporation and the holders of Rights, and the Rights Agent is willing to so act, in connection with the issuance, transfer, exchange and replacement of Rights Certificates, the exercise of Rights and other matters referred to in this Agreement.

E. The Board of Directors of the Corporation proposes that this Agreement be in place for a period of six years.

NOW THEREFORE, in consideration of the premises and respective agreements set forth herein, the parties hereto agree as follows:

## ARTICLE 1 INTERPRETATION

### 1.1 Definitions

In this Agreement, the following words and terms will, unless the context otherwise requires, have the following meanings:

- (a) **"Acquiring Person"** means any Person who is or becomes the Beneficial Owner of 20% or more of the outstanding Voting Shares, provided that the term "Acquiring Person" will not include:
- (i) the Corporation or any Subsidiary of the Corporation;
  - (ii) any Person who becomes the Beneficial Owner of 20% or more of the outstanding Voting Shares as a result of one or any combination of:
    - (A) a Voting Share Reduction;
    - (B) Permitted Bid Acquisitions;
    - (C) an Exempt Acquisition; or
    - (D) a Pro Rata Acquisition,provided that if a Person becomes the Beneficial Owner of 20% or more of the outstanding Voting Shares by reason of one or any combination of a Voting Share Reduction, Permitted Bid Acquisitions, an Exempt Acquisition or a Pro Rata Acquisition and thereafter such Person becomes the Beneficial Owner of any additional Voting Shares (other than pursuant to a Voting Share Reduction, Permitted Bid Acquisitions, an Exempt Acquisition or a Pro Rata Acquisition), then as of the date that such Person becomes the Beneficial Owner of such additional Voting Shares, such Person will become an "Acquiring Person";
  - (iii) for a period of ten days after the Disqualification Date (as defined below), any person who becomes the Beneficial Owner of 20% or more of the outstanding Voting Shares as a result of such Person becoming disqualified from relying on Section 1.1 (f)(viii) solely because such Person or the Beneficial Owner of such Voting Shares has participated in, proposes or intends to make or is participating in a Take-Over Bid or any plan or proposal relating thereto or resulting therefrom, either alone or by acting jointly or in concert with any other Person. For the purposes of this definition, "Disqualification Date" means the first date of public announcement of facts indicating that any Person has participated in, has made, proposes or intends to make or is participating in a Take-Over Bid or any plans or proposals relating thereto or resulting therefrom, including, without limitation, a report filed pursuant to Section 111 of the Securities Act (British Columbia), Section 101 of the Securities Act (Ontario), Section 147.11 of the Securities Act (Quebec) or Section 176 of the Securities Act (Alberta);
  - (iv) an underwriter or member of a banking or selling group that becomes the Beneficial Owner of 20% or more of the outstanding Voting Shares in connection with a *bona fide* distribution to the public of securities pursuant to an underwriting agreement with the Corporation; or
  - (v) a Grandfathered Person, provided that this exception will not be, and will cease to be, applicable to a Grandfathered Person in the event that such Grandfathered Person, after the Record Time, becomes the Beneficial Owner of any additional Voting Shares that increases its Beneficial Ownership of Voting Shares by more than 1% of the number of Voting Shares outstanding from time to time, other than through a Voting Share

Reduction, a Permitted Bid Acquisition, an Exempt Acquisition, a Pro Rata Acquisition or through the exercise of existing rights to acquire additional Voting Shares from the Corporation where such rights were owned by the Grandfathered Person at the Record Time.

- (b) **"Affiliate"** means, when used to indicate a relationship with a specified Person, a Person that, directly, or indirectly through one or more intermediaries or otherwise, controls, or is controlled by, or is under common control with, such specified Person.
- (c) **"Agreement"** means this shareholder rights plan agreement dated for reference October 18, 2010, between the Corporation and the Rights Agent, as amended, modified or supplemented from time to time.
- (d) **"Annual Cash Dividend"** means cash dividends paid at regular intervals in any financial year of the Corporation to the extent that such cash dividends do not exceed, in the aggregate, the greatest of:
  - (i) 200% of the aggregate amount of cash dividends declared payable by the Corporation on its Common Shares in its immediately preceding financial year;
  - (ii) 300% of the arithmetic average of the aggregate amount of cash dividends declared payable by the Corporation on its Common Shares in its three immediately preceding financial years; and
  - (iii) 100% of the aggregate consolidated net income of the Corporation, before extraordinary items, for its immediately preceding financial year.
- (e) **"Associate"** means, when used to indicate a relationship with a specified Person:
  - (i) a corporation of which that Person owns, at law or in equity, shares or securities currently convertible into shares carrying more than 10% of the Voting Rights exercisable with respect to the election of directors under all circumstances or by reason of the occurrence of an event that has occurred and is continuing, or a currently exercisable option or right to purchase such shares or such convertible securities and with whom that Person is acting jointly or in concert;
  - (ii) a partner of that Person acting on behalf of the partnership of which they are partners;
  - (iii) a trust or estate in which that Person has a beneficial interest and with whom that Person is acting jointly or in concert or in which that Person has a beneficial interest of 50% or more or in respect of which that Person serves as a trustee or in a similar capacity provided, however, that a Person shall not be an associate of a trust by reason only of the fact that such Person serves as a trustee or any similar capacity in relation to such trust if such Person is duly licensed to carry on the business of a trust company under the laws of Canada or any province thereof or if the ordinary business of such Person includes the management of investment funds for unaffiliated investors and such Person acts as trustee or in a similar capacity in relation to such trust in the ordinary course of such business; and
  - (iv) a spouse of that Person, any person of the same or opposite sex with whom that person is living in a conjugal relationship outside marriage, a child of that Person or a relative of that Person if that relative has the same residence as that Person.
- (f) **"Beneficial Owner"**: a Person shall be deemed the "Beneficial Owner", and to have "Beneficial Ownership" of, and to "Beneficially Own":
  - (i) any securities as to which such Person or any of such Person's Affiliates is the direct or indirect owner at law or in equity and for the purposes of this Clause 1.1 (f)(i), but without limiting the generality of the foregoing, a Person shall be deemed to be an

owner at law or in equity of all securities:

- (A) owned by a partnership of which the Person is a partner;
  - (B) owned by a trust in which the Person has a beneficial interest and which is acting jointly or in concert with that Person or in which the Person has a beneficial interest of 50% or more;
  - (C) owned jointly or in common with others; and
  - (D) of which the Person may be deemed to be the beneficial owner (whether or not of record) pursuant to the provisions of the Corporations Act, or the Securities Act (British Columbia), the Securities Act (Ontario), the Securities Act (Quebec), the Securities Act (Alberta), or pursuant to Rule 13d-3 or 13d-5 under the Exchange Act of 1934 (or pursuant to any comparable or successor laws, regulations or rules enacted in relation to the provisions of the Corporations Act, the Securities Act (British Columbia), the Securities Act (Ontario), the Securities Act (Quebec), the Securities Act (Alberta) or pursuant to Rule 13d-3 or 13d-5 as in effect on the date of this Agreement);
- (ii) any securities as to which such Person or any of such Person's Affiliates or Associates has, directly or indirectly:
- (A) the right to acquire (whether such right is exercisable immediately or after the lapse or passage of time and whether or not on condition or the happening of any contingency or otherwise) pursuant to any agreement, arrangement, pledge or understanding, whether or not in writing (other than (x) customary agreements with and between underwriters and/or banking group members and/or selling group members with respect to a bona fide public offering of securities; (y) pledges of securities in the ordinary course of business that meet all the conditions specified in Rule 13d-3(d)(3) under the Exchange Act of 1934 (except for the condition in Rule 13d-3(d)(3)(ii)); and (z) pledge agreements with a registered securities dealer relating to the extension of credit for purchases of securities on margin in the ordinary course of the dealer's business), or upon the exercise of any conversion right, exchange right, share purchase right (other than the Rights), warrant or option, or otherwise; or
  - (B) the right to vote such securities (whether such right is exercisable immediately or after the lapse or passage of time and whether or not on condition or the happening of any contingency or otherwise) pursuant to any agreement, arrangement, pledge (other than (x) pledges of securities in the ordinary course of business that meet all the conditions specified in Rule 13d-3(d)(3) under the Exchange Act of 1934 (except for the condition in Rule 13d-3(d)(3)(ii)); and (y) pledge agreements with a registered securities dealer relating to the extension of credit for purchases of securities on margin in the ordinary course of the dealer's business) or understanding (whether or not in writing) or otherwise;
- (iii) any securities which are Beneficially Owned within the meaning of Clauses 1.1 (f)(i) or (ii) by any other Person with which such Person or any of such Person's Affiliates or Associates has any agreement, arrangement or understanding, whether or not in writing (other than (x) customary agreements with and between underwriters and/or banking group members and/or selling group members with respect to a bona fide public offering of securities, (y) pledges of securities in the ordinary course of business that meet all the conditions specified in Rule 13d-3(d)(3) under the Exchange Act of 1934 (except for the condition in Rule 13d-3(d)(3)(ii)) and (z) pledge agreements with a registered securities dealer relating to the extension of credit for purchases of securities on margin in the ordinary course of the dealer's business) with respect to or for the

purpose of acting jointly or in concert in acquiring, holding, voting or disposing of any Voting Shares of any class; and

- (iv) any securities which are directly or indirectly owned at law or in equity by an Associate of such Person;

provided, however, that a Person shall not be deemed the "Beneficial Owner" of, or to have "Beneficial Ownership" of, or to "Beneficially Own", any security:

- (v) where such security has been deposited or tendered pursuant to any Take-Over Bid made by such Person, made by any of such Person's Affiliates or Associates or made by any other Person referred to in Clause 1.1 (f)(iii), until such deposited or tendered security has been taken up or paid for, whichever shall first occur;
- (vi) where such Person, any of such Person's Affiliates or Associates or any other Person referred to in Clause 1.1 (f)(iii), has or shares the power to vote or direct the voting of such security pursuant to a revocable proxy given in response to a public proxy solicitation or where such Person has an agreement, arrangement or understanding with respect to a shareholder proposal or proposals or a matter or matters to come before a meeting of shareholders, including the election of directors;
- (vii) where such Person, any of such Person's Affiliates or Associates or any other Person referred to in Clause 1.1 (f)(iii), has or shares the power to vote or direct the voting of such security in connection with or in order to participate in a public proxy solicitation or where such Person has an agreement, arrangement or understanding with respect to a shareholder proposal or proposals or a matter or matters to come before a meeting of shareholders, including the election of directors;
- (viii) where such Person, any of such Person's Affiliates or Associates or any other Person referred to in Clause 1.1 (f)(iii), holds or exercises voting or dispositive power over such security provided that:
  - (A) the ordinary business of any such Person (the "**Investment Manager**") includes the management of investment funds for others (which others, for greater certainty, may include or be limited to one or more employee benefit plans or pension plans) and such voting or dispositive power over such security is held by the Investment Manager in the ordinary course of such business in the performance of such Investment Manager's duties for the account of another Person (a "**Client**");
  - (B) such Person (the "**Trust Company**") is licensed to carry on the business of a trust company under the laws of Canada or any province thereof and, as such, acts as trustee or administrator or in a similar capacity in relation to the estates of deceased or incompetent Persons (each an "**Estate Account**") or in relation to other accounts (each an "**Other Account**") and holds such voting or dispositive power over such security in the ordinary course of such duties for the estate of any such deceased or incompetent Person or for such other accounts;
  - (C) such Person is established by statute for purposes that include, and a substantial portion of the ordinary business or activity of such Person (the "**Statutory Body**") is, the management of investment funds for employee benefit plans, pension plans, insurance plans or various public bodies; or
  - (D) such Person (the "**Administrator**") is the administrator or trustee of one or more pension funds or plans registered under the laws of Canada or any Province thereof or the laws of the United States of America or any State thereof;

provided, in any of the above cases, that the Investment Manager, the Trust Company, the Statutory Body or the Administrator, as the case may be, is not then making or proposing to make a Take-Over Bid, other than an Offer to Acquire Voting Shares or other securities by means of a distribution by the Corporation or by means of ordinary market transactions (including prearranged trades) executed through the facilities of a stock exchange organized over-the-counter market, alone or by acting jointly or in concert with any other Person; or

- (ix) where such Person is a Client of the same Investment Manager as another Person on whose account the Investment Manager holds or exercises voting or dispositive power over such security, or by reason of such Person being an Estate Account or an Other Account of the same Trust Company as another Person on whose account the Trust Company holds or exercises voting or dispositive power over such security.
- (g) **"Board of Directors"** means the board of directors from time to time of the Corporation or any duly constituted and empowered committee thereof.
- (h) **"Business Day"** means any day other than a Saturday, Sunday or a day on which banking institutions in Vancouver are authorized or obligated by law to close.
- (i) **"Canadian Dollar Equivalent"** means, for any amount which is expressed in United States dollars on any date, the Canadian dollar equivalent of such amount determined by reference to the U.S.-Canadian Exchange Rate on such date.
- (j) **"Canadian-U.S. Exchange Rate"** means, on any date, the inverse of the U.S.-Canadian Exchange Rate.
- (k) **"Close of Business"** means, on any given date, the time on such date (or, if such date is not a Business Day, the time on the next succeeding Business Day) at which the principal transfer office in Vancouver, British Columbia of the transfer agent for the Common Shares of the Corporation (or, after the Separation Time, the office in Vancouver of the Rights Agent) closes to the public.
- (l) **"Common Shares"** means the common shares without par value in the capital of the Corporation as presently constituted, as such shares may be subdivided, consolidated, reclassified or otherwise changed from time to time.
- (m) **"Corporations Act"** means the Business Corporations Act (British Columbia) and the regulations thereunder, as now in effect or as the same may from time to time be amended, re-enacted or replaced.
- (n) **"Competing Permitted Bid"** means a Take-Over Bid made while a Permitted Bid is in existence and that satisfies all of the provisions of a Permitted Bid except that the condition set forth in Section 1.1 (am)(ii) may provide that the Voting Shares that are the subject of the Take-Over Bid may be taken up or paid for on a date which is not earlier than the later of 35 days after the date of the Take-Over Bid or the earliest date on which Voting Shares may be taken up or paid for under any other Permitted Bid that is in existence for the Voting Shares.
- (o) **"Controlled"**: a corporation shall be deemed to be "controlled" by another Person or two or more Persons if:
  - (i) securities entitled to vote in the election of directors carrying more than 50% of the votes for the election of directors are held, directly or indirectly, by or for the benefit of the other Person or Persons; and
  - (ii) the votes carried by such securities are entitled, if exercised, to elect a majority of the Board of Directors of such corporation.
- (p) **"Co-Rights Agents"** means a Co-Rights Agent appointed pursuant to Subsection 4.1(a).

- (q) **"Corporation"** means PETAQUILLA MINERALS LTD.
- (r) **"Disposition Date"** has the meaning ascribed thereto in Subsection 5.1(h).
- (s) **"Dividend Reinvestment Acquisition"** shall mean an acquisition of Voting Shares pursuant to a Dividend Reinvestment Plan.
- (t) **"Dividend Reinvestment Plan"** means a regular dividend reinvestment or other plan of the Corporation made available by the Corporation to holders of its securities where such plan permits the holder to direct that some or all of:
  - (i) dividends paid in respect of Common Shares;
  - (ii) proceeds of redemption of shares of the Corporation;
  - (iii) interest paid on evidence of indebtedness of the Corporation; or
  - (iv) optional cash payments;
 be applied to the purchase from the Corporation of Common Shares.
- (u) **"Effective Date"** means October 18, 2010.
- (v) **"Election to Exercise"** means an election to exercise Rights substantially in the form attached to the Rights Certificate.
- (w) **"Exchange Act of 1934"** means the Securities Exchange Act of 1934 (United States of America), as amended, and the rules and regulations thereunder, as now in effect or as the same may from time to time be amended, re-enacted or repealed.
- (x) **"Exempt Acquisition"** means a share acquisition in respect of which the Board of Directors has waived the application of Section 3.1 pursuant to the provisions of Sections 5.1(a) or (h).
- (y) **"Exercise Price"** means, as of any date, the price at which a holder of a Right may purchase the securities issuable upon exercise of one whole Right which, until adjusted in accordance with the terms hereof, will be \$30.
- (z) **"Expansion Factor"** shall have the meaning ascribed thereto in Section 2.3(a)(1).
- (aa) **"Expiration Time"** means 4:00 p.m. on that date which is the earlier of the date of termination of this Agreement pursuant to Section 5.16 or, if this Agreement is confirmed pursuant to Section 5.16, 4:00 p.m. on the sixth anniversary of the Effective Date.
- (ab) **"Flip-in Event"** means a transaction or event in or pursuant to which a Person becomes an Acquiring Person.
- (ac) **"Grandfathered Person"** means a Person who is the Beneficial Owner of 20% or more of the outstanding Voting Shares of the Corporation determined as at the Record Time.
- (ad) **"Holder"** shall have the meaning ascribed thereto in Section 2.8.
- (ae) **"Independent Shareholders"** means holders of outstanding Voting Shares, other than:
  - (i) any Acquiring Person;
  - (ii) any Offeror;
  - (iii) any Affiliate or Associate of any Acquiring Person or Offeror;
  - (iv) any Person acting jointly or in concert with any Acquiring Person or Offeror, or with

any Affiliate or Associate of any Acquiring Person or Offeror; and

- (v) any employee benefit plan, deferred profit-sharing plan, stock participation plan and any other similar plan or trust for the benefit of employees of the Corporation unless the beneficiaries of the plan or trust direct the manner in which the Voting Shares are to be voted or direct whether the Voting Shares are to be tendered to a Take-Over Bid.
- (af) **"Market Price"** per share of any securities on any date means the average daily Closing Price per Share of such securities on each of the 20 consecutive Trading Days through and including the Trading Day immediately preceding such date provided, however, that if an event of a type analogous to any of the events described in Section 2.3 hereof shall have caused the closing prices used to determine the Market Price on any Trading Day not to be fully comparable with the closing price on such date (or, if such date is not a Trading Day, on the immediately preceding Trading Day), each such closing price so used shall be appropriately adjusted in a manner analogous to the applicable adjustment provided for in Section 2.3 hereof in order to make it fully comparable with the closing price on such date or, if such date is not a Trading Day, on the immediately preceding Trading Day. The closing price per share ("Closing Price per Share") of any securities on any date shall be:
- (i) the closing board lot sale price or, in case no sale takes place on such date, the average of the closing bid and asked prices per security, as reported by the principal Canadian stock exchange (as determined by the Board of Directors) on which such securities are listed and posted for trading;
  - (ii) if for any reason none of such prices is available on such day or the securities are not listed or posted for trading on a Canadian stock exchange, the last sale price or, in case no such sale takes place on such date, the average of the closing bid and asked prices for each of such securities as reported by the principal United States securities exchange (as determined by the Board of Directors) on which such securities are listed or remitted to trading;
  - (iii) if for any reason none of such prices is available on such date or the securities are not listed or remitted to trading on a Canadian stock exchange or a United States securities exchange, the last sale price or, in case no sale takes place on such date, the average of the high bid and low ask prices for each of such securities in the over the counter market, as quoted by any reporting system then in use (as determined by the Board of Directors); or
  - (iv) if for any reason none of such prices is available on such date or the securities are not listed or remitted to trading on a Canadian stock exchange or a United States securities exchange or quoted by any such reporting system, the average of the closing bid and ask prices as furnished by a professional marketmaker making a market in the securities selected by the Board of Directors;

provided, however, that if for any reason none of such prices is available on such day, the Closing Price per Share of such securities on such a date means the fair value per share of such securities on such date as determined by the Board of Directors, after consultation with a nationally recognized investment dealer or investment banker with respect to the fair value per share of such securities. The market price shall be expressed in Canadian dollars and, if initially determined in respect of any date following part of the 20 consecutive trading day period in question in United States dollars, such amount shall be translated into Canadian dollars at such date at the Canadian dollar equivalent thereof.

Notwithstanding the foregoing, where the Board of Directors is satisfied that the Market Price of securities as determined herein was affected by an anticipated or actual Take-Over Bid or by improper manipulation, the Board of Directors may, acting in good faith, determine the Market Price of securities, such determination to be based on a finding as to the price at which a holder of securities of that class could reasonably have expected to dispose of his securities immediately prior to the relevant date excluding any change in price reasonably attributable to

the anticipated or actual Take-Over Bid or to the improper manipulation.

- (ag) **"Nominee"** has the meaning ascribed thereto in Subsection 2.2(c).
- (ah) **"Offer to Acquire"** includes:
  - (i) an offer to purchase or a solicitation of an offer to sell Voting Shares; and
  - (ii) an acceptance of an offer to sell Voting Shares, whether or not such offer to sell has been solicited;or any combination thereof, and the Person accepting an offer to sell shall be deemed to be making an Offer to Acquire to the Person that made the offer to sell.
- (ai) **"Offeror"** means a Person who has announced an intention to make, or who has made, a Take-Over Bid.
- (aj) **"Offeror's Securities"** means the aggregate of all Voting Shares Beneficially Owned by the Offeror on the date of an Offer to Acquire.
- (ak) **"Permitted Bid"** means a Take-Over Bid made by an Offeror by way of a takeover bid circular which also complies with the following additional provisions:
  - (i) the Take-Over Bid is made for all outstanding Voting Shares and to all holders of Voting Shares as registered on the books of the Corporation, other than the Offeror. The Take-Over Bid shall expressly state that Voting Shares issued on the exercise of share purchase warrants, options and other securities convertible into Voting Shares shall, subject to compliance with the procedures applicable generally to the tendering of Voting Shares of the Take-Over Bid, be eligible to be tendered under the Take-Over Bid;
  - (ii) the Take-Over Bid contains, and the take-up and payment for securities tendered or deposited is subject to, an irrevocable and unqualified provision that no Voting Shares will be taken up or paid for pursuant to the Take-Over Bid prior to the close of business on the Permitted Bid Expiry Date and only if at such date more than 50% of the Voting Shares held by Independent Shareholders shall have been deposited or tendered pursuant to the Take-Over Bid and not withdrawn;
  - (iii) the Take-Over Bid contains an irrevocable and unqualified provision that Voting Shares may be deposited pursuant to such Take-Over Bid at any time during the period of time described in Section 1.1 (am)(ii) and that any Voting Shares deposited pursuant to the Take-Over Bid may be withdrawn until taken up and paid for; and
  - (iv) the Take-Over Bid contains an irrevocable and unqualified provision that in the event that the deposit condition set forth in Section 1.1 (am)(ii) is satisfied the Offeror will make a public announcement of that fact and the Take-Over Bid will remain open for deposits and tenders of Voting Shares for not less than ten Business Days from the date of such public announcement.
- (al) **"Permitted Bid Acquisition"** means an acquisition of Voting Shares made pursuant to a Permitted Bid or a Competing Permitted Bid.
- (am) **"Permitted Bid Expiry Date"** means 60 days following the date of the Take-Over Bid.
- (an) **"Person"** includes an individual, body corporate, partnership, syndicate or other form of unincorporated association, a government and its agencies or instrumentalities, any entity or group (as such term is used in Rule 1 3d-5 under the Exchange Act of 1934 as in effect on the date hereof) whether or not having legal personality and any of the foregoing acting in any derivative, representative or fiduciary capacity.

- (ao) **"Pro-Rata Acquisition"** means an acquisition by a Person of Voting Shares pursuant to:
  - (i) a Dividend Reinvestment Acquisition;
  - (ii) a stock dividend, stock split or other event in respect of securities of the Corporation pursuant to which such Person becomes a beneficial owner of Voting Shares on the same pro-rata basis as all other holders of securities;
  - (iii) the exercise by the Person of only those rights to purchase Voting Shares distributed to that Person in the course of a distribution to all holders of securities of the Corporation pursuant to a bona fide rights offering or pursuant to a prospectus; or
  - (iv) a distribution to the public of Voting Shares, or securities convertible into or exchangeable for Voting Shares (and the conversion or exchange of such convertible or exchangeable securities), made pursuant to a prospectus or by way of a private placement, provided that the Person does not thereby acquire a greater percentage of such Voting Shares, or securities convertible into or exchangeable for Voting Shares, so offered than the Person's percentage of Voting Shares beneficially owned immediately prior to such acquisition.
- (ap) **"Record Time"** means 12:01 a.m. (Vancouver time) on October 18, 2010.
- (aq) **"Redemption Price"** has the meaning ascribed thereto in Section 5.1(b).
- (ar) **"Right"** means a right to purchase Voting Shares on and subject to the terms and conditions of this Agreement.
- (as) **"Rights Agent"** means Computershare Investor Services Inc. and any successor rights agent hereunder.
- (at) **"Rights Certificate"** means a certificate representing Rights in substantially the form of Schedule A attached hereto.
- (au) **"Rights Register"** shall have the meaning ascribed thereto in Section 2.6(a).
- (av) (i) "Securities Act (Alberta)" means the Securities Act, SA, 1981, c. S-61, as amended, and the regulations thereunder;
  - (ii) "Securities Act (British Columbia)" means the Securities Act, RSBC 1996, c.41 8, as amended, and the Securities Rules thereunder,
  - (iii) "Securities Act (Ontario)" means the Securities Act, R.S.O. 1990, c.s.5, as amended, and the regulations thereunder; and
  - (iv) "Securities Act (Quebec)" means the Securities Act (L.R.Q., c. V-1. 1);
- (aw) **"Separation Time"** means 4:00 p.m. on the tenth Business Day after the earlier of:
  - (i) the Share Acquisition Date; and
  - (ii) the date of the commencement of or first public announcement of the intent of any Person (other than the Corporation or any Subsidiary of the Corporation) to commence a Take-Over Bid (other than a Permitted Bid or a Competing Permitted Bid), or such earlier or later time as may be determined by the Board of Directors, provided that, if any Take-Over Bid referred to in this clause (ii) expires, is cancelled, terminated or otherwise withdrawn prior to the Separation Time, such Take-Over Bid shall be deemed, for the purposes of this definition, never to have been made.
- (ax) **"Share Acquisition Date"** means the first date of a public announcement or disclosure (which,

for purposes of this definition, shall include, without limitation, a report filed pursuant to Section 101 of the Securities Act (Ontario), Section 111 of the Securities Act (British Columbia), Section 147.11 of the Securities Act (Quebec) and Section 141 of the Securities Act (Alberta)) by the Corporation or an Acquiring Person that a Person has become an Acquiring Person.

- (ay) "Subsidiary": a corporation shall be deemed to be a subsidiary of another corporation if:
  - (i) it is controlled by:
    - (A) that other; or
    - (B) that other and one or more corporations, each of which is controlled by that other; or
    - (C) two or more corporations, each of which is controlled by that other; or
  - (ii) it is a Subsidiary of a corporation that is that other's Subsidiary.
- (az) "**Take-Over Bid**" means an Offer to Acquire Voting Shares, or securities convertible into Voting Shares if, assuming that the Voting Shares or convertible securities subject to the Offer to Acquire are acquired and are Beneficially Owned at the date of such Offer to Acquire by the Person making such Offer to Acquire, such Voting Shares (including Voting Shares that may be acquired upon conversion of securities, convertible into Voting Shares) together with the Offeror's Securities, constitute in the aggregate 20% or more of the outstanding Voting Shares at the date of the Offer to Acquire.
- (ba) "**Trading Day**" means, when used with respect to any securities, a day on which the principal Canadian stock exchange on which such securities are listed or posted for trading is open for the transaction of business or, if the securities are not listed or posted for trading on any Canadian stock exchange, a Business Day.
- (bb) "**U.S.-Canadian Exchange Rate**" means, on any date:
  - (i) if on such date the Bank of Canada sets an average noon spot rate of exchange for the conversion of one United States dollar into Canadian dollars, such rate; and
  - (ii) in any other case, the rate for such date for the conversion of one United States dollar into Canadian dollars calculated in the manner determined by the Board of Directors from time to time.
- (bc) "**U.S. Dollar Equivalent**" means, for any amount which is expressed in Canadian dollars on any date, the United States dollar equivalent of such amount determined by reference to the Canadian-U.S. Exchange Rate on such date.
- (bd) "**Voting Shares**" means the Common Shares and any other shares of the Corporation entitled to vote generally and at all times for the election of directors of the Corporation.
- (be) "**Voting Share Reduction**" means an acquisition or redemption by the Corporation of outstanding Voting Shares which, by reducing the number of Voting Shares outstanding, increases the percentage of Voting Shares Beneficially Owned by a Person to 20% or more of the Voting Shares then outstanding.

## 1.2 Currency

All sums of money which are referred to in this Agreement are expressed in lawful money of Canada, unless otherwise specified.

### 1.3 Headings and References

The headings of the articles, sections and subsections of this Agreement and the table of contents are inserted for convenience of reference only and shall not affect the construction or interpretation of this Agreement. All references to articles, sections, subsections and paragraphs are to articles, sections, subsections and paragraphs of this Agreement. The words "hereto", "herein", "hereof", "hereunder", "this Agreement", "the Rights Agreement" and similar expressions refer to this Agreement including the schedule attached hereto as a whole, as the same may be amended, modified or supplemented at any time or from time to time.

### 1.4 Calculation of Number and Percentage of Beneficial Ownership of Outstanding Voting Shares

For purposes of this Agreement, the percentage of Voting Shares of any class Beneficially Owned by any Person, will be and be deemed to be the product (expressed as a percentage) determined by the formula:

$$100 \times A/B$$

where:

- A = the number of votes for the election of all directors generally attaching to the Voting Shares of the particular class Beneficially Owned by such Person; and
- B = the number of votes for the election of all directors generally attaching to all outstanding Voting Shares of the particular class.

Where any Person is deemed to Beneficially Own unissued Voting Shares such Voting Shares will be deemed to be outstanding for the purpose of calculating the percentage of Voting Shares of the particular class Beneficially Owned by such Person.

### 1.5 Acting Jointly or in Concert

For purposes of this Agreement, whether Persons are acting jointly or in concert is a question of fact in each circumstance, however, a Person shall be deemed to be acting jointly or in concert with another Person if such Person would be deemed to be acting jointly or in concert with such other Person for purposes of Section 91(1) of the *Securities Act* (Ontario), Section 96(1) of the *Securities Act* (British Columbia), Section 111 of the *Securities Act* (Quebec) and Section 131.1(1) of the *Securities Act* (Alberta) (other than by virtue of the inclusion of the word "associate" in Section 91(1) of the *Securities Act* (Ontario), Section 96(1) of the *Securities Act* (British Columbia), and Section 131.1(1) of the *Securities Act* (Alberta) as it exists on the date hereof).

Notwithstanding the foregoing and for greater certainty, the phrase "acting jointly or in concert", wherever used in this Agreement, shall not include conduct:

- (a) unrelated to the Corporation; or
- (b) pertaining to:
  - (i) voting or directing the vote of securities of the Corporation pursuant to a revocable proxy given in response to a public proxy solicitation;
  - (ii) voting or directing the vote of securities of the Corporation in connection with or in order to participate in a public proxy solicitation made or to be made;
  - (iii) having an agreement, arrangement or understanding with respect to a particular shareholder proposal or a particular matter to come before a meeting of shareholders, including the election of directors.

### 1.6 Generally Accepted Accounting Principles

Wherever in this Agreement reference is made to generally accepted accounting principles, such reference shall be deemed to be the recommendations at the relevant time of the Canadian Institute of Chartered

Accountants, or any successor institute, applicable on a consolidated basis (unless otherwise specifically provided herein to be applicable on an unconsolidated basis) as of the date on which a calculation is made or required to be made in accordance with generally accepted accounting principles. Where the character or amount of an asset or liability or item of revenue or expense is required to be determined, or any consolidation or other accounting computation is required to be made for the purpose of this Agreement or any document, such determination or calculation shall, to the extent applicable and except as otherwise specified herein or as otherwise agreed in writing by the parties, be made in accordance with generally accepted accounting principles applied on a consistent basis.

## ARTICLE 2

## RIGHTS

## THE

### 2.1 Legend on Common Share Certificates

Certificates representing Voting Shares which are issued after the Record Time but prior to the earlier of the Separation Time and the Expiration Time, will evidence one Right for each Voting Share represented thereby and shall have impressed, printed or written thereon or otherwise affixed thereto the following legend:

"Until the Separation Time (as such term is defined in the Shareholder Rights Agreement referred to below), this certificate also evidences and entitles the holder hereof to certain rights as set forth in the shareholder rights agreement (the "Shareholder Rights Agreement") dated for reference October 18, 2010, between PETAQUILLA MINERALS LTD. (the "Corporation") and Computershare Investor Services Inc., as Rights Agent, the terms of which are hereby incorporated herein by reference and a copy of which is on file and may be inspected during normal business hours at the principal executive office of the Corporation. Under certain circumstances as set forth in the Shareholder Rights Agreement, such Rights may be amended, redeemed or exchanged, may expire, may lapse, may become void (if, in certain circumstances, they are "Beneficially Owned" by a person who is or becomes an "Acquiring Person", as such terms are defined in the Shareholder Rights Agreement, or a transferee thereof) or may be evidenced by separate certificates and may no longer be evidenced by this certificate. The Corporation will mail or arrange for the mailing of a copy of the Shareholder Rights Agreement to the holder of this certificate without charge as soon as practicable after the receipt of a written request therefor."

Certificates representing Voting Shares that are issued and outstanding at the Record Time will also evidence one Right for each one Voting Share evidenced thereby, notwithstanding the absence of the foregoing legend, until the close of business on the earlier of the Separation Time and the Expiration Time.

### 2.2 Initial Exercise Price; Exercise of Rights; Detachment of Rights

- (a) Exercise Terms: Subject to adjustment as herein set forth, each Right will entitle the holder thereof, from and after the Separation Time and prior to the Expiration Time, to purchase one Voting Share for the Exercise Price. Notwithstanding any other provision of this Agreement, any Rights held by the Corporation or any of its Subsidiaries will be void.
- (b) No Exercise Prior to Separation Time: Until the Separation Time:
  - (i) the Rights will not be exercisable and no Right may be exercised; and
  - (ii) each Right shall be evidenced by the certificate for the associated Voting Share registered in the name of the holder thereof (which certificate shall also be deemed to represent a Rights Certificate) and shall be transferable only together with, and shall be transferred by a transfer of, such associated Voting Share.
- (c) Exercise After Separation Time: From and after the Separation Time and prior to the Expiration

Time:

- (i) the Rights are exercisable; and
- (ii) the registration and transfer of Rights will be separate from and independent of Voting Shares.

Promptly following the Separation Time, the Corporation will prepare and the Rights Agent will mail to each holder of record of Voting Shares as of the Separation Time (other than an Acquiring Person and, in respect of any Rights Beneficially Owned by such Acquiring Person which are not held of record by such Acquiring Person, the holder of such Rights (a "Nominee")), at such holder's address as shown by the records of the Corporation (the Corporation hereby agreeing to furnish copies of such records to the Rights Agent for this purpose):

- (iii) a Rights Certificate appropriately completed, representing the number of Rights held by such holder at the Separation Time and having such marks of identification or designation and such legends, summaries or endorsements printed thereon as the Corporation may deem appropriate and as are not inconsistent with the provisions of this Agreement, or as may be required to comply with any law, rule or regulation or with any rule or regulation of any self-regulatory organization, stock exchange or "system" on which the Rights may from time to time be listed or traded, or to conform to usage; and
- (iv) a disclosure statement describing the Rights;

provided that a Nominee shall be sent the materials provided for in (iii) and (iv) in respect of all Voting Shares of the Corporation held of record by it which are not Beneficially Owned by an Acquiring Person.

- (d) Manner of Exercise: Rights may be exercised, in whole or in part, on any Business Day after the Separation Time and prior to the Expiration Time by submitting to the Rights Agent:
  - (i) the Rights Certificate evidencing such Right;
  - (ii) an election to exercise such Rights (an "Election to Exercise") substantially in the form attached to the Rights Certificate appropriately completed and executed by the holder or his executors or administrators or other personal representatives or his or their legal attorney duly appointed by instrument in writing in form and executed in a manner satisfactory to the Rights Agent; and
  - (iii) payment by certified cheque, banker's draft or money order payable to the order of the Corporation, in a sum equal to the Exercise Price multiplied by the number of Rights being exercised and a sum sufficient to cover any transfer tax or charge which may be payable in respect of any transfer involved and the transfer or delivery of Rights Certificates or the issuance or delivery of certificates of Voting Shares in a name other than that of the holder of the Rights being exercised.
- (e) Issue of Voting Shares: Upon receipt of a Rights Certificate, together with a completed Election to Exercise executed in accordance with Subsection 2.2(d)(ii) which does not indicate that such Right is null and void as provided by Subsection 3.1(b), and payment as set forth in Section 2.2(d)(iii), the Rights Agent (unless otherwise instructed by the Corporation in the event that the Corporation is of the opinion that the Rights cannot be exercised in accordance with this Agreement) will thereupon promptly:
  - (i) requisition from the transfer agent certificates representing the number of Voting Shares to be purchased (the Corporation hereby irrevocably authorizing its transfer agent to comply with all such requisitions);

- (ii) when appropriate, requisition from the Corporation the amount of cash to be paid in lieu of issuing fractional Voting Shares;
  - (iii) after receipt of the certificates referred to in Section 2.2(e)(i), deliver the same to or upon the order of the registered holder of such Rights Certificates, registered in such name or names as may be designated by such holder; and
  - (iv) when appropriate, after receipt, deliver the cash referred to in clause 2.2(e)(ii) to or to the order of the registered holder of such Rights Certificate.
- (f) Partial Exercise: In case the holder of any Rights shall exercise less than all of the Rights evidenced by the Rights Certificate of such holder, a new Rights Certificate evidencing the Rights remaining unexercised (subject to the provisions of Subsection 5.5(a)) will be issued by the Rights Agent to such holder or to such holder's authorized assigns.
- (g) Covenants: The Corporation covenants and agrees to:
- (i) take all such action as may be necessary on its part and within its powers to ensure that all Voting Shares delivered upon exercise of Rights shall, at the time of delivery of the certificates evidencing such Voting Shares (subject to payment of the Exercise Price), be validly authorized, executed, issued and delivered and be fully paid and non-assessable;
  - (ii) take all such action as may be necessary and within its power to comply with any applicable requirements of the Corporations Act, the Securities Act (Ontario), the Securities Act (British Columbia), the Securities Act (Quebec) and the Securities Act (Alberta), and the securities laws or comparable legislation of each of the other provinces and territories of Canada, and any other applicable law, rule or regulation thereof, in connection with the issue and delivery of the Rights Certificates and the issuance of the Voting Shares upon exercise of Rights;
  - (iii) use reasonable efforts to cause all Voting Shares issued upon exercise of Rights to be listed upon the stock exchanges upon which the Voting Shares were traded immediately prior to the Share Acquisition Date;
  - (iv) cause to be reserved and kept available out of the authorized and unissued Voting Shares, the number of Voting Shares that, as provided in this Agreement, will from time to time be sufficient to permit the exercise in full of all outstanding Rights;
  - (v) pay when due and payable, if applicable, any and all federal, provincial and municipal transfer taxes and charges (not including any income or capital taxes of the holder or exercising holder or any liability of the Corporation to withhold tax) which may be payable in respect of the original issuance or delivery of the Rights Certificates, or certificates for the Voting Shares to be issued upon exercise of any Rights, provided that the Corporation shall not be required to pay any transfer tax or charge which may be payable in respect of any transfer involved in the transfer or delivery of Rights Certificates or the issuance or delivery of certificates for Voting Shares in a name other than that of the holder of the Rights being transferred or exercised; and
  - (vi) after the Separation Time, except as permitted by Section 5.1, not take (or permit any subsidiary to take) any action if at the time such action is taken it is reasonably foreseeable that such action will diminish substantially or otherwise eliminate the benefits intended to be afforded by the Rights.
- (h) Authorized Capital: If the number of Common Shares which are not issued or reserved for issue is insufficient to permit the exercise in full of the Rights in accordance with this Section 2.2, then each Right, when such Right is aggregated with a sufficient number of Rights to acquire a whole number of Common Shares, will entitle the holder thereof, after the Separation Time, to purchase that number of Common Shares at the Exercise Price per Common Share equal to the

quotient determined by dividing the difference between the number of authorized Common Shares and the number of Common Shares then issued or allotted or reserved for issuance by the Corporation, by the number of Rights then outstanding.

### 2.3 Adjustments to Exercise Price; Number of Rights

The Exercise Price, the number and kind of securities subject to purchase upon exercise of each Right and the number of Rights outstanding are subject to adjustment from time to time as provided in this Section 2.3.

(a) Share Reorganization: If the Corporation shall at any time after the date of this Agreement:

- (i) declare or pay a dividend on Voting Shares payable in Voting Shares (or other securities exchangeable for or convertible into or giving a right to acquire Voting Shares or other securities of the Corporation) other than pursuant to any optional stock dividend program;
- (ii) subdivide or change the then outstanding Voting Shares into a greater number of Voting Shares;
- (iii) consolidate or change the then outstanding Voting Shares into a smaller number of Voting Shares; or
- (iv) issue any Voting Shares for other securities exchangeable for or convertible into or giving a right to acquire Voting Shares or other securities of the Corporation or in respect of, in lieu of or in exchange for existing Voting Shares, except as otherwise provided in this Section 2.3,

the Exercise Price and the number of Rights outstanding, or, if the payment or effective date therefor shall occur after the Separation Time, the securities purchasable upon exercise of Rights shall be adjusted as of the payment or effective date in the manner set forth below.

If the Exercise Price and number of Rights outstanding are to be adjusted:

- (1) the Exercise Price in effect after such adjustment will be equal to the Exercise Price in effect immediately prior to such adjustment divided by the number of Voting Shares (or other capital stock) (the "Expansion Factor") that a holder of one Voting Share immediately prior to such dividend, subdivision, change, consolidation or issuance would hold thereafter as a result thereof; and
- (2) each Right held prior to such adjustment will become that number of Rights as results from the application of the Expansion Factor,

and the adjusted number of Rights will be deemed to be distributed among the Voting Shares with respect to which the original Rights were associated (if they remain outstanding) and the shares issued in respect of such dividend, subdivision, change, consolidation or issuance, so that each such Voting Share (or other capital stock) will have exactly one Right associated with it in effect following the payment or effective date of the event referred to in Clause 2.3(a)(i), (ii), (iii) or (iv), as the case may be.

For greater certainty, if the securities purchasable upon exercise of Rights are to be adjusted, the securities purchasable upon exercise of each Right after such adjustment will be the securities that a holder of the securities purchasable upon exercise of one Right immediately prior to such dividend, subdivision, change, consolidation or issuance would hold thereafter as a result of such dividend, subdivision, change, consolidation or issuance.

If, after the Record Time and prior to the Expiration Time, the Corporation shall issue any shares of capital stock other than Voting Shares in a transaction of a type described in Clause 2.3(a)(i) or (iv), shares of such capital stock shall be treated herein as nearly equivalent to Voting Shares as may be practicable and appropriate under the circumstances and the

Corporation and the Rights Agent agree to amend this Agreement in order to effect such treatment.

In the event the Corporation shall at any time after the Record Time and prior to the Separation Time issue any Voting Shares otherwise than in a transaction referred to in this Subsection 2.3(a), each such Voting Share so issued shall automatically have one new Right associated with it, which Right shall be evidenced by the certificate representing such associated Voting Share.

- (b) Rights Offering: If the Corporation shall at any time after the Record Time and prior to the Separation Time fix a record date for the issuance of rights, options or warrants to all holders of Voting Shares entitling them (for a period expiring within 21 calendar days after such record date) to subscribe for or purchase Voting Shares (or securities convertible into or exchangeable for or carrying a right to purchase Voting Shares) at a price per Voting Share (or, if a security convertible into or exchangeable for or carrying a right to purchase or subscribe for Voting Shares, having a conversion, exchange or exercise price, including the price required to be paid to purchase such convertible or exchangeable security or right per share) less than the Market Price per Voting Share on such record date, the Exercise Price to be in effect after such record date shall be determined by multiplying the Exercise Price in effect immediately prior to such record date by a fraction:
- (i) the numerator of which shall be the number of Voting Shares outstanding on such record date, plus the number of Voting Shares that the aggregate offering price of the total number of Voting Shares so to be offered (and/or the aggregate initial conversion, exchange or exercise price of the convertible or exchangeable securities or rights so to be offered, including the price required to be paid to purchase such convertible or exchangeable securities or rights) would purchase at such Market Price per Voting Share; and
  - (2) the denominator of which shall be the number of Voting Shares outstanding on such record date, plus the number of additional Voting Shares to be offered for subscription or purchase (or into which the convertible or exchangeable securities or rights so to be offered are initially convertible, exchangeable or exercisable).

In case such subscription price may be paid by delivery of consideration, part or all of which may be in a form other than cash, the value of such consideration shall be as determined in good faith by the Board of Directors, whose determination shall be described in a statement filed with the Rights Agent and shall be binding on the Rights Agent and the holders of Rights. Such adjustment shall be made successively whenever such a record date is fixed, and in the event that such rights, options or warrants are not so issued, or if issued, are not exercised prior to the expiration thereof, the Exercise Price shall be readjusted to the Exercise Price which would then be in effect if such record date had not been fixed, or to the Exercise Price which would be in effect based upon the number of Voting Shares (or securities convertible into, or exchangeable or exercisable for Voting Shares) actually issued upon the exercise of such rights, options or warrants, as the case may be.

For purposes of this Agreement, the granting of the right to purchase Voting Shares (whether from treasury or otherwise) pursuant to the Dividend Reinvestment Plan or any employee benefit stock option or similar plans shall be deemed not to constitute an issue of rights, options or warrants by the Corporation; provided, however, that, in all such cases, the right to purchase Voting Shares is at a price per share of not less than 95% of the current market price per share (determined as provided in such plans) of the Voting Shares.

- (c) Special Distribution: If the Corporation shall at any time after the Record Time and prior to the Separation Time fix a record date for the making of a distribution to all holders of Voting Shares (including any such distribution made in connection with a merger or amalgamation) of evidences of indebtedness, cash (other than an annual cash dividend or a dividend paid in Voting Shares, but including any dividend payable in securities other than Voting Shares), assets or rights, options or warrants (excluding those referred to in Subsection 2.3(b)), the

Exercise Price to be in effect after such record date shall be determined by multiplying the Exercise Price in effect immediately prior to such record date by a fraction:

- (i) the numerator of which shall be the Market Price per Voting Share on such record date, less the fair market value (as determined in good faith by the Board of Directors, whose determination shall be described in a statement filed with the Rights Agent and shall be binding on the Rights Agent and the holders of Rights), on a per share basis, of the portion of the cash, assets, evidences of indebtedness, rights, options or warrants so to be distributed; and
- (2) the denominator of which shall be such Market Price per Voting Share.

Such adjustments shall be made successively whenever such a record date is fixed, and in the event that such a distribution is not so made, the Exercise Price shall be adjusted to be the Exercise Price which would have been in effect if such record date had not been fixed.

- (d) Minimum Adjustments: Notwithstanding anything herein to the contrary, no adjustment in the Exercise Price shall be required unless such adjustment would require an increase or decrease of at least one per cent in the Exercise Price; provided, however, that any adjustments which by reason of this Subsection 2.3(d) are not required to be made shall be carried forward and taken into account in many subsequent adjustment. All calculations under Section 2.3 shall be made to the nearest cent or to the nearest ten-thousandth of a share. Notwithstanding the first sentence of this Subsection 2.3(d), any adjustment required by Section 2.3 shall be made no later than the earlier of:
  - (i) three years from the date of the transaction which gives rise to such adjustment; or
  - (2) the Expiration Date.
- (e) Discretionary Adjustment: If the Corporation shall at any time after the Record Time and prior to the Separation Time issue any shares of capital stock (other than Common Shares), or rights, options or warrants to subscribe for or purchase any such capital stock, or securities convertible into or exchangeable for any such capital stock, in a transaction referred to in Clause 2.3(a)(i) or (iv), if the Board of Directors acting in good faith determines that the adjustments contemplated by Subsections 2.3(a), (b) and (c) in connection with such transaction will not appropriately protect the interests of the holders of Rights, the Board of Directors may determine what other adjustments to the Exercise Price, number of Rights and/or securities purchasable upon exercise of Rights would be appropriate and, notwithstanding Subsections 2.3(a), (b) and (c), such adjustments, rather than the adjustments contemplated by Subsections 2.3(a), (b) and (c), shall be made. The Corporation and the Rights Agent shall have authority without the approval of the holders of the Common Shares or the holders of Rights to amend this Agreement as appropriate to provide for such adjustments.
- (f) Benefit of Adjustments: Each Right originally issued by the Corporation subsequent to any adjustment made to the Exercise Price hereunder shall evidence the right to purchase, at the adjusted Exercise Price, the number of Voting Shares purchasable from time to time hereunder upon exercise of a Right immediately prior to such issue, all subject to further adjustment as provided herein.
- (g) No Change of Certificates: Irrespective of any adjustment or change in the Exercise Price or the number of Voting Shares issuable upon the exercise of the Rights, the Rights Certificates theretofore and thereafter issued may continue to express the Exercise Price per Voting Share and the number of Voting Shares which were expressed in the initial Rights Certificates issued hereunder.
- (h) Timing of Issuance: In any case in which this Section 2.3 shall require that an adjustment in the Exercise Price be made effective as of a record date for a specified event, the Corporation may elect to defer until the occurrence of such event the issuance to the holder of any Right exercised after such record date the number of Voting Shares and other securities of the

Corporation, if any, issuable upon such exercise over and above the number of Voting Shares and other securities of the Corporation, if any, issuable upon such exercise on the basis of the Exercise Price in effect prior to such adjustment;

- (i) Adjustments Regarding Tax: Notwithstanding anything contained in this Section 2.3 to the contrary, the Corporation shall be entitled to make such reductions in the Exercise Price, in addition to those adjustments expressly required by this Section 2.3, as and to the extent that in their good faith judgment the Board of Directors shall determine to be advisable, in order that any:
  - (i) consolidation or subdivision of Voting Shares;
  - (ii) issuance (wholly or in part for cash) of Voting Shares or securities that by their terms are convertible into or exchangeable for Voting Shares;
  - (iv) stock dividends; or
  - (v) issuance of rights, options or warrants referred to in this Section 2.3,

hereafter made by the Corporation to holders of its Voting Shares, shall not be taxable to such shareholders.

#### 2.4 Date on Which Exercise is Effective

Each Person in whose name any certificate for Voting Shares or other securities, if applicable, is issued upon the exercise of Rights shall for all purposes be deemed to have become the holder of record of the Voting Shares or other securities, if applicable, represented thereon, and such certificate shall be dated the date upon which the Rights Certificate evidencing such Rights was duly surrendered in accordance with Subsection 2.2(d) (together with a duly completed Election to Exercise) and payment of the Exercise Price for such Rights (and any applicable transfer taxes and other governmental charges payable by the exercising holder hereunder) was made; provided, however, that if the date of such surrender and payment is a date upon which the transfer books of the Voting Shares of the Corporation are closed, such Person shall be deemed to have become the holder of record of such Voting Shares on, and such certificate shall be dated, the next succeeding Business Day on which the transfer books of the Voting Shares are open.

#### 2.5 Execution, Authentication, Delivery and Dating of Rights Certificates

- (a) Execution: The Rights Certificates shall be executed on behalf of the Corporation, under its corporate seal reproduced thereon, by any one of its Chairman, President, Chief Executive Officer or a Vice-President or Secretary. The signature of any of these officers on the Rights Certificates may be manual or facsimile.
- (b) Valid Signatures: Rights Certificates bearing the manual or facsimile signatures of individuals who were at any time the proper officers of the Corporation shall bind the Corporation, notwithstanding that such individuals or any of them have ceased to hold such offices prior to the countersignature and delivery of such Rights Certificates.
- (c) Delivery: Promptly after the Corporation learns of the Separation Time, the Corporation shall notify the Rights Agent of such Separation Time and shall deliver Rights Certificates executed by the Corporation to the Rights Agent for countersignature, and the Rights Agent shall countersign (manually or by facsimile signature in a manner satisfactory to the Corporation) and send such Rights Certificates to the holders of the Rights pursuant to Subsection 2.2(c) hereof. No Rights Certificate shall be valid for any purpose until countersigned by the Rights Agent in the manner described above.
- (d) Date: Each Rights Certificate shall be dated the date of countersignature thereof.

## 2.6 Registration, Transfer and Exchange

- (a) Maintaining of Register: The Corporation shall cause to be kept a register (the "Rights Register") in which, subject to such reasonable regulations as it may prescribe, the Corporation shall provide for the registration and transfer of Rights. The Rights Agent is hereby appointed registrar for the Rights ("Rights Registrar") for the purpose of maintaining the Rights Register for the Corporation and registering Rights and transfers of Rights as herein provided and the Rights Agent hereby accepts such appointment. If the Rights Agent shall cease to be the Rights Registrar, the Rights Agent shall have the right to examine such register at all reasonable times. After the Separation Time and prior to the Expiration Time, upon surrender for registration of transfer or exchange of any Rights Certificate, and subject to the provisions of Subsection 2.6(c) below, the Corporation shall execute, and the Rights Agent shall countersign and deliver, in the name of the holder or the designated transferee or transferees, as required pursuant to the holder's instructions, one or more new Rights Certificates evidencing the same aggregate number of Rights as did the Rights Certificate so surrendered.
- (b) Effect of Transfer or Exchange: All Rights issued upon any registration of a transfer or exchange of Rights Certificates shall be valid obligations of the Corporation, and such Rights shall be entitled to the same benefits under this Agreement as the Rights surrendered upon such registration of transfer or exchange.
- (c) Transfer or Exchange of Rights: Every Rights Certificate surrendered for registration of transfer or exchange shall have the form of assignment thereon completed and executed, or be accompanied by a written instrument of transfer in form satisfactory to the Corporation or the Rights Agent, as the case may be, executed by the holder thereof or the attorney of such holder duly authorized in writing. As a condition to the issue of any new Rights Certificate under this Section 2.6, the Corporation may require the payment of an amount sufficient to cover any tax or other governmental charge that may be imposed in relation thereto and other expenses, including the reasonable fees and expenses of its Rights Agent, connected therewith.
- (d) No Transfer or Exchange After Termination: The Corporation shall not be required to register the transfer or exchange of any Rights after the Rights have been terminated under Section 5.1(e) hereof.

## 2.7 Mutilated, Destroyed, Lost and Stolen Rights Certificates

- (a) Mutilation: If there shall be delivered to the Corporation and the Rights Agent prior to the Expiration Time, evidence to their satisfaction of the mutilation or defacing of any Rights Certificate, the Corporation shall execute and the Rights Agent shall countersign and deliver a new Rights Certificate upon surrender and cancellation of the mutilated or defaced Rights Certificate.
- (b) Destruction, Loss: If there shall be delivered to the Corporation and the Rights Agent prior to the Expiration Time:
  - (i) evidence to their satisfaction of the destruction, loss or theft of any Rights Certificate; and
  - (ii) such security or indemnity as may be required by them to save each of them and their respective agents harmless, then, in the absence of notice to the Corporation or the Rights Agent that such Rights Certificate has been acquired by a bona fide purchaser, the Corporation shall execute and the Rights Agent shall countersign and deliver, in lieu of any such destroyed, lost or stolen Rights Certificate, a new Rights Certificate evidencing the same number of Rights as did the Rights Certificate so destroyed, lost or stolen.
- (c) Taxes: As a condition to the issue of any new Rights Certificate under this Section 2.7, the Corporation or the Rights Agent may require the payment of an amount sufficient to cover any tax or other governmental charge that may be imposed in relation thereto and any other

expenses, including the reasonable fees and expenses of the Rights Agent, connected therewith.

- (d) Original Obligation: Every new Rights Certificate issued pursuant to this Section 2.7 in lieu of any mutilated, destroyed, lost or stolen Rights Certificate shall evidence an additional original contractual obligation of the Corporation, whether or not the mutilated, destroyed, lost or stolen Rights Certificate shall be at any time enforceable by anyone, and shall be entitled to all the benefits of this Agreement equally and proportionately with any and all other Rights issued hereunder.

## 2.8 Persons Deemed Owners

The Corporation, the Rights Agent and any agent of the Corporation or the Rights Agent may deem and treat the person in whose name such Rights Certificate (or, prior to the Separation Time, the associated Voting Share certificate) is registered as the absolute owner thereof and of the Rights evidenced thereby for all purposes whatsoever. As used in this Agreement, unless the context otherwise requires, the term "holder" of any Right shall mean the registered holder of such Right (or, prior to the Separation Time of the associated Voting Share).

## 2.9 Delivery and Cancellation of Certificates

All Rights Certificates surrendered upon exercise or for redemption, registration of transfer or exchange shall, if surrendered to any person other than the Rights Agent, be delivered to the Rights Agent and, in any case, shall be promptly cancelled by the Rights Agent. The Corporation may at any time deliver to the Rights Agent for cancellation any Rights Certificates previously countersigned and delivered hereunder which the Corporation may have acquired in any manner whatsoever, and all Rights Certificates so delivered shall be promptly cancelled by the Rights Agent. No Rights Certificates shall be countersigned in lieu of or in exchange for any Rights Certificates cancelled as provided in this Section 2.9, except as expressly permitted by this Agreement. The Rights Agent shall destroy all cancelled Rights Certificates and deliver a certificate of destruction to the Corporation.

## 2.10 Agreement of Rights Holders

Every holder of Rights by accepting the same consents and agrees with the Corporation and the Rights Agent and with every other holder of Rights that:

- (a) such holder is bound by and subject to the provisions of this Agreement, as amended from time to time in accordance with the terms hereof, in respect of all Rights held;
- (b) prior to the Separation Time, each Right shall be transferable only together with, and shall be transferred by a transfer of, the associated Voting Share certificate representing such Right;
- (c) after the Separation Time, the Rights Certificates shall be transferable only on the Rights Register as provided herein;
- (d) prior to due presentment of a Rights Certificate (or, prior to the Separation Time, the certificate evidencing the associated Voting Share certificate) for registration of transfer, the Corporation, the Rights Agent and any agent of the Corporation or the Rights Agent may deem and treat the Person in whose name the Rights Certificate (or, prior to the Separation Time, the certificate evidencing the associated Voting Share certificate) is registered as the absolute owner thereof and of the Rights evidenced thereby (notwithstanding any notations of ownership or writing on such Rights Certificate or the certificate evidencing the associated Voting Share made by anyone other than the Corporation or the Rights Agent) for all purposes whatsoever, and neither the Corporation nor the Rights Agent shall be affected by any notice to the contrary;
- (e) such holder has waived all rights to receive any fractional Right or any fractional Voting Shares or other securities upon exercise of a Right (except as provided herein); and
- (f) that, subject to the provisions of Section 5.4, without the approval of any holder of Rights or Voting Shares and upon the sole authority of the Board of Directors, acting in good faith, this Agreement may be supplemented or amended from time to time to cure any ambiguity or to

correct or supplement any provision contained herein which may be inconsistent with the intent of this Agreement or is otherwise defective, as provided herein.

#### 2.11 Rights Certificate Holder Not Deemed a Shareholder

No holder, as such, of any Rights or Rights Certificate shall be entitled to vote, receive dividends or be deemed for any purpose whatsoever the holder of any Voting Share or any other share or security of the Corporation which may at any time be issuable on the exercise of the Rights represented thereby, nor shall anything contained herein or in any Rights Certificate be construed or deemed or confer upon the holder of any Right or Rights Certificate, as such, any right, title, benefit or privilege of a holder of Voting Shares or any other shares or securities of the Corporation or any right to vote at any meeting of shareholders of the Corporation whether for the election of directors or otherwise or upon any matter submitted to the holders of Voting Shares or any other shares of the Corporation at any meeting thereof, or to give or withhold consent to any action of the Corporation, or to receive notice of any meeting or other action affecting any holder of Voting Shares or any other shares of the Corporation except as expressly provided herein, or to receive dividends, distributions or subscription rights, or otherwise, until the Rights or Rights evidenced by the Rights Certificates shall have been duly exercised in accordance with the terms and the provisions hereof.

### ARTICLE 3 ADJUSTMENTS TO THE RIGHTS

#### 3.1 Flip-in Event

- (a) Flip-In: Subject to the provisions of Sections 3.1(b), 3.2 and Section 5.1, if prior to the Expiration Time a Flip-in Event shall occur, each Right shall constitute, effective at the close of business on the tenth Trading Day after the Share Acquisition Date, the right to purchase from the Corporation, upon exercise thereof in accordance with the terms hereof, that number of Voting Shares as have an aggregate Market Price on the date of consummation or occurrence of such Flip-in Event equal to twice the Exercise Price for an amount in cash equal to the Exercise Price (such right to be appropriately adjusted in a manner analogous to the applicable adjustment provided for in Section 2.3 hereof in the event that, after such date of consummation or occurrence, an event of a type analogous to any of the events described in Section 2.3 hereof shall have occurred).
- (b) Certain Rights Void: Notwithstanding anything in this Agreement to the contrary, upon the occurrence of any Flip-in Event, any Rights that are or were Beneficially Owned on or after the earlier of the Separation Time and the Share Acquisition Date by:
- (a) a Acquiring Person (or any Affiliate or Associate of an Acquiring Person or any Person acting jointly or in concert with an Acquiring Person or any Affiliate or Associate of an Acquiring Person); or
- (b) a transferee of Rights, directly or indirectly, of an Acquiring Person (or any Affiliate or Associate of an Acquiring Person or any Person acting jointly or in concert with an Acquiring Person or an Affiliate or Associate of an Acquiring Person), where such transferee becomes a transferee concurrently with or subsequent to the Acquiring Person becoming such in a transfer that the Board of Directors has determined is part of a plan, arrangement or scheme of an Acquiring Person (or any affiliate or associate of an Acquiring Person or any person acting jointly or in concert with an Acquiring Person or any affiliate or associate of an Acquiring Person), that has the purpose or effect of avoiding Section 3.1(b)(i),

shall become null and void without any further action and any holder of such Rights, including transferees, shall thereafter have no right to exercise such Rights under any provision of this Agreement and further shall thereafter not have any other rights whatsoever with respect to such Rights, whether under any provision of this Agreement or otherwise.

- (c) Compliance with Laws: From and after the Separation Time, the Corporation shall do all acts and things as shall be necessary and within its power to ensure compliance with the provisions of this Section 3.1, including without limitation, all such acts and things that may be required to satisfy the requirements of the Securities Act (British Columbia) and the securities laws or comparable legislation of each of the Provinces of Canada in respect of the issue of Voting Shares on the exercise of Rights in accordance with this Agreement.
- (d) Legend: Any Rights Certificate that represents Rights Beneficially Owned by a Person described in either Section 3.1(b)(i) or (ii) or transferred to any Nominee of any such Person, and any Rights Certificate issued upon the transfer, exchange or replacement of any other Rights Certificate referred to in this sentence shall contain and be deemed to contain the following legend:

*"The Rights represented by this Rights Certificate were issued to a Person who was an Acquiring Person or an Affiliate or an Associate of an Acquiring Person (as such terms are defined in the Shareholder Rights Agreement) or a Person who was acting jointly or in concert with an Acquiring Person or an Affiliate or Associate of an Acquiring Person. This Rights Certificate and the Rights represented hereby shall become void in the circumstances specified in Subsection 3.1(b) of the Shareholder Rights Agreement."*

provided, however, that the Rights Agent shall not be under any responsibility to ascertain the existence of facts that would require the imposition of such legend but shall be required to impose such legend only if instructed to do so by the Corporation or if a holder fails to certify upon transfer or exchange in the space provided on the Rights Certificate that such holder is not a Person described in such legend.

### 3.2 Exchange Option

- (a) Optional Exchange: In the event that the Board of Directors acting in good faith shall determine that conditions exist which would eliminate or otherwise materially diminish in any respect the benefits intended to be afforded to the holders of Rights pursuant to this Agreement, the Board of Directors may at its option and without seeking the approval of holders of Voting Shares or Rights at any time after a Flip-in Event has occurred, authorize the Corporation to issue and deliver in respect of each Right which is not void pursuant to Section 3.1(b) either:
- (i) in return for the Exercise Price and Right, cash, debt, equity or other securities or other property or assets (or a combination thereof) having a value equal to twice the Exercise Price; or
  - (ii) in return for the Right and without further charge, subject to any amounts that may be required to be paid under applicable law, cash, debt, equity or other securities or other property or assets (or a combination thereof), having a value equal to the Exercise Price;

in full and final settlement of all rights attaching to the Rights; provided that the value of any such debt, equity or other securities or other property or assets shall be determined by the Board of Directors who may rely for that purpose on the advice of a nationally recognized Canadian firm of investment dealers or investment bankers selected by the Board of Directors. To the extent that the Board of Directors determines in good faith that any action need be taken pursuant to this Section 3.2, the Board of Directors may suspend the exercisability of the Rights for a period up to 60 days following the date of the occurrence of the relevant Flip-in Event in order to determine the appropriate form and value of cash, debt, equity or other securities or other property or assets (or a combination thereof) to be issued or delivered on such exchange for Rights. In the event of any such suspension, the Corporation shall notify the Rights Agent and issue as promptly as practicable a public announcement stating that the exercisability of the Rights has been temporarily suspended.

- (b) Termination of Right to Exercise: If the Board of Directors authorizes and directs the exchange of cash, debt, equity or other securities or other property or assets (or a combination thereof) for

Rights pursuant to Subsection 3.2(a) hereof, then without any further action or notice the right to exercise the Rights will terminate and the only right thereafter of a holder of Rights shall be to receive such cash, debt, equity or other securities or other property or assets (or a combination thereof) in accordance with the determination of the Board of Directors made pursuant to Section 3.2(a). Within 10 Business Days of the Board of Directors authorizing and directing any such exchange, the Corporation shall give notice of such exchange to the holders of such Rights in accordance with Section 5.9. Each such notice of exchange shall state the method by which the exchange of cash, debt, equity or other securities or other property or assets (or a combination thereof) for Rights will be effected.

- (c) Additional Securities: If there shall not be sufficient securities authorized but unissued to permit the exchange in full of Rights pursuant to this Section 3.2, the Corporation will take all such action as may be necessary to authorize additional securities for issuance upon the exchange of Rights provided however, that the Corporation shall not be required to issue fractions of securities or to distribute certificates evidencing fractional securities. In lieu of issuing such fractional securities, subject to Section 5.5(b), there shall be paid to the registered holders of Rights to whom such fractional securities would otherwise be issuable, an amount in cash equal to the same fraction of the market price of a whole such security.

#### **ARTICLE 4 THE RIGHTS AGENT**

##### **4.1 General**

- (a) Appointment of Rights Agent: The Corporation hereby appoints the Rights Agent to act as agent for the Corporation and the holders of Rights in accordance with the terms and conditions hereof and the Rights Agent hereby accepts such appointment. The Corporation may from time to time appoint one or more Co-Rights Agents as it may deem necessary or desirable, subject to the prior approval of the Rights Agent. In such event, the respective duties of the Rights Agent and any Co-Rights Agent shall be as the Corporation may determine with the approval of the Rights Agent and the Co-Rights Agent. The Corporation agrees to pay to the Rights Agent reasonable compensation for all services rendered by it hereunder and, from time to time on demand of the Rights Agent, its reasonable expenses and counsel fees and other disbursements incurred in the administration and execution of this Agreement and the exercise and performance of its duties hereunder. The Corporation also agrees to indemnify the Rights Agent for, and to hold it harmless against, any loss, liability or expense, incurred without negligence, bad faith or willful misconduct on the part of the Rights Agent, for anything done or omitted by the Rights Agent in connection with the acceptance and performance of this Agreement, including the costs and expenses of defending against any claim of liability, which right to indemnification shall survive the termination of this Agreement or the resignation or removal of the Rights Agent.
- (b) Protection of Rights Agent: The Rights Agent shall be protected from, and shall incur no liability for or in respect of, any action taken, suffered or omitted by it in connection with its performance of this Agreement in reliance upon any certificate for Voting Shares, or any Rights Certificate, certificate for other securities of the Corporation, instrument of assignment or transfer, power of attorney, endorsement, affidavit, letter, notice, direction, consent, certificate, statement or other paper or document believed by it to be genuine and to be signed, executed and, where necessary, verified or acknowledged, by the proper Person or Persons.
- (c) The Corporation will inform the Rights Agent in a reasonably timely manner of events which may materially affect the administration of this Agreement by the Rights Agent and, at any time upon written request, will provide to the Rights Agent an incumbency certificate certifying the then current officers of the Corporation.

#### 4.2 Merger or Amalgamation or Change of Name of Rights Agent

- (a) Merger: Any corporation into which the Rights Agent or any successor Rights Agent may be merged or amalgamated with or into, or any corporation succeeding to the shareholder services business of the Rights Agent or any successor Rights Agent, shall be the successor to the Rights Agent under this Agreement without the execution or filing of any paper or any further act on the part of any of the parties hereto, provided that such corporation would be eligible for appointment as a successor Rights Agent under the provisions of Section 4.4 hereof. In case at the time such successor Rights Agent succeeds to the agency created by this Agreement any of the Rights Certificates have been countersigned but not delivered, any such successor Rights Agent may adopt the countersignature of the predecessor Rights Agent and deliver such Rights Certificates so countersigned, and in case at that time any of the Rights Certificates have not been countersigned, any successor Rights Agent may countersign such Rights Certificates either in the name of the predecessor Rights Agent or in the name of the successor Rights Agent, and in all such cases such Rights Certificates shall have the full force and effect provided in the Rights Certificates and in this Agreement.
- (b) Change of Name: In case at any time the name of the Rights Agent is changed and at such time any of the Rights Certificates shall have been countersigned but not delivered, the Rights Agent may adopt the countersignature under its prior name and deliver Rights Certificates so countersigned, and in case at that time any of the Rights Certificates shall not have been countersigned, the Rights Agent may countersign such Rights Certificates either in its prior name or in its changed name and in all such cases such Rights Certificates shall have the full force provided in the Rights Certificates and in this Agreement.

#### 4.3 Duties of Rights Agent

The Rights Agent undertakes the duties and obligations imposed by this Agreement upon the following terms and conditions, by all of which the Corporation and the holders of Rights Certificates, by their acceptance thereof, shall be bound:

- (a) Legal Counsel: The Rights Agent may consult with legal counsel (who may be legal counsel for the Corporation), and the opinion of such counsel shall be full and complete authorization and protection to the Rights Agent as to any action taken or omitted to be taken by it in good faith and in accordance with such opinion.
- (b) Satisfactory Proof: Whenever in the performance of its duties under this Agreement the Rights Agent deems it necessary or desirable that any fact or matter be proved or established by the Corporation prior to taking or suffering any action or omitting to take any action hereunder, such fact or matter (unless other evidence in respect thereof be herein specifically prescribed) may be deemed to be conclusively proved and established by a certificate signed by a person believed by the Rights Agent to be the Chairman, the President, the Chief Executive Officer or any Vice-President and by the Chief Financial Officer, the Treasurer, any Assistant Treasurer, the Secretary or any Assistant Secretary of the Corporation and delivered to the Rights Agent and such certificate shall be full authorization to the Rights Agent for any action taken, omitted or suffered in good faith by it under the provisions of this Agreement in reliance upon such certificate.
- (c) Bad Faith: The Rights Agent shall be liable hereunder only for its own negligence, bad faith or willful misconduct.
- (d) Recitals: The Rights Agent shall not be liable for or by reason of any of the statements of fact or recitals contained in this Agreement or in the certificates representing Voting Shares or the Rights Certificates (except its countersignature thereof) or be required to verify the same, but all such statements and recitals are and will be deemed to have been made only by the Corporation.
- (e) No Responsibility: The Rights Agent shall not be under any responsibility in respect of the validity of this Agreement or the execution and delivery hereof (except the authorization, execution and delivery hereof by the Rights Agent) or in respect of the validity or execution of

any certificate representing Voting Shares or Rights Certificate (except its countersignature thereof), nor will it be responsible for any breach by the Corporation of any covenant or condition contained in this Agreement or in any Rights Certificate, any change in the exercisability of the Rights (including the Rights becoming void pursuant to Section 2.11 or Subsection 3.2(b) hereof) or any adjustment required under the provisions of Section 2.3 hereof or for the manner, method or amount of any such adjustment or the ascertaining of the existence of facts that would require any such adjustment (except with respect to the exercise of Rights after receipt of the certificate contemplated by Section 2.3 hereof describing any such adjustment) nor will it by any act hereunder be deemed to make any representation or warranty as to the authorization or reservation of any Voting Shares to be issued pursuant to this Agreement or any Rights or as to whether any Voting Shares shall, when issued, be duly and validly authorized, executed, issued and delivered and be fully paid and non-assessable.

- (f) Performance By Corporation: The Corporation agrees that it will perform, execute, acknowledge and deliver or cause to be performed, executed, acknowledged and delivered all such further and other acts, instruments and assurances as may reasonably be required by the Rights Agent for the carrying out or performing by the Rights Agent of the provisions of this Agreement.
- (g) Persons To Give Instructions: The Rights Agent is hereby authorized to rely upon and directed to accept instructions in writing with respect to the performance of its duties hereunder from any person believed by the Rights Agent to be the Chairman, the President, the Chief Executive Officer, any Vice-President, the Secretary, any Assistant Secretary, the Chief Financial Officer, the Treasurer or any Assistant Treasurer of the Corporation and to apply to such persons for advice or instructions in connection with its duties, and it shall not be liable for any action taken, omitted or suffered by it in good faith in accordance with the instructions of any such person.
- (h) Ability To Deal: The Rights Agent and any shareholder, director, officer or employee of the Rights Agent may buy, sell or deal in Voting Shares, Rights or other securities of the Corporation or become pecuniarily interested in any transaction in which the Corporation may be interested, or contract with or lend money to the Corporation or otherwise act as fully and freely as though it were not Rights Agent under this Agreement. Nothing herein shall preclude the Rights Agent from acting in any other capacity for the Corporation or for any other legal entity.
- (i) No Liability: The Rights Agent may execute and exercise any of the rights or powers hereby vested in it or perform any duty hereunder either itself or by or through its attorneys or agents, and the Rights Agent shall not be answerable or accountable for any act, default, neglect or misconduct of any such attorneys or agents or for any loss to the Corporation resulting from any such act, omission, default, neglect or misconduct, provided reasonable care was exercised in the selection and continued employment thereof.

#### 4.4 Change of Rights Agent

The Rights Agent may resign and be discharged from its duties under this Agreement upon 60 days' notice (or such lesser notice as is acceptable to the Corporation) in writing delivered or mailed to the Corporation and to each transfer agent of Common Shares by first class or registered mail. The Corporation may remove the Rights Agent upon 60 days' notice in writing, mailed or delivered to the Rights Agent and to each transfer agent of Common Shares by first class or registered mail. If the Rights Agent should resign or be removed or otherwise become incapable of acting, the Corporation shall appoint a successor to the Rights Agent. If the Corporation fails to make such appointment within a period of 60 days after such removal or after it has been notified in writing of such resignation or incapacity by the resigning or incapacitated Rights Agent or by the holder of any Rights (which holder shall, with such notice, submit the Rights Certificate of such holder for inspection by the Corporation), then the holder of any Rights may apply to any court of competent jurisdiction for the appointment of a new Rights Agent. Any successor Rights Agent, whether appointed by the Corporation or by such a court, shall be a trust company incorporated under the laws of Canada or a province thereof authorized to carry on the business of a trust company as principal or through an agent in the Provinces of Ontario or British Columbia. After appointment, the successor Rights Agent shall be vested with the same powers, rights, duties and

responsibilities as if it had been originally named as Rights Agent without further act or deed; provided that the predecessor Rights Agent shall deliver and transfer to the successor Rights Agent any property at the time held by it hereunder, and execute and deliver any further assurance, conveyance, act or deed necessary for the purpose. Not later than the effective date of any such appointment, the Corporation shall file notice thereof in writing with the predecessor Rights Agent and the transfer agent of the Common Shares, and mail a notice thereof in writing to the holders of the Rights. Failure to give any notice provided for in this Section 4.4, however, or any defect therein, shall not affect the legality or validity of the resignation or removal of the Rights Agent or the appointment of the successor Rights Agent, as the case may be.

## **ARTICLE 5 MISCELLANEOUS**

### **5.1 Redemption and Waiver**

- (a) The Board of Directors acting in good faith may, until the occurrence of a Flip-in Event, upon prior written notice delivered to the Rights Agent, determine to waive the application of Section 3.1 to such particular Flip-in Event (which for greater certainty shall not include the circumstances described in Subsection 5.1(h)); provided that if the Board of Directors waives the application of Section 3.1 to a particular Flip-in Event pursuant to this Subsection 5.1(a), the Board of Directors shall be deemed to have waived the application of Section 3.1 to any other Flip-in Event which may arise in respect of any Take-Over Bid then in effect or made prior to the public announcement of the completion or termination of the transaction in respect of which the Board of Directors waived the application of Section 3.1.
- (b) The Board of Directors acting in good faith may, at its option, at any time prior to the provisions of Section 3.1 becoming applicable as a result of the occurrence of a Flip-in Event, elect to redeem all but not less than all of the outstanding Rights at a redemption price of \$0.0001 per Right appropriately adjusted in a manner analogous to the applicable adjustment provided for in Section 2.3 if an event of the type analogous to any of the events described in Section 2.3 shall have occurred (such redemption price being herein referred to as the "Redemption Price"). The redemption of the Rights by the Board of Directors may be made effective at such time, on such basis and with such conditions as the Board of Directors in its sole discretion may establish.
- (c) In the event that prior to the occurrence of a Flip-in Event a Person acquires, pursuant to a Permitted Bid or a Competing Permitted Bid, not less than 90% of the outstanding Voting Shares other than Voting Shares Beneficially Owned at the date of the Permitted Bid or the Competing Permitted Bid by such Person, then the Board of Directors of the Corporation shall immediately upon the consummation of such acquisition without further formality be deemed to have elected to redeem the Rights at the Redemption Price.
- (d) Where a Take-Over Bid that is not a Permitted Bid Acquisition is withdrawn or otherwise terminated after the Separation Time has occurred and prior to the occurrence of a Flip-in Event, the Board of Directors may elect to redeem all the outstanding Rights at the Redemption Price.
- (e) If the Board of Directors is deemed under Subsection 5.1(c) to have elected, or elects under either of Subsection 5.1(b) or (d), to redeem the Rights, the right to exercise the Rights will thereupon, without further action and without notice, terminate and the only right thereafter of the holders of Rights shall be to receive the Redemption Price.
- (f) Within 10 days after the Board of Directors is deemed under Subsection 5.1(c) to have elected, or elects under Subsection 5.1(b) or (d), to redeem the Rights, the Corporation shall give notice of redemption to the holders of the then outstanding Rights by mailing such notice to each such holder at his last address as it appears upon the registry books of the Rights Agent or, prior to the Separation Time, on the registry books of the transfer agent for the Voting Shares. Any notice which is mailed in the manner herein provided shall be deemed given, whether or not the holder receives the notice. Each such notice of redemption will state the method by which the

payment of the Redemption Price will be made.

- (g) Upon the Rights being redeemed pursuant to Subsection 5.1(d), all the provisions of this Agreement shall continue to apply as if the Separation Time had not occurred and Rights Certificates representing the number of Rights held by each holder of record of Voting Shares as of the Separation Time had not been mailed to each such holder and for all purposes of this Agreement the Separation Time shall be deemed not to have occurred.
- (h) The Board of Directors may waive the application of Section 3.1 in respect of the occurrence of any Flip-in Event if the Board of Directors has determined within ten Trading Days following a Share Acquisition Date that a Person became an Acquiring Person by inadvertence and without any intention to become, or knowledge that it would become, an Acquiring Person under this Agreement and, in the event that such a waiver is granted by the Board of Directors, such Share Acquisition Date shall be deemed not to have occurred. Any such waiver pursuant to this Subsection 5.1(b) must be on the condition that such Person, within 14 days after the foregoing determination by the Board of Directors or such earlier or later date as the Board of Directors may determine (the "Disposition Date"), has reduced its Beneficial Ownership of Voting Shares such that the Person is no longer an Acquiring Person. If the Person remains an Acquiring Person at the close of business on the Disposition Date, the Disposition Date shall be deemed to be the date of occurrence of a further Share Acquisition Date and Section 3.1 shall apply thereto.

## 5.2 Expiration

No Person shall have any rights pursuant to this Agreement or any Right after the Expiration Time, except as provided in Section 4.1 hereof.

## 5.3 Issue of New Rights Certificates

Notwithstanding any of the provisions of this Agreement or of the Rights to the contrary, the Corporation may, at its option, issue new Rights Certificates evidencing Rights in such form as may be approved by the Board of Directors to reflect any adjustment or change in the number or kind of securities purchasable upon exercise of Rights made in accordance with the provisions of this Agreement.

## 5.4 Supplements and Amendments

- (a) The Corporation may make amendments to this Agreement to correct any clerical or typographical error or which are required to maintain the validity of this Agreement as a result of any change in any applicable legislation or regulations thereunder. The Corporation may, prior to the date of the shareholders' meeting referred to in Section 5.16, supplement or amend this Agreement without the approval of any holders of Rights or Voting Shares in order to make any changes which the Board of Directors acting in good faith may deem necessary or desirable. Notwithstanding anything in this Section 5.4 to the contrary, no such supplement or amendment shall be made to the provisions of Article 4 except with the written concurrence of the Rights Agent to such supplement or amendment.
- (b) Subject to the Section 5.4(a), the Corporation may, with the prior consent of the holders of Voting Shares obtained as set forth below, at any time prior to the Separation Time, amend, vary or rescind any of the provisions of this Agreement and the Rights (whether or not such action would materially adversely affect the interests of the holders of Rights generally). Such consent shall be deemed to have been given if the action requiring such approval is authorized by the affirmative vote of a majority of the votes cast by Independent Shareholders present or represented at and entitled to be voted at a meeting of the holders of Voting Shares duly called and held in compliance with applicable laws and the constating documents of the Corporation.
- (c) The Corporation may, with the prior consent of the holders of Rights, at any time on or after the Share Acquisition Date, vary or delete any of the provisions of this Agreement and the Rights (whether or not such action would materially adversely affect the interests of the holders of Rights generally), provided that no such amendment, variation or deletion shall be made to the

provisions of Article 4 except with the written concurrence of the Rights Agent thereto. Such consent shall be deemed to have been given if such amendment, variation or deletion is authorized by the affirmative votes of the holders of Rights present or represented at and entitled to be voted at a meeting of the holders and representing 50% plus one of the votes cast in respect thereof.

- (d) Any approval of the holders of Rights shall be deemed to have been given if the action requiring such approval is authorized by the affirmative votes of the holders of Rights present or represented at and entitled to be voted at a meeting of the holders of Rights and representing a majority of the votes cast in respect thereof. For the purposes hereof, each outstanding Right (other than Rights which are void pursuant to the provisions hereof) shall be entitled to one vote, and the procedures for the calling, holding and conduct of the meeting shall be those, as nearly as may be, which are provided in the Corporation's constating documents and the Company Act with respect to meetings of shareholders of the corporation.
- (e) Any amendments made by the Corporation to this Agreement pursuant to Subsection 5.4(a) which are required to maintain the validity of this Agreement as a result of any change in any applicable legislation or regulation thereunder shall:
  - (i) if made before the Separation Time, be submitted to the shareholders of the Corporation at the next meeting of shareholders and the shareholders may, by the majority referred to in Subsection 5.4(b), confirm or reject such amendment;
  - (ii) if made after the Separation Time, be submitted to the holders of Rights at a meeting to be called for on a date not later than immediately following the next meeting of shareholders of the Corporation and the holders of Rights may, by resolution passed by the majority referred to in Subsection 5.4(c), confirm or reject such amendment.

Any such amendment shall be effective from the date of the resolution of the Board of Directors adopting such amendment, until it is confirmed or rejected or until it ceases to be effective (as described in the next sentence) and, where such amendment is confirmed, it continues in effect in the form so confirmed. If such amendment is rejected by the shareholders or the holders of Rights or is not submitted to the shareholders or holders of Rights as required, then such amendment shall cease to be effective from and after the termination of the meeting at which it was rejected or to which it should have been but was not submitted or from and after the date of the meeting of holders of Rights that should have been but was not held, and no subsequent resolution of the Board of Directors to amend this Agreement to substantially the same effect shall be effective until confirmed by the shareholders or holders of Rights as the case may be.

## 5.5 Fractional Rights and Fractional Voting Shares

- (a) No Fractional Rights: The Corporation shall not be required to issue fractions of Rights or to distribute Right Certificates which evidence fractional Rights. After the Separation Time, in lieu of issuing fractional Rights the Corporation shall pay to the holders of record of the Right Certificates, at the time such fractional Rights would otherwise be issuable, an amount in cash equal to the same fraction of the Market Price of one whole Right that the fraction of a Right that would otherwise be issuable is of one whole Right.
- (b) No Fractional Common Shares: The Corporation shall not be required to issue fractions of Voting Shares upon exercise of the Rights or to distribute certificates which evidence fractional Voting Shares. In lieu of issuing fractional Voting Shares, the Corporation shall pay to the holders of record of Right Certificates at the time such Rights are exercised as herein provided, an amount in cash equal to the same fraction of the Market Price of one Voting Share that the fraction of a Voting Share that would otherwise be issuable upon the exercise of such Right is of a whole Voting Share.

## 5.6 Rights of Action

Subject to the terms of this Agreement, rights of action in respect of this Agreement, other than rights of

action vested solely in the Rights Agent, are vested in the respective holders of the Rights, and any holder of any Rights, without the consent of the Rights Agent or of the holder of any other Rights may, on such holder's own behalf and for such holder's own benefit and the benefit of other holders of Rights, enforce, and may institute and maintain any suit, action or proceeding against the Corporation to enforce, or otherwise act in respect of, such holder's right to exercise the Rights of such holder in the manner provided in the Rights Certificate of such holder and in this Agreement. Without limiting the foregoing or any remedies available to the holders of Rights, it is specifically acknowledged that the holders of Rights would not have an adequate remedy at law for any breach of this Agreement and shall be entitled to specific performance of the obligations under, and injunctive relief against actual or threatened violations of the obligations of any Person subject to, this Agreement.

#### 5.7 Regulatory Approvals

Any obligation of the Corporation or action or event contemplated by this Agreement shall be subject to the receipt of any requisite approval or consent from any governmental or regulatory authority, and without limiting the generality of the foregoing, necessary approvals of the Toronto Stock Exchange and other exchanges will be obtained, such as to the issuance of Voting Shares upon the exercise of Rights under Section 2.2(d) and the issuance of convertible debt, equity or other securities or other property or assets under section 3.2. Notwithstanding anything to the contrary in this Agreement, no supplement or amendment to this Agreement or to the terms of the Rights may be made without the prior consent of the Toronto Stock Exchange.

#### 5.8 Declaration as to Non-Canadian Holders

If in the opinion of the Board of Directors (who may rely upon the advice of counsel) any action or event contemplated by this Agreement would require compliance by the Corporation with the securities laws or comparable legislation of a jurisdiction outside Canada, the Board of Directors acting in good faith shall take such actions as it may deem appropriate to ensure such compliance. In no event shall the Corporation or the Rights Agent be required to issue or deliver Rights, or securities issuable on exercise of Rights to persons who are citizens, residents or nationals of any jurisdiction other than Canada, in which such issue or delivery would be unlawful without registration of the relevant persons or securities for such purposes.

#### 5.9 Notices

- (a) Notices or demands authorized or required by this Agreement to be given or made by the Rights Agent or by the holder of any Rights to or on the Corporation shall be sufficiently given or made if delivered, sent by registered or certified mail, postage prepaid (until another address is filed in writing with the Rights Agent), or sent by facsimile or other form of recorded electronic communication, charges prepaid and confirmed in writing, as follows:

PETAQUILLA MINERALS LTD.  
#410 – 475 West Georgia Street  
Vancouver, BC V6B 4H9

Attention: Joao C. Manuel, Chief Executive Officer  
Telecopier No.: (604) 694-0063

With a copy to:

Max Pinsky Personal Law Corporation  
1780 – 400 Burrard Street  
Vancouver, BC V6C 3A6

Attention: Max Pinsky, Barrister and Solicitor  
Telecopier No.: (604) 689-9940

- (b) Notices or demands authorized or required by this Agreement to be given or made by the Corporation or by the holder of any Rights to or on the Rights Agent shall be sufficiently given or made if delivered, sent by registered or certified mail, postage prepaid (until another address

is filed in writing with the Corporation), or sent by facsimile or other form of recorded electronic communication, charges prepaid and confirmed in writing, as follows:

Computershare Investor Services Inc.  
2nd Floor, 510 Burrard Street  
Vancouver, BC V6C 3B9

Attention: Manager, Client Services  
Telecopier No.: (604) 661-9401

- (c) Notices or demands authorized or required by this Agreement to be given or made by the Corporation or the Rights Agent to or on the holder of any Rights shall be sufficiently given or made if delivered or sent by first class mail, postage prepaid, addressed to such holder as it appears upon the register of the Rights Agent or, prior to the Separation Time, on the register of the Corporation for its Voting Shares. Any notice which is mailed or sent in the manner herein provided shall be deemed given, whether or not the holder receives the notice.
- (d) Any notice given or made in accordance with this Section 5.9 shall be deemed to have been given and to have been received on the day of delivery, if so delivered, on the third Business Day (excluding each day during which there exists any general interruption of postal service due to strike, lockout or other cause) following the mailing thereof, if so mailed, and on the day of telegraphing, telecopying or sending of the same by other means of recorded electronic communication (provided such sending is during the normal business hours of the addressee on a Business Day and if not, on the first Business Day thereafter). Each of the Corporation and the Rights Agent may from time to time change its address for notice to the other given in the manner aforesaid.

#### 5.10 Costs of Enforcement

The Corporation agrees that if the Corporation or any other Person the securities of which are purchasable upon exercise of Rights, fails to fulfill any of its obligations pursuant to this Agreement, then the Corporation or such Person shall reimburse the holder of any Rights for the costs and expenses (including legal fees) incurred by such holder in actions to enforce his rights pursuant to any Rights or this Agreement.

#### 5.11 Successors

All of the covenants and provisions of this Agreement by or for the benefit of the Corporation or the Rights Agent shall bind their respective successors and assigns and shall enure to the benefit of their respective successors and permitted assigns hereunder.

#### 5.12 Benefits of this Agreement

Nothing in this Agreement shall be construed to give to any Person other than the Corporation, the Rights Agent and the holders of Rights any legal or equitable right, remedy or claim under this Agreement and this Agreement shall be for the sole and exclusive benefit of the Corporation, the Rights Agent and the holders of Rights.

#### 5.13 Governing Law

This Agreement and each Right issued hereunder shall be deemed to be a contract made under the laws of British Columbia and for all purposes shall be governed by and construed in accordance with such laws.

#### 5.14 Severability

If any term or provision hereof or the application thereof in any circumstance shall, in any jurisdiction and to any extent, be invalid or unenforceable, such term or provision shall be ineffective as to such jurisdiction to the extent of such invalidity or unenforceability without invalidating or rendering unenforceable the remaining terms and provisions hereof or the application of such term or provision in circumstances other than those as to which it is held invalid or unenforceable.

5.15 Effective Date

This Agreement is effective and in full force and effect in accordance with its terms from and after the Effective Date, subject to confirmation pursuant to section 5.16.

5.16 Confirmation

The Corporation shall request the confirmation of this Agreement at a general meeting of holders of Voting Shares to be held no later than six months from the date of this Agreement, and for a second time at the general meeting next following the third anniversary of the Effective Date. If the Agreement is not confirmed at such meetings by a majority of the votes cast by holders of Voting Shares who vote in respect of the confirmation of this Agreement, this Agreement and all outstanding Rights shall terminate and be void and of no further force and effect on and from the close of business on the date of termination of such meeting; provided, that termination shall not occur if a Flip-in Event has occurred (other than a Flip-in Event which has been waived pursuant to Section 5.1(a) or (h) hereof) prior to the date upon which this Agreement would otherwise terminate pursuant to this Section 5.16.

5.17 Determinations and Actions by the Board of Directors

The Board of Directors shall have the exclusive power and authority to administer and amend this Agreement and to exercise all rights and powers specifically granted to the Board of Directors or the Corporation, or as may be necessary or advisable in the administration of this Agreement, including, without limitation, the right and power to (a) interpret the provisions of this Agreement and (b) make all determinations deemed necessary or advisable for the administration of this Agreement (including a determination to terminate or redeem or not to terminate or redeem the Rights or to amend the Agreement). All such actions, calculations, interpretations and determinations (including, for purposes of the balance of this sentence, all omissions with respect to the foregoing) which are done or made by the Board of Directors shall be final, conclusive and binding on the Corporation, the Rights Agent, the holders of Rights and all other parties and shall not subject the Board of Directors to any liability to the holders of Rights.

5.18 Counterparts

This Agreement may be executed in any number of counterparts and each of such counterparts shall for all purposes be deemed to be an original, and all such counterparts shall together constitute one and the same instrument.

IN WITNESS WHEREOF the parties hereto have caused this Agreement to be duly executed.

**PETAQUILLA MINERALS LTD.**

c/s

By: \_\_\_\_\_ (signature)

\_\_\_\_\_ (name - please print)

Authorized Signatory

**COMPUTERSHARE INVESTOR SERVICES INC.**

By: \_\_\_\_\_ (signature)

\_\_\_\_\_ (name - please print)

Authorized Signatory

By: \_\_\_\_\_ (signature)

\_\_\_\_\_  
Authorized Signatory (name - please print)

This is page 39 to that certain Shareholder Rights Plan Agreement **between PETAQUILLA MINERALS LTD.** and **COMPUTERSHARE INVESTOR SERVICES INC.** dated for reference the 18<sup>th</sup> day of October, 2010.

**SCHEDULE A TO THE SHAREHOLDER RIGHTS AGREEMENT  
DATED FOR REFERENCE OCTOBER 18, 2010, BETWEEN  
PETAQUILLA MINERALS LTD. AND  
COMPUTERSHARE INVESTOR SERVICES INC.**

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**[Form of Rights Certificate]**

Certificate No. \_\_\_\_\_ Rights \_\_\_\_\_

THE RIGHTS ARE SUBJECT TO REDEMPTION OR MANDATORY EXCHANGE, AT THE OPTION OF **PETAQUILLA MINERALS LTD.**, ON THE TERMS SET FORTH IN THE SHAREHOLDER RIGHTS AGREEMENT. RIGHTS BENEFICIALLY OWNED BY ACQUIRING PERSONS (AS SUCH TERMS ARE DEFINED IN THE SHAREHOLDER RIGHTS AGREEMENT) OR CERTAIN TRANSFEREES THEREOF ARE VOID.

**Rights Certificate**

This certifies that \_\_\_\_\_, or registered assigns, is the holder of record of the number of Rights set forth above, each one of which entitles the holder of record thereof, subject to the terms, provisions and conditions of the Shareholder Rights Agreement (the "**Shareholder Rights Agreement**"), dated as of March 7, 2006, between PETAQUILLA MINERALS LTD. (the "**Corporation**"), a corporation existing under the Business Corporations Act, (British Columbia) and COMPUTERSHARE INVESTOR SERVICES INC., a company incorporated under the laws of Canada, as Rights Agent under the Shareholder Rights Agreement, to purchase from the Corporation at any time after the Separation Time and prior to the Expiration Time (as such terms are defined in the Shareholder Rights Agreement), one common share of the Corporation (a "**Common Share**") (subject to adjustment as provided in the Shareholder Rights Agreement) at the Exercise Price referred to below, upon presentation and surrender of this Rights Certificate with a completed and executed Form of Election to Exercise at the office of the Rights Agent in Vancouver, Canada. The Exercise Price shall initially be \$30 (Cdn.) per Common Share and shall be subject to adjustment in certain events as provided in the Shareholder Rights Agreement.

In certain circumstances described in the Shareholder Rights Agreement, the Rights evidenced hereby may entitle the holder of record thereof to purchase shares of an entity other than the Corporation or to purchase or receive in exchange for such Rights assets, securities or shares of the Corporation other than Voting Shares or more or less than one Voting Share, or some combination of the foregoing, all as provided in the Shareholder Rights Agreement.

This Rights Certificate is subject to all of the terms, provisions and conditions of the Shareholder Rights Agreement which terms, provisions and conditions are hereby incorporated herein by reference and made a part hereof and to which reference is hereby made for a full description of the rights, limitations of rights, obligations, duties and immunities thereunder of the Rights Agent, the Corporation and the holders of the Rights Certificates. A copy of the Shareholder Rights Agreement is on file at the principal executive office of the Corporation and is available upon written request.

This Rights Certificate, with or without other Rights Certificates, upon surrender at the offices of the Rights Agent designated for such purpose, may be exchanged for another Rights Certificate or Rights Certificates of like tenor and date evidencing the aggregate number of Rights equal to the aggregate number of Rights evidenced by the Rights Certificate or Rights Certificates so surrendered. If this Rights Certificate shall be exercised in part, the holder of record shall be entitled to receive, upon surrender hereof, another Rights Certificate or Rights Certificates for the number of whole Rights not exercised.

Subject to the provision of the Shareholder Rights Agreement, the Rights evidenced by this Certificate may be redeemed by the Corporation at a redemption price of \$0.0001 per Right, subject to adjustment in certain events, under certain circumstances at the option of the Corporation.

Subject to the provisions of the Shareholder Rights Agreement, the Rights evidenced by this Certificate

may be terminated or amended by the Corporation at its option without the consent of holders of Rights.

No fractional Voting Shares will be issued upon the exercise of any Right or Rights evidenced hereby nor will Rights Certificates be issued for less than one whole Right. After the Separation Time, in lieu of issuing fractional Rights a cash payment will be made as provided in the Shareholder Rights Agreement.

No holder of this Rights Certificate, as such, shall be entitled to vote or receive dividends or be deemed for any purpose the holder of Voting Shares or of any other securities which may at any time be issuable on the exercise hereof, nor shall anything contained in the Shareholder Rights Agreement or herein be construed to confer upon the holder hereof, as such, any of the rights of a shareholder of the Corporation or any right to vote for the election of directors or upon any matter submitted to shareholders of the Corporation at any meeting, to give or withhold consent to any corporate action, to receive notice of meetings or other actions affecting shareholders of the Corporation (except as provided in the Shareholder Rights Agreement), to receive dividends or subscription rights or otherwise, until the Rights evidenced by this Rights Certificate shall have been exercised as provided in the Shareholder Rights Agreement.

This Rights Certificate shall not be valid or obligatory for any purpose until it shall have been countersigned by the Rights Agent.

WITNESS the facsimile signature of the proper officers of the Corporation.

**PETAQUILLA MINERALS LTD.**

c/s

By: \_\_\_\_\_ (signature)  
\_\_\_\_\_ (name - please print)  
Authorized Signatory

Countersigned by and on behalf of the Rights Agent,  
**COMPUTERSHARE INVESTOR SERVICES INC.**

By: \_\_\_\_\_ (signature)  
\_\_\_\_\_ (name - please print)  
Authorized Signatory

[Form of Reverse Side of Rights Certificate]

PETAQUILLA MINERALS LTD. - FORM OF ASSIGNMENT

(To be executed by the holder of record if such holder desires to transfer the Rights.)

FOR VALUE RECEIVED \_\_\_\_\_ hereby sells, assigns and transfers  
unto \_\_\_\_\_  
\_\_\_\_\_ (please  
print name and address of transferee)

this Rights Certificate, together with all right, title and interest therein, and does hereby irrevocably constitute and appoint \_\_\_\_\_ as attorney, to transfer the within Rights Certificate on the books of the Corporation with full power of substitution.

Dated: \_\_\_\_\_ [month, day, year]

Signature Guaranteed: \_\_\_\_\_  
Signature  
*(Signature must correspond to name as written upon the face of this Rights Certificate in every particular, without alteration or enlargement or any change whatsoever.)*

**The signature of the person executing this power must be guaranteed by a Canadian chartered bank or eligible guarantor institution with membership in an approved signature guarantee medallion program.**

**CERTIFICATION**  
(To be completed if true)

The undersigned hereby represents, warrants and certifies, for the benefit of all holders of Rights and Voting Shares, that the Rights evidenced by this Rights Certificate are not, and, to the knowledge of the undersigned, have never been, Beneficially Owned by an Acquiring Person or an Affiliate or Associate of an Acquiring Person or any Person acting jointly or in concert with an Acquiring Person or an Affiliate or Associate of an Acquiring Person (as such terms are defined in the Shareholder Rights Agreement).

Signature Guaranteed: \_\_\_\_\_  
Signature  
*(Signature must correspond to name as written upon the face of this Rights Certificate in every particular, without alteration or enlargement or any change whatsoever.)*

## NOTICE

**In the event the certification set forth above is not completed in connection with a purported assignment, the Corporation will deem the Beneficial Owner of the Rights evidenced by this Rights Certificate to be an Acquiring Person or an Affiliate or Associate of an Acquiring Person or any Person acting jointly or in concert with an Acquiring Person or an Affiliate or Associate of an Acquiring Person (as defined in the Shareholder Rights Agreement) and accordingly will deem the Rights evidenced by this Rights Certificate to be void and not transferable or exercisable.**

**FORM OF ELECTION TO EXERCISE**

(To be executed if the holder desires to exercise the Rights Certificate)

TO:     Computershare Investor Services Inc.  
          2nd floor – 510 Burrard Street  
          Vancouver, BC V6C 3B9

The undersigned hereby irrevocably elects to exercise \_\_\_\_\_ whole Rights represented by the attached Rights Certificate to purchase the Voting Shares issuable upon the exercise of such Rights and requests that certificates for such Voting Shares be issued in the name of:

Address:

\_\_\_\_\_  
\_\_\_\_\_

Social Insurance or Other Taxpayer Identification Number:

\_\_\_\_\_

If such number of Rights shall not be all the whole Rights evidenced by this Rights Certificate, a new Rights Certificate for the balance of such whole Rights shall be registered in the name of and delivered to:

Full Address, including postal code:

\_\_\_\_\_  
\_\_\_\_\_

Social Insurance or Other Taxpayer Identification Number:

\_\_\_\_\_

Dated: \_\_\_\_\_ [month, day, year]

Signature Guaranteed:

\_\_\_\_\_

Signature

*(Signature must correspond to name as written upon the face of this Rights Certificate in every particular, without alteration or enlargement or any change whatsoever.)*

**The signature of the person executing this power must be guaranteed by a Canadian chartered bank or eligible guarantor institution with membership in an approved signature guarantee medallion program.**

**CERTIFICATION**  
(To be completed if true)

The undersigned hereby represents, warrants and certifies for the benefit of all holders of Rights and Voting Shares, that the Rights evidenced by this Right Certificate are not, and, to the knowledge of the undersigned, have never been, Beneficially Owned by an Acquiring Person or an Affiliate or Associate of an Acquiring Person or any Person acting jointly or in concert with an Acquiring Person or an Affiliate or Associate of an Acquiring Person (as such terms are defined in the Shareholder Rights Agreement).

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Signature

*(Signature must correspond to name as written upon the face of this Rights Certificate in every particular, without alteration or enlargement or any change whatsoever.)*

**NOTICE**

**In the event the certification set forth above is not completed in connection with a purported assignment, the Corporation will deem the Beneficial Owner of the Rights evidenced by this Rights Certificate to be an Acquiring Person or an Affiliate or Associate of an Acquiring Person or any Person acting jointly or in concert with an Acquiring Person or an Affiliate or Associate of an Acquiring Person (as defined in the Shareholder Rights Agreement) and accordingly will deem the Rights evidenced by this Rights Certificate to be void and not transferable or exercisable.**

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER PURSUANT TO  
SECTION 302 OF THE SARBANES-OXLEY ACT 2002**

I, Joao Manuel, Chief Executive Officer of Petaquilla Minerals Ltd., certify that:

1. I have reviewed this annual report on Form 20-F of Petaquilla Minerals Ltd.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Company as of, and for, the periods presented in this report;
4. The company's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures as defined in Exchange Act Rules 13a-15(e) and 15d-15(e) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the company and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the company's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the company's internal control over financial reporting that occurred during the period covered by the annual report that has materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting; and
5. The company's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Company's auditors and the audit committee of the Company's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the company's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the company's internal control over financial reporting.

Date: August 29, 2011

By: /s/ Joao Manuel  
Joao Manuel  
Chief Executive Officer  
(principal executive officer)

**CERTIFICATION OF CHIEF FINANCIAL OFFICER PURSUANT TO  
SECTION 302 OF THE SARBANES-OXLEY ACT 2002**

I, Ezequiel Sirotinsky, Chief Financial Officer of Petaquilla Minerals Ltd., certify that:

1. I have reviewed this annual report on Form 20-F of Petaquilla Minerals Ltd.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Company as of, and for, the periods presented in this report;
4. The company's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures as defined in Exchange Act Rules 13a-15(e) and 15d-15(e) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the company and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the company's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the company's internal control over financial reporting that occurred during the period covered by the annual report that has materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting; and
5. The company's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Company's auditors and the audit committee of the Company's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the company's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the company's internal control over financial reporting.

Date: August 29, 2011

By: /s/ Ezequiel Sirotinsky  
Ezequiel Sirotinsky  
Chief Financial Officer  
(principal financial officer)

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with Annual Report of Petaquilla Minerals Ltd. (the "Company") on Form 20-F for the fiscal period ended May 31, 2011, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Joao Manuel, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to the best of our knowledge:

1. The Report fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934, as amended; and
2. The information contained in the Report fairly presents, in all materials respects, the financial condition and results of operations of the Company.

/s/ Joao Manuel  
Joao Manuel  
(principal executive officer)

Dated: August 29, 2011

The foregoing certification is being furnished solely to accompany the Report pursuant to 18 U.S.C § 1350, and is not being filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and is not to be incorporated by reference into any filing of the Company, whether made before or after the date hereof, regardless of any general incorporation language in such filing.

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with Annual Report of Petaquilla Minerals Ltd. (the "Company") on Form 20-F for the fiscal period ended May 31, 2011, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Ezequiel Sirotinsky, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to the best of our knowledge:

3. The Report fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934, as amended; and
4. The information contained in the Report fairly presents, in all materials respects, the financial condition and results of operations of the Company.

/s/ Ezequiel Sirotinsky  
Ezequiel Sirotinsky  
(principal financial and accounting officer)

Dated: August 29, 2011

The foregoing certification is being furnished solely to accompany the Report pursuant to 18 U.S.C § 1350, and is not being filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and is not to be incorporated by reference into any filing of the Company, whether made before or after the date hereof, regardless of any general incorporation language in such filing.