

PROBE RESOURCES LTD.

INTERIM CONSOLIDATED FINANCIAL STATEMENTS

UNAUDITED

For the three and six month periods ended February 28, 2010

NOTICE OF NO AUDITOR REVIEW OF INTERIM FINANCIAL STATEMENTS

Under National Instrument 51-102, part 4, subsection 4.3(3)(a), if an auditor has not performed a review of the interim financial statements, they must be accompanied by a notice indicating that the financial statements have not been reviewed by an auditor.

The accompanying unaudited interim financial statements of the Corporation have been prepared by, and are the responsibility of, the Corporation's management.

The Corporation's independent auditor has not performed a review of these financial statements in accordance with the standards established by the Canadian Institute of Chartered Accountants for a review of interim financial statements by an entity's auditor.

PROBE RESOURCES LTD.
CONSOLIDATED BALANCE SHEETS
For the periods ended February 28, 2010 and August 31, 2009

<u>ASSETS</u>	<u>2/28/10</u> Unaudited	<u>8/31/09</u> Audited
Current		
Cash and cash equivalents	\$ 2,075,970	\$ 752,772
Restricted cash – Note 3	2,890,611	6,155,638
Accounts receivable	4,464,093	6,463,115
Prepaid expenses and deposits – Note 11(c)	277,377	662,578
Deferred financing costs – Note 6	<u>801,514</u>	<u>-</u>
	10,509,565	14,034,103
Restricted cash – Note 3	246,329	256,251
Accounts receivable - other	547,500	547,500
Reclamation and performance deposits – Note 8	4,176,911	4,176,911
Office equipment – Note 4	299,311	374,627
Oil and natural gas properties – Notes 5 and 9	<u>42,843,955</u>	<u>49,697,583</u>
	<u>\$ 58,623,571</u>	<u>\$ 69,086,975</u>

LIABILITIES

Current		
Accounts payable and accrued liabilities – Notes 11	\$ 18,232,632	\$ 29,073,971
Note payable – Notes 6, 7 and 12	<u>24,748,899</u>	<u>16,560,108</u>
	42,981,531	45,634,079
Asset retirement obligation – Note 9	4,032,618	3,929,197
Asset retirement obligation received – Note 9	<u>579,718</u>	<u>463,756</u>
	<u>47,593,867</u>	<u>50,027,032</u>

SHAREHOLDERS' EQUITY

Share capital – Note 10	42,712,280	42,712,280
Contributed surplus – Note 10	5,041,582	4,924,274
Deficit	<u>(36,724,158)</u>	<u>(28,576,611)</u>
	<u>11,029,704</u>	<u>19,059,943</u>
	<u>\$ 58,623,571</u>	<u>\$ 69,086,975</u>

Nature of Operations and Ability to Continue as a Going Concern – Note 1
Litigation Settlement and Commitments – Notes 17 and 18

See accompanying notes to consolidated financial statements.

PROBE RESOURCES LTD.
CONSOLIDATED STATEMENTS OF OPERATIONS AND DEFICIT
For the three and six month periods ended February 28, 2010 and 2009

	<u>Three months Ended</u>		<u>Six Months Ended</u>	
	<u>2/28/10</u>	<u>2/28/09</u>	<u>2/28/10</u>	<u>2/28/09</u>
	<u>Unaudited</u>	<u>Unaudited</u>	<u>Unaudited</u>	<u>Unaudited</u>
Revenue	\$ 5,082,117	\$ 3,764,341	\$ 12,160,920	\$ 3,836,620
Oil and natural gas				
Production expenses				
Operating expenses				
Lease operating expenses	357,533	218,670	771,138	423,072
Transportation	301,700	131,460	841,576	158,066
Insurance	240,395	195,706	478,728	339,298
Other	<u>8,209</u>	<u>18,914</u>	<u>45,400</u>	<u>18,914</u>
	907,837	564,750	2,136,842	939,350
Depletion and accretion	<u>4,380,889</u>	<u>2,862,362</u>	<u>13,861,761</u>	<u>2,921,198</u>
Net production revenue (expense)	<u>(206,609)</u>	<u>337,229</u>	<u>(3,837,683)</u>	<u>(23,928)</u>
General and administrative expense				
Depreciation and Amortization				
of office equipment	27,240	30,157	84,362	57,704
Administrative expenses	202,714	237,944	465,185	439,645
Consulting fees	108,054	148,313	194,752	290,276
Directors' fees – Note 11	25,002	27,000	52,502	40,000
Legal and professional fees – Note 11	169,696	42,016	556,401	195,556
Stock-based compensation – Note 10	58,655	166,630	117,308	308,116
Wages and benefits – Note 11	<u>568,071</u>	<u>1,210,918</u>	<u>1,131,690</u>	<u>1,811,699</u>
	<u>1,159,432</u>	<u>1,862,978</u>	<u>2,602,200</u>	<u>3,142,996</u>
Operating loss	(1,366,041)	(1,525,749)	(6,439,883)	(3,166,924)
Net interest expense	<u>(1,664,529)</u>	<u>(657,486)</u>	<u>(2,896,456)</u>	<u>(652,992)</u>
Loss before other items	<u>(3,030,570)</u>	<u>(2,183,225)</u>	<u>(9,336,339)</u>	<u>(3,819,916)</u>
Other items:				
Foreign exchange gain	<u>139,592</u>	<u>316,416</u>	<u>1,188,792</u>	<u>962,762</u>
Net loss and comprehensive loss	(2,890,978)	(1,866,819)	(8,147,547)	(2,857,154)
Deficit, beginning of period	<u>(33,833,180)</u>	<u>(7,940,616)</u>	<u>(28,576,611)</u>	<u>(6,950,281)</u>
Deficit, end of period	<u>\$ (36,724,158)</u>	<u>\$ (9,807,435)</u>	<u>\$ (36,724,158)</u>	<u>\$ (9,807,435)</u>
Basic and diluted loss per share	<u>\$ (0.03)</u>	<u>\$ (0.02)</u>	<u>\$ (0.08)</u>	<u>\$ (0.03)</u>
Weighted average number of shares outstanding	<u>105,049,866</u>	<u>104,383,200</u>	<u>105,049,866</u>	<u>104,383,200</u>

See accompanying notes to consolidated financial statements.

PROBE RESOURCES LTD.
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the three and six month periods ended February 28, 2010 and 2009

	<u>Three months Ended</u>		<u>Six Months Ended</u>	
	<u>2/28/2010</u>	<u>2/28/2009</u>	<u>2/28/2010</u>	<u>2/28/2009</u>
	<u>Unaudited</u>	<u>Unaudited</u>	<u>Unaudited</u>	<u>Unaudited</u>
Cash provided by (used in):				
Operating Activities				
Net loss	\$ (2,890,978)	\$ (1,866,819)	\$ (8,147,547)	\$ (2,857,154)
Add items not affecting cash:				
Depletion and accretion	4,381,209	2,884,577	13,862,082	2,943,413
Amortization	27,240	30,157	84,362	57,704
Foreign exchange (gain) loss	(274,487)	(16,286)	(1,514,240)	350,919
Note forgiveness – related party	-	461,680	-	461,680
Interest expense added to principal	397,659	-	397,659	-
Stock-based compensation	58,655	158,582	117,308	300,068
Deferred financing cost amortization	287,887	-	345,399	-
	<u>1,987,185</u>	<u>1,651,891</u>	<u>5,145,023</u>	<u>1,256,630</u>
Changes in working capital and other balances:				
Restricted cash	1,059,975	(1,256)	3,274,949	(42,955)
Accounts receivable	(73,460)	(3,909,189)	1,999,022	(3,799,337)
Prepaid expenses and other	9,082,414	(1,106,272)	385,201	(1,172,526)
Accounts payable and accrued liabilities	(8,212,964)	330,986	(10,057,678)	(148,428)
Litigation settlement payment	-	-	(1,472,625)	-
Other	-	-	-	60,085
	<u>3,843,150</u>	<u>(3,033,840)</u>	<u>(726,108)</u>	<u>(3,846,531)</u>
Financing Activity				
Proceeds from issuance of notes payable	-	17,463,661	9,867,773	17,432,157
Principal payment on notes	(458,649)	-	(1,437,752)	-
Net proceeds from asset retirement obligation received	115,963	-	115,963	(1,223)
Deferred financing costs	-	-	(1,150,241)	-
	<u>(342,686)</u>	<u>17,463,661</u>	<u>7,395,743</u>	<u>17,430,934</u>
Investing Activities				
Note receivable – related party	-	-	-	(863,667)
Reclamation and performance deposits	-	(153,438)	-	(777,211)
Additions to equipment	(1,543)	(10,377)	(9,046)	(44,935)
Additions to oil and natural gas properties	(4,622,452)	(14,417,603)	(5,249,370)	(26,117,103)
Additions to deferred costs	-	(904,381)	-	(904,379)
	<u>(4,623,995)</u>	<u>(15,485,799)</u>	<u>(5,258,416)</u>	<u>(28,707,295)</u>
Foreign exchange gain (loss)	31,110	122,285	(88,021)	(244,920)
Increase (decrease) in cash	(1,092,421)	(933,693)	1,323,198	(15,367,812)
Cash and cash equivalents, beginning of period	<u>3,168,391</u>	<u>2,098,315</u>	<u>752,772</u>	<u>16,532,434</u>
Cash and cash equivalents, end of period	<u>\$ 2,075,970</u>	<u>\$ 1,164,622</u>	<u>\$ 2,075,970</u>	<u>\$ 1,164,622</u>

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PROBE RESOURCES LTD.
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the three and six month periods ended February 28, 2010 and 2009

	<u>Three months Ended</u>		<u>Six Months Ended</u>	
	<u>2/28/2010</u>	<u>2/29/2009</u>	<u>2/28/2010</u>	<u>2/29/2009</u>
	<u>Unaudited</u>	<u>Unaudited</u>	<u>Unaudited</u>	<u>Unaudited</u>
Cash paid for interest	<u>\$ 717,528</u>	<u>\$ 1,179</u>	<u>\$ 1,458,487</u>	<u>\$ 4,713</u>
Cash paid for income taxes	<u>=====</u>	<u>=====</u>	<u>=====</u>	<u>=====</u>

Supplementary Information with Respect to Non-cash Transactions – Note 14

See accompanying notes to consolidated financial statements.

PROBE RESOURCES LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
For the three and six month periods ended February 28, 2010

Note 1 Nature of Operations and Ability to Continue as a Going Concern

Probe Resources Ltd. (the “Company”) is a public company listed on the TSX Venture Exchange (TSX-V) and was incorporated under the British Columbia Business Corporations Act on November 15, 1988. At February 28, 2010, the Company owned interests in four oil and natural gas producing properties and a total of six Federal oil and natural gas blocks located in the United States Gulf of Mexico.

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles applicable to a going concern, which assumes that the Company will be able to meet its obligations and continue its operations for its next fiscal year. Realization values may be substantially different from carrying values as shown and these financial statements do not give effect to adjustments that would be necessary to the carrying values and classification of assets and liabilities should the Company be unable to continue as a going concern. At February 28, 2010, the Company had a working capital deficiency of \$32,471,966 and had not yet achieved profitable operations and expects to incur further losses in the near term development of its business, which raises significant doubt about the Company’s ability to continue as a going concern. The Company’s ability to continue as a going concern is dependent upon its ability to generate future profitable operations and cash flow and/or to obtain the necessary financing to meet its obligations and repay its liabilities arising from normal business operations when they come due.

Note 2 Significant Accounting Policies

These interim financial statements were prepared using accounting policies consistent with those used in the preparation of the Company’s audited financial statements for the year ended August 31, 2009.

The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from these estimates. In management’s opinion, the financial statements have been prepared within reasonable limits of materiality.

These financial statements do not include all the note disclosures required for the annual financial statements and as a result these interim financial statements should be read in conjunction with the Company’s audited financial statements for the year ended August 31, 2009.

PROBE RESOURCES LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
For the three and six month periods ended February 28, 2010

Note 2 Significant Accounting Policies – (cont'd)

International Financial Reporting Standards

In 2006, the Canadian Accounting Standards Board (“AcSB”) published a new strategic plan that will significantly affect financial reporting requirements for Canadian companies. The AcSB strategic plan outlines the convergence of Canadian GAAP and IFRS over an expected five year transitional period. In February 2008 the AcSB announced that 2011 is the changeover date for publicly-listed companies to use IFRS, replacing Canada’s own GAAP. The date is for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The transition date of January 1, 2011 will therefore require the restatement for comparative purposes of amounts reported by the Company for the year ended August 31, 2011. While the Company has begun assessing the adoption of IFRS for 2011, the financial reporting impact of the transition to IFRS is not determinable at this time.

Note 3 Restricted Cash

Current

As at February 28, 2010, and August 31, 2009, \$2,890,611 (US\$2,746,163) and \$6,155,638 (US\$5,621,587), respectively, represented a restricted, cash balance in Current Assets related to the cash management arrangement associated with the Debt Restructuring Agreement (“DRA”) that was effective on August 31, 2009 (note 7). The restricted cash balance at August 31, 2009 represents primarily current period customer collection amounts that will be paid to the creditors (including the debt instrument holders) in the DRA and to the Company for operating and general administrative costs, gas and condensate transportation charges and royalty payments on the related properties.

Non-current

As at February 28, 2010, and August 31, 2009, restricted deposit of \$246,329 (US\$234,020) and \$256,251 (US\$234,019), respectively, represents primarily a certificate of deposit held as office rent security for a US\$230,000 bank letter of credit. As at February 28, 2010, and August 31, 2009, the Company does not have a bank line of credit on its credit facilities and accordingly does not have any amounts outstanding on a bank line of credit.

Note 4 Office Equipment

	February 28, 2010		
	<u>Cost</u>	<u>Accumulated Amortization</u>	<u>Net Book Value</u>
Computer equipment	\$ 77,707	\$ 44,715	\$ 32,992
Office furniture and fixtures	355,123	136,380	218,743
Leasehold improvements	<u>69,209</u>	<u>21,633</u>	<u>47,576</u>
	<u>\$ 502,039</u>	<u>\$ 202,728</u>	<u>\$ 299,311</u>

PROBE RESOURCES LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
For the three and six month periods ended February 28, 2010

Note 4 Office Equipment – (cont'd)

	August 31, 2009		
	<u>Cost</u>	<u>Accumulated Amortization</u>	<u>Net Book Value</u>
Computer equipment	\$ 77,513	\$ 23,081	\$ 54,432
Office furniture and fixtures	351,075	80,736	270,339
Leasehold improvements	<u>64,042</u>	<u>14,186</u>	<u>49,856</u>
	<u>\$ 492,630</u>	<u>\$ 118,003</u>	<u>\$ 374,627</u>

Note 5 Oil and Natural Gas Properties

The asset categories of oil and natural gas interests at February 28, 2010, and August 31, 2009 were as follows:

	February 28, 2010		
	<u>Cost</u>	<u>Accumulated Depletion</u>	<u>Net Book Value</u>
Proved properties including lease and well equipment	\$71,013,525	\$42,142,334	\$28,871,191
Unproved properties			
Undeveloped	331,700	-	331,700
In process of development	<u>13,641,064</u>	<u>-</u>	<u>13,641,064</u>
	<u>\$ 84,986,289</u>	<u>\$ 42,142,334</u>	<u>\$ 42,843,955</u>
	August 31, 2009		
	<u>Cost</u>	<u>Accumulated Depletion</u>	<u>Net Book Value</u>
Proved properties including lease and well equipment	\$ 50,719,078	\$ 28,320,816	\$ 22,398,262
Unproved properties			
Undeveloped	429,505	-	429,505
In process of development	<u>26,869,816</u>	<u>-</u>	<u>26,869,816</u>
	<u>\$ 78,018,399</u>	<u>\$ 28,320,816</u>	<u>\$49,697,583</u>

PROBE RESOURCES LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
For the three and six month periods ended February 28, 2010

Note 5 Oil and Natural Gas Properties – (cont'd)

The Company has four properties currently in its proved properties amount. High Island Block 115 is a proved well in the Gulf of Mexico which was acquired during June 2007 with an add-on ownership in December 2007 and an overall working interest ownership of 41.5% (30.9% net revenue interest). South Timbalier Block 214 is a proved well with production start up in the second fiscal quarter of 2009 and has a working interest of 100% (70% net revenue interest). Two wells (East Cameron 36 A-1 well and East Cameron 37 A-2 well) were completed and placed in production in early February 2010. The two wells have a working interest of 52.0% (35.4% net revenue interest in the A-1 well and 35.6% net revenue interest in the A-2 well). While both wells costs are in the Proved properties category, the East Cameron 37 A-2 well has experienced mechanical issues requiring remediation and did not have production volumes for the current quarter. The South Timbalier Block 214, East Cameron 36 and East Cameron 37 properties and interests were acquired in fiscal year 2008 as part of Cutter Energy transaction described below.

Management has evaluated the carrying value of its proved and unproved properties and has determined that no impairment provision is required at February 28, 2010, and August 31, 2009.

Agreement to Purchase Oil and Gas Rights

On May 22, 2008, the Company's wholly-owned subsidiary Probe Resources US Ltd. ("Probe US") announced it has entered into an agreement (the "Agreement in Principle") with certain arm's length parties (the "Vendors") to purchase a 75% working interest rights associated with approximately 26,500 acres on six Federal oil and natural gas lease blocks located in the United States Gulf of Mexico (collectively, the "Concessions"). After completion of the Cutter Transaction, as described below, the Company became the Operator of the Concessions on a 100% working interest basis.

On June 6, 2008, the Company agreed to acquire the remaining 25% working interest rights from Cutter Energy on the Concessions noted above (the "Cutter Transaction"). Cutter Energy is owned by Scott Broussard (President, CEO, and Chairman of Probe) and the acquisition is, therefore, considered to be a non-arm's-length transaction. Total consideration for the Cutter interest rights is US\$829,594 cash, and the issue of up to 4,000,000 Common Shares. The Company issued 2,000,000 Common Shares upon closing of the transaction and 666,667 Common shares on March 3, 2009 upon completion of the South Timbalier 214 well. The Company will issue to Cutter the remaining 1,333,333 Common Shares, 666,666 common shares for each occurrence of up to two additional successful wells at distinct leases within 24 months from the date of the agreement. Two wells completed recently in the East Cameron properties will result in the issuance of the shares.

Pursuant to the terms of the Agreements, the Vendors along with Cutter have delivered to Probe US not less than a 69.5% net revenue interest in each of the Concessions. Probe US paid an aggregate amount of US\$4,250,000 as consideration to the Vendors and US\$829,524 and issued 2,000,000 common shares valued at \$0.50 per share to Cutter. The Agreement provides Probe US the opportunity to conduct a drilling program on the Concessions.

PROBE RESOURCES LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
For the three and six month periods ended February 28, 2010

Note 5 Oil and Natural Gas Properties – (cont'd)

On April 29, 2009, the Company announced that it had entered into a joint venture on its East Cameron 36, East Cameron 37 and Vermillion 20 Blocks. The terms of the arrangement included a proportionate payment at time of the joint venture (received in April 2009) and proportionate contributions in the future for development and production costs by the joint venture participants. The joint venture participants became working interest owners in the prospects, with Probe retaining an overall approximately 52% working interest and approximately 36% net revenue interest before Project Payout and approximately 42% working interest and 30% net revenue interest after Project Payout.

Note 6 Notes Payable

Notes payables consisted of the following:

	<u>2/28/10</u>	<u>8/31/09</u>
Credit Facility Loan	\$ 16,435,871	\$ 6,840,480
Senior Second Notes	8,205,903	9,220,930
Other short term notes	<u>107,125</u>	<u>498,698</u>
	<u>\$ 24,748,899</u>	<u>\$16,560,108</u>

All of the balances were classified in the current liability section of the Consolidated Balance Sheet due to their expected maturity or repayment schedule.

Credit Facility Loan

On February 19, 2009 the Company entered into a credit facility (“Loan”) with an institutional lender in the amount of US\$8,500,000 which was amended and increased on November 10, 2009 by US\$9,250,000. The initial Loan was for initially a term of six months from the date of advance (the “Maturity Date”). The Loan is collateralized by certain of the Company’s oil and natural gas properties. Interest is at an annual rate of 18% payable and compounded monthly on amounts outstanding at month end. In consideration of the initial Loan and its provisions, the Lender received a \$480,000 commitment fee and 7,000,000 share purchase warrants to purchase 7,000,000 common shares of the Company at a price of \$0.25 per share for a four year period expiring February 19, 2013. Finders’ fees were paid in connection with the Loan equal to 4% (\$428,162) of the funds raised by the Company and 4% (280,000) in warrants of the Company exercisable into a common share at a price of \$0.25 per share on or before February 19, 2010. The warrants were not exercised. The fair value of the Loan on inception was equal to the cash received and accordingly no consideration was allocated to the warrants. The fair value of the warrants issued for finders’ fees was determined using the Black-Scholes model as described in note 10. The loan fees and finders’ fees were initially deferred to be expensed over the original term of the Loan. The Company did not repay the loan within the original six month term and, effective August 31, 2009, the Loan was included in the Debt Restructuring Agreement (note 7). The interest rate on the balance outstanding remained at the 18% annual rate (including the increased borrowing amount in November, 2009) while monthly debt service payments are determined and made from monthly net restricted cash flow under the Debt Restructuring Agreement arrangement. Certain covenants and reporting requirements of the original Loan Agreement were also modified as part of the Debt Restructuring and Forbearance

PROBE RESOURCES LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
For the three and six month periods ended February 28, 2010

Note 6 Notes Payable – (cont'd)

Credit Facility Loan – (cont'd)

Agreements. For the Forbearance Agreement that was executed in conjunction with the Debt Restructuring Agreement, an additional US\$500,000 fee was incurred by the Company was added to the balance of the Loan as of August 31, 2009. As a result of the amended terms from the Debt Restructuring Agreement process, the deferred financing costs as of August 31, 2009 of \$753,938 were written off.

The amended and increased credit facility transaction in November 2009 had underwriting and amendment fees of US\$1,000,000 which were included in the overall borrowing amount of US\$9,250,000. Interest is at an annual rate of 18% compounded monthly on amounts outstanding at month end. The fees incurred were deferred and are being expensed over the expected one year time period of the increased borrowing period. Debt service for the increased Loan value is expected to be generated from net production payments from the two wells of the East Cameron development.

Note Purchase Agreement – Senior Secured Notes

On January 22, 2009 the Company entered into a Note Purchase Agreement whereby the Company issued and sold senior secured notes (“Notes”) in the aggregate principal amount of US\$10,000,000 (the “Notes”) to a Single Holder (the “Holder”). The net proceeds to the Company, as a result of the negotiated discount to face value of the Notes, was CDN\$7,000,000(US\$5,626,233). The Notes are collateralized by certain oil and natural gas properties. The Notes bear interest at a rate of 15% per annum, fixed and payable monthly in arrears on principal outstanding. The principal was originally scheduled to be paid by monthly payments of US\$200,000. The initial term of the Notes was two years with an extension option at the election of the Company for an additional two years upon payment of an extension fee of US\$300,000 in each of the second and third years of the total term. As additional consideration for the Notes, the Holder received, at the time of initial execution, 7,000,000 share purchase warrants exercisable into 7,000,000 common shares of the Company at a price of \$0.20 per share through November 28, 2013. The fair value of the Notes on inception was equal to the cash received and accordingly no consideration was allocated to the warrants. The fair value of the warrants issued for finders’ fees was determined using the Black-Scholes model as described in note 10. The Note fees and finders’ fee were initially deferred to be expensed over the original term of the Notes. Effective August 31, 2009, the Notes were included in the Debt Restructuring Agreement (note 7).

As a result of the amended terms from the Debt Restructuring Agreement process, the deferred financing costs as of August 31, 2009 of \$907,542 and the unamortized note discount of \$4,020,195 were written off.

PROBE RESOURCES LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
For the three and six month periods ended February 28, 2010

Note 6 Notes Payable – (cont'd)

Other Notes – Corporate Insurance Financing

During the year ended August 31, 2009, the Company obtained insurance financing for certain of its annual insurance policies by an unsecured short term note payable in the amounts of \$574,089 (US\$523,756) and \$48,091 (US\$43,875) bearing interest at 3.21% per annum, repayable in monthly installments of \$64,284 (US\$58,976) and \$6,930 (US\$6,358) maturing on March 8, 2010.

Note 7 Debt Restructuring Agreement

The Company has entered into a Debt Restructuring Agreement (the “DRA”) which became effective on August 31, 2009. The DRA schedules repayment of the Company’s outstanding past due trade payables and credit agreements (note 6) in an orderly manner consistent with monthly collected revenues, following deduction for general and administrative as well as lease operating costs, transportation payments and royalty payments of the Company.

Under the terms of the DRA, repayment will be made to all trade creditors with interest at an annual rate of 10%. The outstanding credit agreements are also included in the DRA. Interest rates on the existing loans and notes remained at their original rate. Monthly debt service on the agreements are determined in the DRA monthly payments based upon available cash as defined by the DRA and is allocated among the various Creditor classes, including the credit facilities, within the provisions of the DRA. The Company’s cash collection on the revenue from the properties secured by the DRA are maintained in a restricted cash account until distribution to the Company or Creditors by the DRA Creditors’ Agent (Restricted Cash – Note 3). The Company also agreed to restrictions on the sale of certain Company assets and to certain monthly reporting requirements. In the event of a rise (or decline) in the price or sales volume of natural gas, the repayment schedule self adjusts. A Creditors’ Committee was formed under the DRA to resolve future issues, and a Creditors’ Agent has been selected by the Creditors’ Committee to oversee payments by the Company. The DRA expires on August 31, 2010 and does not have established renewal or extension provisions for outstanding balances at the time of expiration. As of February 28, 2010 the DRA creditors’ balances were US\$26,393,686, consisting of accounts payable balances of US\$12,735,752 and note payable balances of US\$13,657,935 (see note 6).

Note 8 Reclamation and Performance Deposits

The reclamation and performance deposits consisted of non-interest bearing cash deposits provided to the insurers as collateral to secure certain performance and plugging and abandonment bonds. The deposits as of February 28, 2010 were \$4,176,911 (US\$3,916,663) and the same as of August 31, 2009.

Note 9 Asset Retirement Obligations

The future asset retirement obligations result from the Company’s net ownership interest in wells and facilities. Management estimates the total undiscounted amount of future cash flows required to reclaim and abandon wells and facilities as at February 28, 2010, and August 31, 2009 is approximately \$4,300,000 with a present value recorded liability of

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Note 9 Asset Retirement Obligations – (cont'd)

\$4,032,618 and \$3,927,197 at February 28, 2010, and August 31, 2009, respectively.

The following table reconciles the asset retirement obligations associated with the retirement of oil and natural gas properties:

	<u>2/28/10</u>	<u>8/31/09</u>
Balance, beginning of the year	\$ 3,929,197	\$ 706,435
Liabilities incurred	-	3,082,160
Accretion expense	<u>103,421</u>	<u>140,602</u>
Balance, end of the period	<u>\$ 4,032,618</u>	<u>\$ 3,929,197</u>

Asset Retirement Obligation Received

The asset retirement obligation received consists of amounts that the Company has withheld from revenue payments to its partners on the High Island 115 well. The liability will be paid by the Company to the operator of the High Island 115 property as plugging and abandonment costs are incurred in the future.

Note 10 Share Capital

Authorized:

Unlimited common shares without par value

Issued:

	<u>Share Capital</u>		<u>Contributed Surplus</u>
	<u>Number of Shares</u>	<u>Amount</u>	
Balance, September 1, 2008	104,383,200	\$ 42,623,302	\$ 3,789,693
Issued for lease acquisition	666,666	100,000	-
Less: share issue costs	-	(11,022)	-
Finders' fee warrants	-	-	33,600
Share purchase options	<u>-</u>	<u>-</u>	<u>1,100,981</u>
Balance, August 31, 2009	<u>105,049,866</u>	<u>\$ 42,712,280</u>	<u>\$ 4,924,274</u>
Share purchase options	<u>-</u>	<u>-</u>	<u>117,308</u>
Balance, February 28, 2010	<u>105,049,866</u>	<u>\$ 42,712,280</u>	<u>\$ 5,041,582</u>

On January 22, 2009 the Company closed a US\$4,000,000 tranche of a senior secured notes issue (the "Notes") for CDN\$2,800,000 (US\$2,200,047 net proceeds to the Company) in connection therewith. The Company then issued 2,800,000 of the 7,000,000 warrants to the Holder where each warrant entitles the Holder thereof to purchase one common share of the Company on or before November 28, 2013 at an exercise price of \$0.20 per share.

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Note 10 Share Capital – (cont'd)

On February 10, 2009 the Company closed the second tranche of a note issue by issuing US\$6,000,000 Notes for CDN\$4,200,000 (US\$3,351,955 net proceeds to the Company). In addition, the Company issued the remaining 4,200,000 of the 7,000,000 warrants to the Holder where each warrant entitles the Holder to purchase one common share of the Company on or before November 28, 2013 at an exercise price of \$0.20 per share (note 7).

Fees were paid in connection with the issue of the Notes equal to 4% (\$277,271.90) of the funds raised and 4% (280,000) in warrants of the Company exercisable into common shares at a price of \$0.25 per warrant on or before February 9, 2010 (note 6).

On February 19, 2009 the Company closed a credit facility (“Loan”) with an institutional lender in the amount of US \$8,500,000. The Loan was for a term of six months from the date of advance (the “Maturity Date”). Interest is at an annual rate of 18% payable and compounded monthly on amounts outstanding at month end. Regular principal payments were to be made over a six-month period which will, upon completion, retire the Loan. The Lender received a \$480,000 commitment fee and 7,000,000 share purchase warrants to purchase 7,000,000 common shares of the Company at a price of \$0.25 per share for a four year period expiring February 19, 2013. Fees were paid in connection with the Loan equal to 4% (\$428,162) of the funds raised by the Company and 4% (280,000) in warrants of the Company exercisable into a common share at a price of \$0.25 per warrant on or before February 19, 2010 (note 6). The warrants were not exercised.

By way of a Purchase and Sale Agreement, dated June 4, 2008, and effective as of April 1, 2008 among the Company, Probe US, and Cutter Energy LLC (“Cutter”), a private entity controlled by L. Scott Broussard, the Company acquired from Cutter a 25% interest in the Leases. The acquisition was accepted by the TSXV on June 30, 2008. Aggregate payable by the Company to Cutter was: (1) US\$829,594 cash (paid); (2) 2,000,000 Common Shares upon approval (issued); and (3) 666,666, 666,667, and 666,667 Common Shares for each occurrence of up to three successful wells at distinct leases within 24 months from the date of the agreement. The first installment of 666,666 Common Shares was issued to Cutter on March 3, 2009 upon the completion of the South Timbalier 214 Well. The second and final installment of the Common Shares are expected to be issued due to the two wells added during the quarter in the East Cameron properties.

Stock-Based Compensation Plan

Effective March 26, 2009, the Company adopted a rolling share option plan where the maximum number of common shares reserved for issue to any one person under the plan cannot exceed 10% of the issued and outstanding number of common shares at the date of the grant and the maximum number of common shares reserved for issue to a consultant or a person engaged in investor relations activities cannot exceed 2% of the issued and outstanding number of common shares at the date of the grant. The exercise price of each option granted under the plan may not be less than the Discounted Market Price (as that term is defined in the policies of the TSX). Options may be granted for a maximum term of ten (10) years from the date of the grant, are non-transferable and expire within 45 days of termination of employment or holding office as director or officer of the Company.

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Note 10 Share Capital – (cont'd)

Stock-Based Compensation Plan – (cont'd)

Information regarding the Company's outstanding share purchase options is summarized as follows:

	<u>Six Months Ended</u> <u>February 28, 2010</u>		<u>Year Ended</u> <u>August 31, 2009</u>	
	<u>Number</u>	<u>Weighted</u> <u>Average</u> <u>Exercise</u> <u>Price</u>	<u>Number</u>	<u>Weighted</u> <u>Average</u> <u>Exercise</u> <u>Price</u>
Outstanding, beginning of period	8,329,413	\$0.35	5,012,910	\$0.45
Granted	800,000	\$0.20	3,616,503	\$0.21
Forfeited	<u>(300,000)</u>	<u>\$0.40</u>	<u>(300,000)</u>	<u>\$0.50</u>
Outstanding, end of period	<u>8,829,413</u>	<u>\$0.33</u>	<u>8,329,413</u>	<u>\$0.35</u>
Exercisable, end of period	<u>6,170,913</u>	<u>\$0.34</u>	<u>6,039,526</u>	<u>\$0.33</u>

Share purchase options outstanding at February 28, 2010 are as follows:

<u>Number of</u> <u>Options</u>	<u>Exercise</u> <u>Price</u>	<u>Expiry Date</u>
563,910	\$0.67	July 26, 2012
100,000	\$0.49	October 26, 2012
250,000	\$0.60	November 22, 2012
3,799,000	\$0.40	March 5, 2013
370,000	\$0.40	October 2, 2013
912,580	\$0.19	February 10, 2014
2,033,923	\$0.20	June 1, 2014
400,000	\$0.15	September 20, 2014
<u>400,000</u>	<u>\$0.25</u>	<u>September 20, 2014</u>
<u>8,829,413</u>		

On September 1, 2009, an optionee ceased to be employed by the Company. Within 45 days after the optionee ceasing to be an employee 100,000 unvested share purchase options exercisable at \$0.40 vesting on October 3, 2009 expired and 100,000 unvested share purchase options exercisable at \$0.40 vesting on October 3, 2010 were forfeited. Additionally, 100,000 vested share purchase options exercisable at \$0.40 until October 2, 2013 expired unexercised.

On September 21, 2009 the Company granted incentive stock options to an employee of the Company to purchase up to 800,000 common shares in the capital stock of the Company on or before September 20, 2014. 200,000 options were exercisable immediately at \$0.15 per share, 200,000 options are exercisable at \$0.15 per share and are to vest 365 days after September 21, 2009, 200,000 options are exercisable at \$0.25 and are to vest 730 days after September 21, 2009, and the remaining 200,000 options are exercisable at \$0.25 per share and are to vest 1095 days after September 21, 2009.

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For the three and six month periods ended February 28, 2010

Note 10 Share Capital – (cont'd)

Stock-Based Compensation Plan – (cont'd)

The weighted average contractual life of outstanding options is 3.60 years.

The fair value of the share purchase options granted during the six months ended February 28, 2010 and the year ended August 31, 2009 of \$52,000 and \$664,793 was estimated using the Black-Scholes option pricing model using the following assumptions:

	<u>February 28, 2010</u>	<u>August 31, 2009</u>
Risk-free interest rate	1.23%	1.30% - 2.22%
Dividend yield	0.00%	0.00%
Expected stock price volatility	119.42%	116.65% - 223.99%
Weighted average expected stock option life	5 years	5 years

Share Purchase Warrants

Information regarding the Company's outstanding share purchase warrants is summarized below:

	<u>Six Months Ended February 28, 2010</u>		<u>Year Ended August 31, 2009</u>	
	<u>Number</u>	<u>Weighted Average Exercise Price</u>	<u>Number</u>	<u>Weighted Average Exercise Price</u>
Balance, beginning of period	31,071,874	\$0.37	88,531,224	\$0.67
Issued	-	\$ -	14,560,000	\$0.23
Expired	<u>(560,000)</u>	<u>\$ -</u>	<u>(72,019,350)</u>	<u>\$0.74</u>
Balance, end of period	<u>30,511,874</u>	<u>\$0.37</u>	<u>31,071,874</u>	<u>\$0.37</u>

Share purchase warrants outstanding at February 28, 2010 are as follows:

<u>Number of Warrants</u>	<u>Exercise Price</u>	<u>Expiry Date</u>
16,511,874	\$0.50	June 6, 2010
7,000,000	\$0.20	November 28, 2013
<u>7,000,000</u>	\$0.25	February 19, 2013
<u>30,511,874</u>		

PROBE RESOURCES LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
For the three and six month periods ended February 28, 2010

Note 10 Share Capital – (cont'd)

Share Purchase Warrants – (cont'd)

Financing costs of \$33,600 with respect to 560,000 share purchase warrants issued for finders' fees during the year ended August 31, 2009 and included in the share purchase warrants outstanding above, were estimated using the Black-Scholes option pricing model with the following assumptions:

	<u>2009</u>
Risk-free interest rate	1.30%
Dividend yield	0.00%
Expected stock price volatility	116.39%
Weighted average expected warrant	1 year

Note 11 Related Party Transactions

- a) For the six months ended February 28, 2010 and 2009 the Company incurred the following fees charged by directors and former directors of the Company or by entities of which a director is a partner or entities with directors in common with the Company:

	<u>2010</u>	<u>2009</u>
Directors' fees	\$ 52,502	\$ 16,000
Legal fees	86,435	252,095
Wages and benefits	<u>79,074</u>	<u>78,031</u>
	<u>\$ 218,011</u>	<u>\$ 346,126</u>

These charges were measured by the exchange amount which is the amount agreed upon by the transacting parties.

- b) At February 28, 2010, and August 31, 2009, accounts payable and accrued liabilities include \$303,204 and \$337,627, respectively, due to directors of the Company or to private entities with directors in common with the Company.
- c) At February 28, 2010, and August 31, 2009, an officer of the Company was indebted to the Company for \$9,428 from payroll advances. This amount is included in prepaid expenses and deposits.
- d) On September 2, 2008, the Company advanced USD\$750,000 to an officer of the Company as a relocation/home ownership loan. The advance bears interest at 5% and is repayable on the earlier of January 1, 2010, or immediately in the case of the borrower's termination of the employment agreement dated February 12, 2008. The loan was forgiven as to 50% after one year and the remaining 50% after the second year unless the employment is terminated. The first 50% of the loan was forgiven on January 1, 2009 and the balance was forgiven on January 1, 2010.

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Note 12 Financial Instruments and Risk Management

At February 28, 2010, and August 31, 2009 the Company's financial instruments consisted of cash, cash equivalents and restricted cash, accounts receivable, prepaids, notes payable, accounts payable and accrued liabilities. The fair values of cash, cash equivalents and restricted cash, accounts receivable, prepaids, accounts payable and accrued liabilities approximate their carrying amount due to the short-term maturity of those instruments. The Company is exposed to risks arising from the creditors balances in the Debt Restructuring Agreement. The financial risks include market risk relating to commodity prices, interest rates and foreign exchange rates, credit risk and liquidity risk.

a) Market Risk

Market risk, the risk that the fair value or future cash flows of financial assets or liabilities will fluctuate due to movements in market prices, comprises the following:

(i) Commodity price risk

The Company sells all of its oil and natural gas production at current market prices on the date of sale.

(ii) Foreign exchange risk

The Company is exposed to foreign exchange risks to the extent it transacts in primarily US dollars, while measuring and reporting its results in Canadian dollars (CAD). Since time passes between the recording of a receivable or payable transaction and its collection or payment, the Company is exposed to gains or losses on US\$ amounts and on balance sheet translation of monetary accounts denominated in US\$ amounts upon spot rate fluctuations from quarter to quarter.

In addition, additions to oil and gas properties are recorded and translated at historical cost. Changes in foreign exchange rate between US dollar and Canadian dollar could have a significant exchange fluctuation on the results of operations. As at February 28, 2010 a 10% increase in the value of the US dollar to the Canadian dollar would have negatively impacted net earnings (loss) by an estimated \$2,963,000 unfavorable impact. A similar decrease of 10% would have had the opposite impact.

b) Credit Risk

Credit risk reflects the risk the Company may be unable to recover accounts receivable and have access to its bank balances. The Company's accounts receivable are primarily with secure oil and gas companies. The Company's bank accounts are with secure financial institutions. As such, management believes from its evaluation that it does not currently have any significant credit risk.

c) Liquidity Risk

Liquidity risk is the risk the Company will encounter difficulties in meeting its financial obligations. The Company manages liquidity risk by continuously

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Note 12 Financial Instruments and Risk Management – (cont'd)

monitoring forecast and actual cash flows and the use of debt facilities and equity facilities as needed. All of the Company's debt obligations (including the Debt Restructuring Agreement) except for the amended and increased credit facility transaction in November 2009 are repayable or subject to renegotiations in the current fiscal year.

Note 13 Segmented Information

The Company has one operating segment, oil and gas operations, and operates in two geographical regions as follows:

February 28, 2010	US	Canada	Total
Revenues (for the six months)	<u>\$ 12,160,920</u>	<u>\$ -</u>	<u>\$ 12,160,920</u>
Current assets	\$ 10,465,787	\$ 43,778	\$ 10,509,565
Oil and natural gas properties	42,843,955	-	42,843,955
Office equipment	295,686	3,625	299,311
Other assets	<u>4,970,740</u>	<u>-</u>	<u>4,970,740</u>
Total Assets	<u>\$ 58,576,168</u>	<u>\$ 47,403</u>	<u>\$ 58,623,571</u>
August 31, 2009	US	Canada	Total
Revenues (for the year)	<u>\$ 23,918,542</u>	<u>\$ -</u>	<u>\$ 23,918,542</u>
Current assets	\$ 13,990,325	\$ 43,778	\$ 14,034,103
Oil and natural gas properties	49,697,583	-	49,697,583
Office equipment	367,182	7,445	374,627
Other assets	<u>4,980,662</u>	<u>-</u>	<u>4,980,662</u>
Total Assets	<u>\$ 69,035,752</u>	<u>\$ 51,223</u>	<u>\$ 69,086,975</u>

All oil and natural gas properties of the Company are in the US Gulf of Mexico in federal waters.

Note 14 Non-Cash Transactions

Investing and financing activities that do not have a direct impact on current cash flows are excluded from the statements of cash flows.

During the three and six months ended February 28, 2010 and 2009, the following transactions were included or excluded from the statement of cash flows:

- a) The Company included amounts of \$65,370 (2009: \$24,942) and \$113,410 (2009: \$35,168) in operating expenses in asset retirement obligation pursuant to the provision of an asset retirement obligation.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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Note 14 Non-Cash Transactions – (cont'd)

- b) The Company's acquisition of oil and gas properties excludes amounts of \$1,738,294 (2009: \$14,604,806) and \$870,720 (2009 \$5,728,187) included in accounts payable.

Note 15 Income Taxes

As of August 31, 2009 and 2008, reconciliation of income taxes at statutory rates is as follows:

	<u>2009</u>	<u>2008</u>
Loss before income taxes	\$ <u>21,626,330</u>	\$ <u>4,076,271</u>
Statutory tax rates	<u>30.17%</u>	<u>34.12%</u>
Computed income tax recovery	\$ 6,524,000	\$ 1,390,800
Effect of reduction in statutory rate	(372,000)	(267,100)
Expiry of loss carry forward	(25,000)	(19,300)
Foreign income taxed at other than CDC Rate	573,000	(1,100)
Permanent differences	(3,016,000)	(405,900)
Financing fees	468,000	667,400
Other	658,000	-
Net change in valuation allowance	<u>(4,810,000)</u>	<u>(1,364,800)</u>
Total income taxes (recovery)	\$ <u>-</u>	\$ <u>-</u>

Significant components of the Company's future tax assets and liabilities, after applying enacted corporate income tax rates, are as follows:

	<u>2009</u>	<u>2008</u>
Future income tax assets		
Non-capital loss carried forward	\$ 5,193,000	\$ 996,000
Exploration and development costs	243,000	216,000
Capital assets	40,000	9,000
Financing costs	<u>1,133,000</u>	<u>587,000</u>
	6,609,000	1,808,000
Valuation allowance	<u>(6,609,000)</u>	<u>(1,808,000)</u>
Future income tax assets	\$ <u>-</u>	\$ <u>-</u>

At August 31, 2009, the Company has estimated losses for income tax purposes that can be used to reduce future taxes payable. These losses expire at varying dates to 2029.

The amount of Canadian non-capital losses available for carry forward is \$10,027,000. The amount of US net-operating losses available for carry forward is \$7,674,000.

The Company has recorded a valuation allowance against its future income tax assets based on the extent that it is more likely-than-not that sufficient taxable income will not be realized during the carry-forward periods to utilize all the future tax assets.

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Note 16 Comparative Figures

Certain comparative figures for the six months ended February 28, 2009 have been reclassified to conform to the financial statement presentation adopted for the current period.

Note 17 Litigation Settlement

During November 2009, the Company announced that it had reached a Litigation Settlement of all claims and dismissal of a lawsuit initiated by a party (Frankel) against Probe Resources US LTD and an officer of the Company alleging the use of confidential information related to certain properties previously acquired by Probe, thereby removing the uncertainty surrounding such claims and the concomitant material legal expenses. As a condition of the settlement, the Company paid US\$1.25 million (CA\$1,472,625) and the Litigation Settlement counterparty also received small overriding royalties effective for November 2009 production forward on certain Probe properties. Probe and management vigorously denied any wrongdoing with respect to all of the matters alleged and the settlement specifically acknowledges that there was no admission of liability on either party's part. For the year ended August 31, 2009, the Company recorded a provision of \$1,472,625 (US\$1,250,000) for the settlement that was paid during November 2009.

Note 18 Commitments

Operating Leases

The Company has a non-cancelable operating lease for its office facility. The lease has schedule increases, requires the Company to pay its share of operating costs, and expires in December 2013.

Future minimum payments under operating lease for the remaining term are as follows:

February 28, 2011	\$363,000
February 28, 2012	\$376,088
February 28, 2013	\$376,088
December 31, 2013	\$313,406

Note 19 Capital Risk Management

The company's objectives when managing capital are: to safeguard the Company's ability to continue as a going concern; to maintain optimal capital structure, while ensuring the Company's strategic objectives are met and to provide an appropriate return to shareholders relative to the risk of the Company's underlying assets.

In the management of capital, the Company includes share capital, contributed surplus, deficit, interest bearing debt, debt restructure agreement balances, cash and cash equivalents.

PROBE RESOURCES LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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Note 19 Capital Risk Management – (cont'd)

The Company maintains and adjusts its capital structure based on changes in economic conditions and the Company's planned requirements. The Company may adjust its capital structure by issuing new equity and/or debt, selling and/or acquiring assets, and controlling its capital expenditures program.