



**Eaglewood Energy Inc.**  
**ANNUAL REPORT**  
**For the year ended December 31, 2010**

## **PRESIDENT'S MESSAGE**

The year 2010 was a very active year for the Company and we saw huge volatility in the share price, as is the nature of active, early stage exploration companies. We participated in our first exploration well, the Oilsearch operated Korka-1 well on our PPL 260 license in the highlands, and prepared to drill our first operated well, Ubuntu-1, on our PPL 259 license in the forelands, which was drilled in the first quarter of 2011.

Although encountering excellent reservoir sand and registering elevated gas readings while drilling through the target zone, unfortunately Korka was water wet and abandoned as dry hole in June, 2010.

In order to ensure we met our PPL 259 license commitment, in April we proceeded to award contracts for a drilling rig and helicopter which would be required to drill our first PPL 259 well, Ubuntu-1, keeping the license in good standing. In November of 2010 we successfully farmed out 50% of the Ubuntu prospect of PPL 259 (representing approximately 3 percent of the license and approximately 6 percent of the license after relinquishment), however Eaglewood still retains a 90% interest in the remainder of the license.

The Ubuntu-1 well successfully drilled to the target reservoirs and resulted in a hydrocarbon discovery. During the operations phase, various delays were experienced and those resulted in cost over-runs. In particular the mobilisation of the drilling rig was burdened with weather and barge scheduling issues related to the late delivery of the rig from the previous well and customs clearance delays and there were a number of teething problems with the rig which had to be overcome. The significant cost over-run and lack of a farmout partner for our second planned well in PPL 259 meant we could only drill one well prior to de-mobilising the rig away from the license area. This further increased total costs of the Ubuntu well as the mobilisation and de-mobilisation costs were not amortised over the multiple well program originally anticipated. However, unlike Korka, Ubuntu-1 was a discovery encountering hydrocarbons in one of the three zones targeted and the well was suspended in February 2011 as a potential future producer.

The Ubuntu discovery and the successful appraisal of the Stanley discovery on PRL-4 significantly de-risked our PPL 259 prospect inventory. The remainder of 2011 will be focused on further de-risking and enhancing the value of PPL 259 license. We plan to acquire additional seismic over the Ubuntu discovery and mature some of our other prospects into drilling locations. We are also considering ways to upgrade the road through the license which would provide cheaper and easier access to many of our prospects. Additionally, we will be working toward a unitization agreement with the Operator of PRL 4, as we believe part of the Stanley pool in PRL 4 is in our PPL 259 license.

As our PPL 260 and 259 original license tenures are due to expire in 2011, we will be relinquishing half our acreage and applying for five year extensions on the remaining acreage, which is typically granted on licenses in good standing. Sufficient work has been done on both licenses to put them in good standing and to allow us to retain the most prospective parts of the licenses. We continue to wait for our PPL 257 and 258 license extensions which were submitted over a year ago and though we expect the extension is forthcoming, we do not yet have the signed instrument from the Energy Minister.

The past year has been a challenging one, however we are pleased to report a hydrocarbon discovery with the Ubuntu-1 well and we look forward to a successful 2011. I'd like to thank the Directors, employees and most importantly the shareholders for their patience as Eaglewood realizes it's potential in 2011.

A handwritten signature in blue ink, appearing to read 'Brad Hurtubise', with a stylized flourish at the end.

Brad Hurtubise  
President and CEO

Management's discussion and analysis ("MD&A") of Eaglewood Energy Inc.'s (the "Company" or "Eaglewood") financial condition and results of operations should be read in conjunction with the consolidated financial statements for the year ended December 31, 2010 and 2009 and related notes therein prepared in accordance with Canadian generally accepted accounting principles. The effective date of this MD&A is April 13, 2011.

Additional information relating to the Company is available on SEDAR at [www.sedar.com](http://www.sedar.com) and the Company's website at [www.eaglewoodenergy.ca](http://www.eaglewoodenergy.ca).

#### **FORWARD-LOOKING STATEMENTS**

Certain statements contained in this MD&A may constitute forward-looking statements. These statements relate to future events or the Company's future performance. All statements, other than statements of historical fact, may be forward-looking statements. Forward-looking statements are often, but not always, identified by the use of words such as "seek", "anticipate", "plan", "continue", "estimate", "expect", "may", "will", "project", "predict", "propose", "potential", "targeting", "intend", "could", "might", "should", "believe" and similar expressions. These statements involve known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in such forward-looking statements. The Company believes that the expectations reflected in those forward-looking statements are reasonable but no assurance can be given that these expectations will prove to be correct and such forward-looking statements included in this MD&A should not be unduly relied upon as actual results may vary. These statements speak only as of the date of this MD&A and are expressly qualified, in their entirety, by this cautionary statement.

In particular, this MD&A contains forward-looking statements, pertaining to the following:

- capital expenditure programs;
- development of resources;
- treatment under governmental regulatory and taxation regimes;
- expectations regarding the Company's ability to raise capital;
- expenditures to be made by the Company to meet certain work commitments; and
- work plans to be conducted by the Company.

With respect to forward-looking statements listed above and contained in this MD&A, the Company has made assumptions regarding, among other things:

- the Papua New Guinea legislative and regulatory environment;
- the impact of increasing competition;
- unpredictable changes to the market prices for oil and natural gas;
- that costs related to development of the oil and gas properties in Papua New Guinea will remain consistent with historical experiences;
- anticipated results of exploration activities;
- availability of additional financing and farm-in or joint venture partners; and
- the Company's ability to obtain additional financing in a timely manner and on satisfactory terms.



The Company's actual results could differ materially from those anticipated in these forward-looking statements as a result of the risk factors set forth below and elsewhere in this MD&A:

- volatility in the market prices for oil and natural gas;
- uncertainties associated with estimating resources;
- geological, technical, drilling and processing problems;
- liabilities and risks, including environmental liabilities and risks, inherent in oil and natural gas operations;
- fluctuations in currency and interest rates;
- incorrect assessments of the value of acquisitions;
- unanticipated results of exploration activities;
- competition for, among other things, capital, acquisitions of reserves, equipment, undeveloped lands and skilled personnel;
- lack of availability of additional financing and farm-in or joint venture partners;
- unpredictable weather conditions; and
- other factors referred to under "Risk Factors" in the Company's annual information form for the year ended December 31, 2010, dated April 13, 2011 and filed on SEDAR on April 20, 2011.

Undue reliance should not be placed on forward-looking statements as the plans, intentions or expectations upon which they are based might not occur. Readers are cautioned that the foregoing lists of factors are not exhaustive. The forward-looking statements contained in this MD&A are expressly qualified by this cautionary statement. The Company does not undertake any obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, unless required by law.

## **COMPANY OVERVIEW**

Eaglewood is an international, junior oil and gas company which trades on the TSX Venture Exchange (trading symbol "EWD"). The Company's primary activity is exploration and development of its four petroleum prospecting licenses located in Papua New Guinea (the "PNG Licenses") which were acquired from Transeuro Energy in October 2007. The Company has no oil and gas properties other than the PNG Licenses. Currently there is no production or reserves associated with the PNG Licenses.

To reduce the Company share of costs and risks associated with exploration activities, the Company has entered into three farm-out agreements relating to its PNG licenses. In 2009, the Company farmed out a 70 percent interest in PPL 260 and a 10 percent interest in PPL 259. During 2010, the Company entered into a farm-out agreement for a 50 percent interest in two graticular blocks (representing approximately 3 percent of the license and approximately 6 percent of the license after relinquishment (see note 13)) within PPL 259 containing the Ubuntu prospect. The farmee paid 50 percent of the drilling and other participating interest costs related to Ubuntu-1. In addition, the farmee paid Eaglewood US \$4,500,000 for reimbursement of costs related to engineering work on river transport and liquids handling design and previous expenditures on the Ubuntu prospect.

During 2010, the first exploration well in license PPL 260, Korka-1, was drilled. The well encountered no commercial quantities of hydrocarbons and was subsequently plugged and

abandoned. In late 2010, the Company spud its first exploration well in license PPL 259, Ubuntu-1, which resulted in a gas and gas condensate discovery in 2011 (see SUBSEQUENT EVENTS).

## **2010 SIGNIFICANT EVENTS**

- On March 24, 2010, Eaglewood closed a private placement special warrants offering for gross proceeds of \$23,625,000 (net proceeds \$22.3 million) and issued 13,500,000 special warrants at a price of \$1.75 per special warrant. On April 12, 2010, the special warrants were deemed exercised and the Company issued 13,500,000 common shares and the special warrants were cancelled.
- In mid-April 2010, the first exploration well in license PPL 260, Korka-1, was spud. Unfortunately, Korka-1 encountered no commercial quantities of hydrocarbons and was subsequently plugged and abandoned.
- On November 11, 2010, Eaglewood announced it had entered into a farm-out agreement whereby the farmee would earn a 50 percent participating interest in the Ubuntu prospect located within two graticular blocks in license PPL 259 (representing approximately 3 percent of the license and approximately 6 percent of the license after relinquishment (see note 13 of the financial statements)) in exchange for paying Eaglewood US \$4,500,000, comprised of the farmee's acquisition of engineering work to date on condensate stripping, river transport and liquids handling designs and previous expenditures on the Ubuntu prospect. In addition, the farmee will pay 50 percent of the drilling and its other participating interest costs relating to Ubuntu-1.
- On December 13, 2010, Eaglewood spud its first exploration well in PPL 259, Ubuntu-1.
- On December 17, 2010, the Company closed a short-form prospectus offering for gross proceeds of \$10,125,000 (net proceeds \$9.4 million) and issued 13,500,000 common shares at \$0.75 per common share.

## **SUBSEQUENT EVENTS**

### **(a) Ubuntu-1 well results**

On February 7, 2011, Eaglewood announced that it was suspending the Ubuntu-1 well as a gas and gas condensate discovery. On February 11, 2011, Eaglewood further announced that wireline logging and data acquisition programs had been completed in Ubuntu-1 including the recovery of down-hole hydrocarbon samples and sidewall cores. New seismic data acquisition is planned in PPL 259 over the Ubuntu discovery area.

### **(b) Rig assignment**

In April 2010, the Company entered into an Agreement of Assignment in relation to Rig 103 for the purpose of drilling two wells. On February 18, 2011, the Company assigned its second rig slot to a third party, and is no longer obligated to drill a second well with this rig.

### **(c) Over-allotment**

On January 20, 2011, the Company closed the over-allotment option pursuant to its December 2010 equity financing in which the Underwriters purchased an additional 710,000 common shares at \$0.75 per common share for aggregate gross proceeds of \$532,500.



**(d) License extension application**

On March 29, 2011, the Company submitted to the Department of Petroleum and Energy of PNG, an application for a five year extension on the PPL 259 license. Under the PNG Oil and Gas Act, the license is deemed to still be in effect while the extension request is under review by the Minister. In accordance with the terms of the license renewal, 50 percent of the area for PPL 259 will be relinquished when, and if, the extension is granted.

**DESCRIPTION OF PNG LICENSES AND COMMITMENTS**

Each of the PNG Licenses gives the Company the right to explore for oil and natural gas on specified blocks in PNG. If exploration is successful, the Company can apply to the PNG government for either a retention license or a development license. A retention license is generally applied for if natural gas reserves have been identified but additional time is required to either prepare a development plan or, if the amount of natural gas reserves is not of a sufficient commercial quantity, to explore for further natural gas reserves. A development license is generally applied for if oil and/or natural gas reserves have been discovered and production is commercially viable. The PNG government has historically granted retention or development licenses however there is a risk that a retention or development license may not be granted to the Company when, or on the terms, applied for.

***PPL 259***

Originally granted on June 30, 2005, PPL 259 has a six year term that is due to expire on June 29, 2011. It covers 1,377,000 gross acres, all onshore, in the foreland region of the Papuan Fold Belt of PNG. PPL 259 is a natural gas and natural gas liquids play for the Company. The Company has a 90 percent participating interest in PPL 259 excluding two blocks within the license area surrounding the Ubuntu prospect. A 10 percent participating interest in PPL 259 was farmed-out in 2009. In November 2010, the Company farmed-out a 50 percent interest in two graticular blocks surrounding the Ubuntu prospect (representing approximately 3 percent of the license and approximately 6 percent of the license after relinquishment (see note 13 of the financial statements)) reducing the Company's share of Ubuntu-1 to 40 percent.

There is a commitment to drill an exploration well on the license. On September 21, 2010 the Minister for Petroleum and Energy approved a variation to the drilling commitment moving it to year five of the license term which is 2010. Drilling of the Ubuntu-1 well commenced in December 2010. On February 7, 2011, Eaglewood announced that it was suspending the Ubuntu-1 well as a gas and gas condensate discovery. On February 11, 2011, Eaglewood further announced that wireline logging and data acquisition programs had been completed in Ubuntu-1 including the recovery of down-hole hydrocarbon samples and sidewall cores. The estimated gross cost of the well is approximately US \$39,800,000 (Company share 40 percent, net cost approximately US \$15,920,000).

In the event of a discovery there is a requirement to drill an appraisal well by June 30, 2011. An appraisal well is not currently warranted until further seismic is acquired. On March 7, 2011 a variation application was submitted to the Department of Petroleum and Energy requesting the

requirement to drill an appraisal well is replaced by a seismic acquisition programme and further geological studies.

On March 29, 2011, the Company submitted to the Department of Petroleum and Energy of PNG, an application for a five year extension on the PPL 259 license. Under the PNG Oil and Gas Act, the license is deemed to still be in effect while the extension request is under review by the Minister. In accordance with the terms of the license renewal, 50 percent of the area for PPL 259 will be relinquished when, and if, the extension is granted.

The Company expects that the PPL 259 license will be extended and that the appraisal well drilling commitment will be replaced with the seismic programme.

#### ***PPL 260***

Originally granted on March 14, 2005, PPL 260 has a six year term that was due to expire on March 13, 2011. It covers 1,559,250 gross acres, all onshore, in the highland region of the Papuan Fold Belt of PNG. PPL 260 is an anticipated natural gas and natural gas liquids play for the Company. The Company has a 30 percent participating interest in PPL 260. In 2009, the Company farmed-out a 70 percent participating interest. The farmee assumed operatorship in 2009.

There was a commitment to drill one exploration well by March 13, 2010. Pre-drilling activities for the first exploration well, Korka-1, began in March and drilling was underway during April 2010. Unfortunately, the exploration well encountered no hydrocarbons and was plugged and abandoned. The gross cost of the exploration well was approximately US \$57,000,000 (net cost to the Company estimated at approximately US \$6,600,000). Location and timing decisions for a second exploration well are being evaluated.

In December 2010, the Operator of the license submitted a request for a five year extension of the license upon its expiry in March 2011. Under the PNG Oil and Gas Act, the license is deemed to still be in effect while the extension request is under review by the Minister. In accordance with the terms of the license renewal, 50 percent of the area for PPL 260 will be relinquished when, and if, the extension is granted. The area to be relinquished was determined by the Operator after an extensive review of seismic and aero/gravity magnetic surveys done on the license. The Company expects that the PPL 260 license will be extended.

#### ***PPL 257***

Originally granted on October 20, 2004, PPL 257 had an initial six year term that was due to expire on October 19, 2010. Under the PNG Oil and Gas Act, the license is deemed to still be in effect while the Company awaits review of its extension request by the Minister. PPL 257 currently covers 1,741,500 gross acres located in the Cape Vogel Basin of PNG. The prospective area is predominantly offshore but includes an onshore area that will be instrumental for conducting geological field work. PPL 257 is an anticipated natural gas play for the Company. The Company holds a 100 percent participating interest in PPL 257. There was a commitment to drill one exploration well by October 20, 2009 under the initial term of the license that was not met. However, the Company met the other commitments under the license including seismic acquisition. The Company estimates that the cost of drilling one exploration well is approximately US \$60,000,000.



On March 18, 2010, the Company submitted a request for a five year extension to the license upon its expiry in October 2010 which is subject to PNG government approval. In accordance with the terms of a license extension, the Company will relinquish 50 percent of the area for PPL 257 when, and if, the extension is approved by the PNG government. The area to be relinquished was determined by the Company after an extensive review of seismic and aero/gravity magnetic surveys done on the license. The Company expects that PPL 257 will be extended and that the previous drilling commitment will be added to future work commitments.

***PPL 258***

Originally granted on October 20, 2004, PPL 258 had an initial a six year term that was due to expire on October 19, 2010. Under the PNG Oil and Gas Act, the license is deemed to still be in effect while the Company awaits review of its extension request by the Minister. PPL 258 currently covers 2,227,500 gross acres, all onshore, in the North New Guinea Basin of PNG. PPL 258 is an anticipated oil play for the Company. The Company holds a 100 percent participating interest in PPL 258. There was a commitment to drill one exploration well by October 20, 2009 under the initial term of the license that was not met. However, the Company met the other commitments under the license including seismic acquisition. The Company estimates that the cost of drilling one exploration well is approximately US \$30,000,000.

On March 18, 2010, the Company submitted a request for a five year extension to the license upon its expiry in October 2010 which is subject to PNG government approval. In accordance with the terms of a license extension, the Company will relinquish 50 percent of the area for PPL 258 when, and if, the extension is approved by the PNG government. The area to be relinquished was determined by the Company after an extensive review of seismic and aero/gravity magnetic surveys done on the license. For PPL 258, there is a risk that the Petroleum Advisory Board may recommend against extension to the PNG government. In the event that PPL 258 is not extended, the Company would be advised and would be provided the opportunity to appeal such decision.

The PNG government retains the right to back-in for up to a 22.5 percent interest at cost which can be exercised at the time a development license is granted. The PNG government also has a two percent royalty over any oil or natural gas production that may occur with respect to the PNG Licenses.

Pursuant to the acquisition of the PNG Licenses, the Company granted the vendor the right to acquire a 10 percent interest in all, but not less than all, of the PNG Licenses, exercisable within 60 days from the date which the Company completes the drilling and testing of a third well on the PNG Licenses by paying to the Company 10 percent of all costs incurred in respect of the PNG Licenses up to that date and by agreeing to pay 10 percent of the ongoing costs with respect to the exploration and development of the PNG Licenses.

The Company has issued bank guarantees totaling approximately \$160,000 (100,000 Papua New Guinea dollars for each license) as security against the capital requirements associated with the PNG Licenses. If the Company does not fulfill its commitments under a PNG License and has not applied for and been granted an extension, it could potentially lose its guarantee and the applicable PNG License could be revoked by the PNG government.

As the Company does not currently generate sufficient cash flow from operating activities to fund its activities, it will need to raise equity financing and/or enter into joint venture or farm-out arrangements to finance its exploration commitments for the PNG Licenses. In March 2010, the Company closed a private placement for net proceeds of approximately \$22.3 million and in November 2010 the Company farmed-out a 50 percent interest in two graticular blocks within the PPL 259 license area surrounding the Ubuntu prospect. As part of the farm-out, the Company received US \$4,500,000 in addition to reducing its share of gross drilling costs for Ubuntu-1 from 90 percent to 40 percent. On December 17, 2010, the Company closed a short-form prospectus offering for gross proceeds of \$10,125,000 (net proceeds \$9.4 million) and issued 13,500,000 common shares at \$0.75 per common share. The Company is in on-going discussions with potential farm-out partners to meet the PPL 257 and 258 commitments.

#### **SELECTED ANNUAL INFORMATION**

The following is a summary of selected financial information for the Company for the periods indicated:

(\$000's except per share data)	Year ended December 31,	
	2010	2009
Revenue	57	21
Loss before discontinued operations	3,220	3,546
Net loss	3,220	3,546
Loss per share before discontinued operations	0.05	0.06
Total loss per share	0.05	0.06
Total assets	70,969	30,489

#### **RESULTS OF OPERATIONS**

The Company had net losses of \$3,220,146 and \$3,545,980 for the years ended December 31, 2010 and 2009, respectively.

Total expenses for the year ended December 31, 2010 were \$3,277,476 (2009 – \$3,567,101).

The Company's most significant expenses, excluding the foreign exchange gains, were as follows:

	Year ended December 31,	
	2010	2009
General and administrative	\$1,375,959	\$1,746,102
Stock-based compensation	954,936	614,844
Travel	435,028	417,581
Professional fees	329,459	145,513
Public company	193,932	63,275



**Eaglewood Energy Inc.**  
**Management Discussion and Analysis**  
Canadian Dollars unless otherwise stated

The following table provides a breakdown of the Company's general and administrative ("G&A") expenses by material component:

	Year ended December 31,	
	2010	2009
Salaries & wages	\$1,609,433	\$1,428,817
Office costs	345,658	214,850
Office rent	109,870	121,856
Other general and administrative	41,341	29,481
Overhead recoveries	(730,343)	(48,903)
	<b>1,375,959</b>	<b>1,746,102</b>

The G&A expenses for the year ended December 31, 2010 are \$370,000 lower than the previous year. In 2010, overhead recoveries increased by \$681,000 thereby reducing the total G&A costs in 2010. Overhead recoveries increased for two reasons. First, per the Joint Operating Agreement for PPL 259, Company recovers a percentage of the capital expenditures as compensation for the indirect services provided to the Joint Venture. For 2010, the indirect service recovery was \$297,000 (2009 - \$16,000). Second, as the Operator of the joint venture, the Company is eligible to recover its direct charges, such as the cost of its Australia and PNG offices. As the focus of the personnel in these offices was largely on PPL 259 in the fourth quarter of 2010, a larger portion of the costs were attributed to PPL 259, and therefore were partially recoverable from the joint venture partners. This accounted for recovery of \$433,000 in 2010, versus \$40,000 in 2009. In 2009, the direct charges were allocated equally among each license in PNG and only 10% of the costs allocated to PPL 259 were recoverable, versus 60% in the late 2010.

Salaries and wages increased \$180,000 over the previous year, partially attributable to the addition of a Senior Geologist (April) and a Controller (October) in 2010 and general salary increases.

Office costs increased \$131,000 over the previous year. In 2010, both the Australian and Canadian offices moved to new locations, resulting in an additional expenditures of \$30,000 incurred to set up the new offices. Due to increased activity in PNG, additional office supplies, computer/internet fees, etc. were incurred, resulting in an increase in expenditures of \$30,000 over the previous year. Telephone and communication is up \$66,000 over the previous year. With the drilling activity in PNG, more telephone charges have been incurred as more calls were made between Canada, Australia and PNG, and more roaming charges were incurred due to travel to the field. In addition, well control insurance of \$12,000 was incurred in 2010 (2009 – nil). Office rent decreased \$12,000 over the previous year, as an accrual for office rent was reversed, and the amount will be offset against funds owed to Eaglewood.

Stock based compensation increased \$340,092 in 2010 when compared to 2009. The increase is a result of the 575,000 options issued in April 2010 and the 1,090,000 options issued in November 2010. This increase in costs as a result of additional options, was offset by \$233,771 (2009 – nil) of stock based compensation that was capitalized.

Travel expenses increased slightly over the prior year. Travel to the technical office in Australia and site visits to Papua New Guinea are integral to the Company's operations.



Professional fees were \$184,000 higher than the fees incurred in 2009. The Company has incurred \$23,000 in fees related to the IFRS project management fees and approximately \$22,000 related to overseas tax filings. Legal fees increased by \$125,000, of which \$115,000 is related to matters on PPL 259 and the farm-out agreement.

Public company expenses increased by \$130,000 over the previous year. The majority of this increase was due to filing fees relating to the private placement special warrants offering and short form prospectus during the first quarter of 2010. Fees paid to Directors were also higher in 2010, as a new fee schedule was adopted.

#### **SELECTED QUARTERLY INFORMATION**

The following is a summary of selected financial information for the Company for the periods indicated:

(\$000's except per share data)	Dec 31 2010	Sep 30 2010	Jun 30 2010	Mar 31 2010	Dec 31 2009	Sep 30 2009	Jun 30 2009	Mar 31 2009
Revenue	18	17	16	6	2	-	5	14
Loss before discontinued operations	723	1,117	104	1,276	1,311	818	716	701
Net loss	723	1,117	104	1,276	1,311	818	716	701
Loss per share before discontinued operations	0.01	0.02	0.01	0.02	0.03	0.01	0.01	0.01
Total loss per share	0.01	0.02	0.01	0.02	0.03	0.01	0.01	0.01
Total assets	70,969	55,066	53,213	52,021	30,488	32,178	31,753	32,416

- The Company currently has no oil or gas production to offset its expenses. The Company's expenses are described more fully in RESULTS OF OPERATIONS.
- The Company's main assets are petroleum and natural gas properties and cash.
- The increase in assets for the quarter ended March 31, 2010 is mainly the result of the Company's private placement special warrants offering. The Company received net proceeds of \$22.3 million and issued 13,500,000 common shares.
- The increase in assets for the quarter ending December 31, 2010 is mainly the result of the Company's short-form prospectus offering and the Talisman farm-out. The Company received net proceeds of \$9.4 million and issued 13,500,000 common shares in the equity offering. The Company received approximately US\$4.5 million for engineering work and prior Ubuntu prospect expenditures (see 2010 SIGNIFICANT EVENTS).

#### **FINANCIAL CONDITION**

At December 31, 2010, the Company had total assets of \$70,969,342 compared to \$30,488,516 at December 31, 2009. During the year ended December 31, 2010 the Company received \$22.3

million from the issuance of warrants, \$9.4 million from the issuance of common shares and US\$4.5 million from the farm-out of the Ubuntu prospect of PPL 259 resulting in an increase in petroleum and natural gas properties and related assets.

The Company does not currently generate sufficient cash flow from its operating activities to fund its activities and has relied upon fees from farm-outs and the issuance of equity to provide additional funding. The Company's financial statements are presented 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 operations. The Company's ability to continue as a going concern is dependent upon its ability to raise equity financing and/or enter into joint venture or farm-out arrangements in the PNG Licenses within the next twelve months to meet its exploration commitments and working capital requirements. In March 2010, the Company closed a private placement special warrants offering for net proceeds of approximately \$22.3 million and in November 2010 the Company farmed-out a 50 percent interest in two graticular blocks within the PPL 259 license area surrounding the Ubuntu prospect. As part of the farm-out, the Company received US \$4,500,000 in addition to reducing its share of gross drilling costs for Ubuntu-1 from 90 percent to 40 percent. On December 17, 2010, the Company closed a short-form prospectus offering for net proceeds of \$9.4 million. Management believes there is the opportunity for the Company to enter into further farm-out or joint venture arrangements and/or raise further equity in 2010/2011 and therefore continue as a going concern. However, there are no assurances that the Company will be successful in achieving these objectives. If the Company is unable to raise equity financing and/or secure farm-out or joint venture partners, the Company may be unable to continue as a going concern. The Company's financial statements do not reflect the adjustments to the carrying values of assets and liabilities, including any impairment in its petroleum and natural gas properties, and the reported expenses and balance sheet classifications that would be necessary if the Company is unable to continue as a going concern, and such adjustments could be material.

## **LIQUIDITY**

At December 31, 2010, the Company had net working capital of \$15,542,991 compared to net working capital of \$13,593,265 at December 31, 2009.

- The total cash and cash equivalents and restricted cash is \$15,608,464 (2009 - \$13,622,795). Cash raised in 2010 from the issuance of common shares, net of commission and share issue costs were \$31,983,183. These funds were used in the addition of capital assets of \$27,818,710, and operating activities of \$2,214,748. The change in non-cash working capital added \$35,944 to cash and cash equivalents.
- The accounts receivable balance is \$10,137,259 (2009 - \$394,652). This is comprised of Joint Venture receivables of \$9,827,759 (2009 - \$370,243), GST receivables of \$291,733 (2009 - \$8,216), and various other receivables of \$17,767 (2009 - \$16,193). The increase to Joint Venture receivables and GST receivables is indicative of the increase in activities in the 4<sup>th</sup> quarter of 2010 related to the Ubuntu prospect, compared to the activity in 2009.
- Prepaid expenses of \$21,727 (2009 – nil) consists of refundable deposits for office space and supplies.
- The balance of accounts payable and accrued liabilities is \$10,224,459 (2009 - \$424,182). This balance includes payables outstanding to vendors for invoices not



payable until after year-end \$8,944,350 (2009 – \$403,333). \$556,607 (2009 – nil) is payable to the PPL 259 10% farmee as their share of the cash restricted as security for the letter of credit issued to the rig provider. The balance of the accounts payable and accrued liabilities of \$723,502 (2009 - \$20,849) is related to withholding tax payable, country taxes for expatriates working in PNG, payroll taxes and bonuses.

## **CAPITAL EXPENDITURES**

A summary of capital expenditures for the year is provided below.

PPL 259 – Ubuntu-1 exploration well, including mobilization	\$	16,044,737
PPL 260 – Korka-1 exploration well		6,647,204
PPL 259 - seismic program		4,904,826
PPL 260 – operator overhead		482,410
PPL 259 – Feed Study		131,400
Overhead		307,333
Other*		(985,772)
		27,532,138
Office furniture and equipment		286,572
<b>Total capital expenditures for the year ended December 31, 2010</b>		<b>27,818,710</b>

\*includes payment made by farmee for Sunk Costs (prior year costs) of USD\$1.5 million

## **2011 WORK PROGRAM AND OUTLOOK**

### *2011 Work Program*

The Company's 2011 work program is primarily based on meeting its PNG License commitments which includes gathering appraisal data on the Ubuntu Discovery in PPL 259. The Company has a second exploration well planned for PPL 259 for late 2011 or early 2012. However, as the Company does not currently have sufficient working capital available to meet its entire planned 2011 capital program, the Company is in discussions with industry partners to enter into further joint venture or farm-out arrangements in the PNG Licenses.

### *PPL 259 Work Program*

On September 21, 2010, the Minister for Petroleum and Energy granted the Company a variation to the original drilling commitment for PPL 259 from 2009 to 2010. Ubuntu-1 was expected to spud in August 2010 but due to delays in mobilization of the drilling rig caused by weather, barge scheduling and helicopter operations, the actual spud date was December 12, 2010.

Ubuntu-1 was suspended on February 17, 2011 as a gas and gas condensate discovery. The Company is currently undertaking studies on the discovery with a view to recommending an appraisal Work Program & Budget to the PNG Department of Petroleum and Energy. The Company holds a 40 percent participating interest in Ubuntu-1. The rig is expected to be fully demobilized from the Ubuntu wellsite by mid-April 2011.

The second planned exploration well in PPL 259, Herea-1, has been postponed, pending a reserves revision following the discovery of significantly thicker than anticipated net pay on



Stanley-2, an appraisal well drilled in the adjacent PRL-4 license. The Company is currently seeking additional farm-out or joint venture partners to reduce its net interest and share of costs for Herea-1. Assuming a successful farm-in of the prospect, the Operator plans to acquire prospect infill seismic in Q3 2011 and begin pad construction in Q4 2011.

The Company acquired additional seismic in PPL 259 during January and February of 2011, at an estimated gross cost of US \$3,500,000 (net cost to the Company approximately US \$3,150,000). Processing and interpretation of the new seismic data, along with reprocessing of 570 line km of vintage seismic was completed in March 2011. The Company has completed a front end engineering ("FEED") study for the rapid commercialization of PPL 259 via condensate stripping followed by a small scale liquefied natural gas project, and is awaiting a final report. The estimated gross cost of the FEED study is expected to be approximately US \$4,500,000.

#### *PPL 257 and 258*

For PPL 257 and 258, the Company has applied to the PNG government for a five-year extension to each of the licenses. Both licenses were due to expire in October 2010, however, they both remain valid while the extension requests await review by the Minister (SEE DESCRIPTION OF PNG LICENSES AND COMMITMENTS). The Company continues to discuss farm-out/joint venture arrangements with partners for these licenses. Offers are being reviewed and a work program will be agreed with the successful farminee for an equity position.

#### *PPL 260*

During the second quarter of 2010, the first exploration well, Korka-1, was drilled in PPL 260. Unfortunately, the well did not encounter hydrocarbons and was plugged and abandoned. The gross cost of drilling Korka-1 was approximately US \$57,000,000 (net cost to the Company approximately US \$6,600,000). The current 6 year term of the license was due to expire in March 2011. In December 2010, the operator, Oil Search (PNG) Ltd., submitted an application for a 5 year extension which requires relinquishment of 50% of the graticular blocks within the license. The license remains valid while the extension request awaits review by the Minister (SEE DESCRIPTION OF PNG LICENSES AND COMMITMENTS). The most prospective part of the license will be retained and a work program submitted. The program for years 1 and 2 comprise surface geological studies to high grade the most prospective areas. This work will be completed in 2011 and 2012 and Eaglewood's share of costs will not exceed US\$ 300,000.

As a result of the nature of the petroleum and natural gas exploration, development and exploitation industry, budgets are regularly reviewed with respect to both the success of expenditures and other opportunities that become available. Accordingly, while it is currently intended by management of the Company that the general expenditures set out in the work program above will be made by the Company, actual expenditures may in fact differ from these plans, amounts and allocations.

Additionally, completion of activities are subject to potential barriers such as, but not limited to, lack of capital, lack of available equipment and poor weather which may impact the time of completions. Additional risk factors are disclosed in the Company's Annual Information Form dated April 13, 2011 which is available on SEDAR at [www.sedar.com](http://www.sedar.com).

#### **OUTSTANDING SHARE DATA**

As at April 13, 2011, the Company had 87,148,942 common shares outstanding and 5,846,000 stock options outstanding under its stock option plan. The Company also had 7,800,000 performance warrants outstanding.

#### **OFF BALANCE SHEET ARRANGEMENTS**

The Company has no off-balance sheet arrangements.

#### **RELATED PARTY TRANSACTIONS**

For the year ended December 31, 2010, the Company paid \$221,776 (2009 - \$70,795) for legal services to a firm of which an officer of the Company is a partner.

For the year ended December 31, 2010, the Company paid \$12,000 (2009 - \$12,000) in management fees to a company controlled by a director. These fees were paid for administrative services which were provided by the director.

#### **FINANCIAL INSTRUMENTS AND OTHER INSTRUMENTS**

The Company's financial instruments consist of cash and cash equivalents, restricted cash, accounts receivable and accounts payable and accrued liabilities. Unless otherwise noted, it is management's opinion that the Company is not exposed to significant interest, currency or credit risks arising from these financial instruments. The fair values of these financial instruments approximate their carrying values, unless otherwise noted.

#### **INTERNATIONAL FINANCIAL REPORTING STANDARDS**

On January 1, 2011 International Financial Reporting Standards ("IFRS") will become generally accepted accounting principles in Canada. The adoption date of January 1, 2011 will require the restatement, for comparative purposes, of amounts reported by Eaglewood for the year ended December 31, 2010, including the opening balance sheet as at January 1, 2010.

The IFRS conversion project is being led by internal staff, assisted by an external advisor. The Company's auditors have been, and will continue to be, involved throughout the process to ensure the Company's policies are in accordance with these new standards.

The Company has developed a project plan for the transition to IFRS which includes the following three phases:

- *Diagnostic phase* which includes the identification of significant differences between IFRS and Canadian GAAP at a high level as relevant to the Company;
- *Detailed assessment and design phase* which includes: the identification, evaluation and selection of accounting policies necessary for the Company to transition to IFRS; the assessment of IFRS 1, *First-Time Adoption of IFRS*, elections; the identification of any



business impacts resulting from the identified accounting differences; and training analysis and information systems analysis.

- *Implementation phase* which includes implementing all of the required changes necessary for IFRS compliance.

As of December 31, 2010, Eaglewood has substantially completed its IFRS conversion project. Eaglewood has analyzed accounting policy alternatives and completed the majority of its IFRS accounting policies. The Company has completed its January 1, 2010 opening balance sheet and the quarterly comparative IFRS financial information. The Company's external auditors have reviewed the IFRS accounting policies and are finalizing audit procedures on the IFRS opening balance sheet. Eaglewood will continue to update its IFRS conversion project to reflect new and amended accounting standards issued by the International Accounting Standards Board ("IASB").

In July 2009, the IASB issued amendments to IFRS-1, *First-Time Adoption of International Financial Reporting Standards* ("IFRS 1"). IFRS 1 provides entities adopting IFRS for the first time with a number of optional exemptions and mandatory exceptions in certain areas to the general requirement for full retrospective application of IFRS. Eaglewood has elected to use the following exemptions:

- *Property, Plant and Equipment ("PP&E")* – IFRS 1 provides the option to value PP&E assets in the Exploration and Evaluation ("E&E") phase at their deemed cost, defined as the carrying amount assigned to these assets under Canadian GAAP at the date of transition, January 1, 2010. The exemption is permissible for entities such as Eaglewood who currently follow the full cost accounting guideline under Canadian GAAP.
- *Share Based Payments* – IFRS 1 allows Eaglewood an exemption on IFRS 2 – *Share Based Payments*, to equity instruments which vested before the Company's transition date to IFRS.

The transition from Canadian GAAP to IFRS is significant and may materially affect Eaglewood's reported financial position and results of operations but Eaglewood expects the transition will not have a major impact on the Company's operations, strategic decisions or cash flow. At this time, Eaglewood has identified key differences that will impact the financial statements as follows:

- *Re-classification of E&E expenditures from PP&E* – Upon transition to IFRS, Eaglewood will re-classify all its E&E assets that are currently included in the PP&E balance on the consolidated balance sheet. This will consist of the book value of its exploration properties. E&E assets will not be depleted and must initially be assessed for impairment at the transition date and subsequently when indicators suggest the possibility of impairment. Eaglewood has currently determined approximately \$18.7 million of PP&E will be classified as E&E in the opening balance sheet prepared under IFRS as January 1, 2010 and that there is no transitional impairment of the E&E assets.
- *Share-based payments* – The Company has determined the major difference from current Canadian GAAP that would impact the Company is estimating forfeiture rates in advance as opposed to recognizing the impact when the forfeiture occurs. Eaglewood does not anticipate the difference to be significant.
- *Functional currency* – The Company has determined that under IFRS, its functional currency will become US dollars. The reporting currency of the Company will continue to



be Canadian dollars. The impact of translating the financial statements from the US dollar functional currency to the Canadian dollar presentation currency will be captured in the cumulative translation account within shareholders' equity. The most significant impact of the change in functional currency is for the foreign currency exchange gains/losses previously reported in the income statement. Under IFRS, the income statement foreign exchange gain/loss will represent the foreign exchange gains/losses arising from transactions denominated in currencies other than US dollars.

In addition to the accounting policy differences, the Company's transition to IFRS will impact the internal controls over financial reporting, the disclosure controls and procedures and information technology ("IT") systems as follows:

- *Internal controls over financial reporting*— Based on the Company's accounting policies under IFRS Eaglewood has assessed whether additional controls or changes in procedures are required. Eaglewood does not consider these changes to be significant.
- *Disclosure controls and procedures*— Throughout the transition process, Eaglewood will be assessing stakeholder's information requirements and will ensure that adequate and timely information is provided while ensuring the Company maintains its due process regarding information that is disclosed.
- *IT Systems*— Eaglewood has assessed the readiness of its accounting software and continues to assess other system requirements that may be needed in order to perform ongoing calculations and analysis under IFRS. These changes are not considered to be significant.

Even though Eaglewood has made many preliminary decisions based on information known to date, the assessments of differences between IFRS and Canadian GAAP have not yet been finalized or approved by Eaglewood's Board of Directors. The Company continues to monitor developments and caution that certain items may change based on new facts and circumstances.

#### **ADDITIONAL DISCLOSURE FOR VENTURE ISSUERS WITHOUT SIGNIFICANT REVENUE**

The Company is a venture issuer that has not had significant revenue from operations in either of its last two financial years. In accordance with National Instrument 51-102, additional disclosure on material costs is presented below.

	Year ended December 31,	
	2010	2009
General and administrative:		
Salaries & wages	\$1,609,433	\$1,428,817
Office costs	345,658	214,850
Office rent	109,870	121,856
Other general and administrative	41,341	29,481
Overhead recoveries	(730,343)	(48,903)
Total general and administrative	1,375,959	\$1,746,102
Capitalized exploration and development costs	27,532,138	\$4,574,062



**Eaglewood Energy Inc.**  
**Consolidated Financial Statements**  
**For the year ended December 31, 2010**

April 14, 2011

**Independent Auditor's Report**

**To the Shareholders of Eaglewood Energy Inc.**

We have audited the accompanying consolidated financial statements of Eaglewood Energy Inc., which comprise the consolidated balance sheets as at December 31, 2010 and 2009 and the consolidated statements of net loss, comprehensive loss and deficit and cash flows for the years then ended, and the related notes including a summary of significant accounting policies.

**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.

**Auditor's responsibility**

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

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

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

**Opinion**

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





**Emphasis of matter**

Without qualifying our opinion, we draw attention to note 1 in the consolidated financial statements which describes matters and conditions that indicate the existence of a material uncertainty that may cast significant doubt about the corporation's ability to continue as a going concern.

*Pricewaterhouse Coopers LLP*

**Chartered Accountants**

Calgary, Alberta  
Canada

**Eaglewood Energy Inc.**  
**Consolidated Balance Sheets**  
Canadian Dollars

	December 31, 2010	December 31, 2009
<b>ASSETS</b>		
<b>Current Assets</b>		
Cash and cash equivalents	\$ 12,858,739	\$ 13,622,795
Restricted cash (note 3)	2,749,725	-
Accounts receivable	10,137,259	394,652
Prepaid expenses and refundable deposits	21,727	-
	<b>25,767,450</b>	<b>14,017,447</b>
Petroleum and natural gas properties (note 4 and 5)	45,201,892	16,471,069
	<b>\$ 70,969,342</b>	<b>\$ 30,488,516</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Current Liabilities</b>		
Accounts payable and accrued liabilities	\$ 10,224,459	\$ 424,182
	<b>10,224,459</b>	<b>424,182</b>
Asset retirement obligation (note 6)	728,805	-
	<b>10,953,264</b>	<b>424,182</b>
<b>Shareholders' Equity</b>		
Share Capital (note 7)	73,411,547	41,289,488
Contributed Surplus (note 7)	3,390,026	2,340,195
Deficit	(16,785,495)	(13,565,349)
	<b>60,016,078</b>	<b>30,064,334</b>
	<b>\$ 70,969,342</b>	<b>\$ 30,488,516</b>

Contingencies and commitments (note 13)

Approved by the Board of Directors

Ray Antony, Director and Chairman

  
Mark Sarssam, Director

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



**Eaglewood Energy Inc.**  
**Consolidated Statements of Net Loss, Comprehensive Loss and Deficit**  
Canadian Dollars

	December 31, 2010	December 31, 2009
<b>Revenue</b>		
Interest Income	\$ 57,330	\$ 21,211
<b>Expenses</b>		
General and administrative	1,375,959	1,746,102
Stock based compensation	954,936	614,844
Travel	435,028	417,581
Professional fees	329,459	145,513
Public company	193,932	63,275
Consulting	69,267	14,268
Depreciation	50,462	18,279
Bank charges and interest	43,417	11,384
Management fees	12,000	12,000
Other	381	3,912
Foreign exchange loss(gain)	(187,365)	519,943
	<b>3,277,476</b>	<b>3,567,101</b>
<b>Net loss and comprehensive loss for the year</b>	<b>(3,220,146)</b>	<b>(3,545,890)</b>
<b>Deficit, beginning of year</b>	<b>(13,565,349)</b>	<b>(10,019,459)</b>
<b>Deficit, end of year</b>	<b>\$ (16,785,495)</b>	<b>\$ (13,565,349)</b>
<b>Net loss per common share – basic and diluted</b>	<b>\$ (0.05)</b>	<b>\$ (0.06)</b>
<b>Weighted average common shares – basic and diluted</b>	<b>70,099,254</b>	<b>57,863,983</b>

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

**Eaglewood Energy Inc.**  
**Consolidated Statements of Cash Flow**  
Canadian Dollars

	December 31, 2010	December 31, 2009
<b>Cash flows related to the following activities:</b>		
<b>Operating activities</b>		
Net loss	\$ (3,220,146)	\$ (3,545,890)
Items not involving cash:		
Stock based compensation	954,936	614,844
Depreciation	50,462	18,279
	(2,214,748)	(2,912,767)
Changes in non-cash working capital (note 11)	(50,834)	3,740
	(2,265,582)	(2,909,027)
<b>Investing activities</b>		
Additions to petroleum and natural gas properties	(27,818,710)	(4,587,237)
Issuance of letter of credit	(5,659,018)	-
Release of letter of credit	2,909,293	-
Proceeds from farm-outs	-	18,161,316
Changes in non-cash working capital (note 11)	(15,846)	(114,242)
	(30,584,281)	13,459,837
<b>Financing activities</b>		
Issue of common shares (net of commissions)	32,345,900	290,000
Share issue costs	(362,717)	-
Changes in non-cash working capital (note 11)	102,624	-
	32,085,807	290,000
<b>Net increase (decrease) in cash</b>	<b>(764,056)</b>	<b>10,840,810</b>
<b>Cash and cash equivalents, beginning or year</b>	<b>13,622,795</b>	<b>2,781,985</b>
<b>Cash and cash equivalents, end of year</b>	<b>\$ 12,858,739</b>	<b>\$ 13,622,795</b>
Cash and cash equivalents composed of:		
Cash in banks	\$ 12,858,739	\$ 13,622,795
Term deposits	-	-
	\$ 12,858,739	\$ 13,622,795
<b>Supplementary information:</b>		
Interest received	\$ 57,330	\$ 21,211
Interest paid	\$ -	\$ -
Taxes paid	\$ -	\$ -

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



**1. Nature of Operations and Going Concern**

Eaglewood Energy Inc. (collectively with its subsidiary, the “Company” or “Eaglewood”) is a development stage enterprise whose primary activity is exploration of its Papua New Guinea (“PNG”) licenses. The Company has commenced exploration drilling activities but does not have any production revenue.

The Company’s consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (“Canadian GAAP”) 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 operations. The Company has not generated any petroleum revenue to date and for the year ended December 31, 2010, the Company reported a net loss of approximately \$3.2 million. At December 31, 2010, the Company had an accumulated deficit of approximately \$16.8 million and net working capital of approximately \$15.5 million. In addition to its ongoing working capital requirements, the Company has financial commitments related to its PNG licenses as described in note 13(c). These circumstances raise significant doubt as to the ability of the Company to continue as a going concern.

The Company’s ability to continue as a going concern is dependent upon its ability to raise equity financing and/or enter into joint venture or farm-out arrangements in the next twelve months. On March 24, 2010, Eaglewood closed a private placement special warrants offering for gross proceeds of \$23,625,000. The Company received net proceeds of approximately \$22.3 million and issued 13,500,000 special warrants at a price of \$1.75 per special warrant. On April 12, 2010, the special warrants were deemed exercised and the Company issued 13,500,000 common shares and the special warrants were cancelled. On November 11, 2010, Eaglewood announced it had entered into a farm-out agreement whereby the farmee would earn a 50 percent participating interest in the Ubuntu prospect located within two graticular blocks in license PPL 259 (representing approximately 3 percent of the license and approximately 6 percent of the license after relinquishment (see note 13)) in exchange for paying Eaglewood US \$4,500,000, comprised of the farmee’s acquisition of engineering work to date on river transport and liquids handling designs and previous expenditures on the Ubuntu prospect. In addition, the farmee will pay 50 percent of the drilling and its other participating interest costs relating to Ubuntu-1. On December 17, 2010, the Company closed a short-form prospectus offering for gross proceeds of \$10,125,000 (net proceeds \$9.4 million) and issued 13,500,000 common shares at \$0.75 per common share. Management believes there is the opportunity for the Company to raise additional equity and/or enter into further farm-out or joint venture arrangements in 2011 and therefore continue as a going concern. However, there are no assurances that the Company will be successful in achieving these objectives. These financial statements do not reflect the adjustments to the carrying values of assets and liabilities, including any impairment in the petroleum and natural gas properties, and the reported expenses and balance sheet classifications that would be necessary if the Company is unable to continue as a going concern, and such adjustments could be material.

**2. Significant Accounting Policies**

The consolidated financial statements have been prepared by management in accordance with Canadian GAAP. The preparation of consolidated financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the amounts recorded in

the consolidated financial statements and accompanying notes. Actual results could differ from those estimates. The consolidated financial statements have, in management's opinion, been properly prepared using careful judgment with reasonable limits of materiality and with the framework of the significant accounting policies summarized below.

**(a) Consolidation**

The consolidated financial statements include the accounts of the Company and its subsidiary. All significant inter-company accounts and transactions have been eliminated.

**(b) Cash and cash equivalents**

Cash and cash equivalents include cash in bank accounts and short-term deposits that are redeemable at any time without penalty. Cash and cash equivalents are designated as held-for-trading and are carried at fair value. Fair value was determined using Level 1 as described in note 8.

**(c) Petroleum and natural gas properties**

The Company has adopted the Canadian Accounting Standard for Enterprises in the Development Stage. All direct costs relating to the exploration and development of the PNG petroleum prospecting licenses to date, including capital expenditures and pre-operating costs, are capitalized including the cost of the acquisition of the licenses, exploration and development, annual license fees and administrative costs that are directly related to exploration activities. When production begins, these capitalized costs will be amortized following the unit-of-production method based on proved reserves.

The carrying values of petroleum and natural gas properties are not intended to reflect their future value. In particular, the future value of the petroleum and natural gas properties depends on the ability of the Company to obtain financing, the start-up of commercial production and the future profitability of the properties. Accordingly, the petroleum and natural gas properties are assessed in each reporting period to determine if there are events or circumstances that would indicate it is unlikely such costs will be recovered in the future. If there are costs that are considered unlikely to be recovered, they are charged to earnings.

Amortization of petroleum and natural gas properties will follow the unit-of-production method based on proved reserves when production begins. Office equipment and furniture are depreciated at declining balance rates of 20 to 30 percent.

**(d) Asset retirement obligations**

The Company recognizes the estimated fair value of future retirement obligations associated with capital assets as a liability in the period in which they are incurred, normally when the asset is purchased or developed. The fair value of future retirement obligations is capitalized and amortized over the same period as the underlying asset. The Company estimates the liability based on the estimated costs to abandon and reclaim the wells and well sites under the terms of the exploration licenses. Actual retirement obligations settled during the period reduce the asset retirement liability.



**(e) Financial Instruments**

All financial instruments are initially recognized at fair value on the balance sheet. The Company has classified each financial instrument into one of the following categories: held-for-trading, available-for-sale, held-to-maturity, loans and receivables and other financial liabilities. Subsequent measurement of financial instruments is based on their classification.

Cash equivalents are designated as “held-for-trading” and are measured at fair value. Accounts receivable are designated as “loans and receivables” and are carried at cost. Accounts payable are designated as “other financial liabilities” and are carried at cost.

**(f) Stock-based Compensation**

The Company uses the fair value method for valuing stock option grants using the Black-Scholes option pricing model. The estimated fair value is expensed over the vesting period with a corresponding increase to contributed surplus. Upon exercise of the stock options, consideration paid by the option holder together with the amount previously recognized in contributed surplus is recorded as an increase to share capital.

**(g) Foreign Currency Translation**

The Company’s reporting currency is Canadian dollars.

Business conducted in PNG is considered to be an “integrated foreign operation” for accounting purposes and therefore its financial statements are translated into Canadian dollars using the temporal method. Under the temporal method, foreign denominated monetary assets and liabilities are translated at the exchange rates in effect at the balance sheet date. Foreign denominated non-monetary assets and liabilities are translated at historical exchange rates.

Foreign denominated revenues and expenses are translated at the average exchange rate for the period, except for charges related to non-monetary assets which are translated at the historical exchange rate for the assets to which the charge relates, and material items where a specific date can be identified for the transaction which is translated at the exchange rate on that specific date. Any resulting foreign exchange gains or losses are included in the determination of net income.

**(h) Joint ventures**

Some of the Company’s exploration and development activities are conducted jointly with others. The consolidated financial statements reflect only the Company’s proportionate interest in such activities.

**(i) Basic and diluted loss per share**

Basic loss per share is calculated using the weighted average number of common shares outstanding for the period. The Company follows the treasury stock method to calculate diluted per share amounts. The treasury stock method assumes that any proceeds from the exercise of in-the-money stock options or other dilutive instruments, in addition to stock-based compensation not yet recognized, would be used to purchase common shares at the average market price during the period. Diluted earnings per share do not include any anti-dilutive conversions.

**(j) Income taxes**

The Company follows the liability method of accounting for income taxes. Under this method, income tax liabilities and assets are recognized for the estimated tax consequences attributed to differences between the amounts reported in the financial statements and their respective tax bases, using substantively enacted income tax rates. The effect of a change in income tax rates on future income tax assets is recognized in income in the period that the change occurs.

**(k) Measurement uncertainty**

The timely preparation of the consolidated financial statements in conformity with Canadian GAAP requires that management make estimates and assumptions and use judgment regarding the reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the period. These estimates are subject to measurement uncertainty. Accordingly, actual results may differ from estimated amounts and affect the results reported in these consolidated financial statements.

Significant estimates used in the preparation of the consolidated financial statements include future income taxes, stock-based compensation and asset impairment.

**3. Restricted cash**

In conjunction with the rig assignment agreement for the drilling rig to be used within PPL 259, the Company was required to provide Letters of Credit ("LOCs") in the amount of US \$5,500,000. The LOCs were provided by a major Canadian bank in the form of a hold on the Company's funds. In November 2010, when the Company entered into a 50% farm-out agreement on this property, the farmee provided security for 50% of the LOC. As a result, the hold on the Company's funds was reduced by US \$2,750,000. In February 2011, the Company transferred its rig assignment to another party. The terms of the transaction are such, that at the end of the mobilization of the rig, the assignee will provide an LOC to the rig provider, thereby releasing Eaglewood's outstanding LOC. On April 12, 2011, US \$1,250,000 of the LOC was released. The balance is expected to be released in May 2011.

**4. Petroleum and natural gas properties**

December 31, 2010:	Accumulated depletion and depreciation		
	Cost	depreciation	Net book value
Petroleum and natural gas properties	\$44,897,595	\$ -	\$44,897,595
Office furniture and equipment	396,569	92,272	304,297
	<b>\$45,294,164</b>	<b>\$92,272</b>	<b>\$45,201,892</b>



**Eaglewood Energy Inc.****Notes to the Consolidated Financial Statements**

Year ended December 31, 2010 and 2009, Canadian dollars unless otherwise stated

December 31, 2009:	Accumulated depletion and depreciation		Net book value
	Cost		
Petroleum and natural gas properties	\$16,402,882	\$ -	\$16,402,882
Office furniture and equipment	109,997	41,810	68,187
	<b>\$16,512,879</b>	<b>\$41,810</b>	<b>\$16,471,069</b>

The petroleum and natural gas properties were reduced for the amount of cash received from the farm-outs of PPL 259 (see note 5).

As at December 31, 2010, the cost of the petroleum and natural gas properties includes \$44,897,595 (as at December 31, 2009 - \$16,402,882) relating to unproved properties which have been excluded from costs subject to depletion and depreciation.

Included in petroleum and natural gas properties is \$996,311 (as at December 31, 2009 -\$464,291) of capitalized general and administrative expenses related to exploration activities.

**5. Farm-outs**

In November 2010, the Company completed a Farm-out Agreement ("FOA") in relation to the Ubuntu Prospect of PPL 259. The Ubuntu Prospect is the graticular blocks 1847 and 1848 ("Contract Area") of PPL 259 (representing approximately 3 percent of the license and approximately 6 percent of the license after relinquishment (see note 13)). The terms of the transaction were: the Company transferred an undivided 50% interest of the rights and obligations derived from the Contract Area, and an undivided 50% interest in all equipment, inventories, supplies, accounts receivable and other assets forming part of the joint account under the Original JOA pertaining to the Contract Area; the farmee paid US\$3M for the technical, engineering, and river navigation work completed by Eaglewood; \$1.5M for Sunk costs and 50% of the Dry Hole Costs incurred prior to the Effective Date (November 25, 2010); 50% of the Rig Costs incurred after the Effective Date; and arranged a release of 50% of the Letter of Credit ("LOC") which was issued by the Company under the Rig Assignment Agreement as their share of the LOC.

In June 2009, Eaglewood entered into a farm-out agreement relating to PPL 259 with a farmee. Under the terms of the farm-out agreement, the farmee paid Eaglewood US \$15,000,000 to earn a 10 percent participating interest in PPL 259. The farmee had the opportunity to earn an additional 50 percent participating interest in PPL 259 by paying Eaglewood US \$20,000,000 by December 15, 2009 to fund the cost of drilling the first exploration well, Ubuntu-1. However, the farmee was unable to complete the funding within the required time period and as a result continues to hold a 10 percent participating interest in PPL 259.

In April 2009, Eaglewood entered into a farm-out agreement relating to PPL 260. Under the terms of the farm-out agreement, the farmee paid Eaglewood US \$1,500,000 and conducted a seismic program at its sole cost to earn a 10 percent participating interest in PPL 260 and the right to elect to earn an additional 60 percent participating interest in PPL 260 in exchange for agreeing to pay 90 percent of the cost of drilling one exploration well up to a maximum gross cost of US \$50,000,000. In August 2009, the

farmee elected to drill a well to earn the additional interest. Upon completion of the well, Eaglewood's participating interest in PPL 260 became 30 percent. The farmee has assumed operatorship.

The petroleum and natural gas properties were reduced for the amount of cash received from the farm-outs of PPL 259 and 260.

## 6. Asset Retirement Obligation

The Company has recognized an asset retirement obligation in relation to the Ubuntu-1 well.

The total undiscounted amount of the estimated cash flows required to settle the obligations is US \$2,696,865 (2009 – \$nil) with an annual inflation rate of 2%, which has been discounted using a credit-adjusted rate of 8.0 per cent. The settlement of the obligation is expected to occur in 17 years.

## 7. Share capital

### (a) Authorized

The Company is authorized to issue an unlimited number of common shares and preferred shares.

### (b) Common shares issued

	Number of shares	Amount
<b>Balance, December 31, 2008</b>	<b>57,744,942</b>	<b>\$ 40,771,686</b>
Issued on exercise of options	800,000	517,802
<b>Balance, December 31, 2009</b>	<b>58,544,942</b>	<b>\$41,289,488</b>
Special warrant private placement (i)	13,500,000	22,443,750
Share issue costs (i)	-	(175,738)
Bought deal equity offering (ii)	13,500,000	9,618,750
Share issue costs (ii)	-	(186,979)
Issued on exercise of options	644,000	382,973
Issued on exercise of warrants	50,000	39,303
<b>Balance, December 31, 2010</b>	<b>86,238,942</b>	<b>\$73,411,547</b>

- (i) On March 24, 2010, the Company closed a special warrant private placement offering for gross proceeds of \$23,625,000 (net proceeds of \$22,443,750 after sales commission but before other issue costs). A total of 13,500,000 special warrants were issued at a price of \$1.75 per special warrant. Each special warrant entitled the holder to receive, without the payment of any additional consideration, one common share of the Company on the exercise or deemed exercise of the special warrants. On April 12, 2010 the special warrants were deemed exercised and the Company issued 13,500,000 common shares to the holders of the special warrants.
- (ii) On December 17, 2010, the Company closed a bought deal equity offering for gross proceeds of \$10,125,000 (net proceeds of \$9,618,750 after sales commission but before other issue costs). A total of 13,500,000 shares were issued at a price of \$0.75 per share.



**(c) Stock options**

The Company has a stock option plan for directors, officers, employees and consultants. Under the Company's stock option plan, the Company may grant options of up to 10 percent of the issued and outstanding common shares. The plan is administered by the Board of Directors. In accordance with the policies of the TSX Venture Exchange, the option exercise price, when granted, is based on the closing price of the Company's shares on the TSX-V on the last trading day prior to the grant, subject to a permitted discount. Options granted under the plan have an exercise period not exceeding five years. The vesting period is determined at the time of grant at the discretion of the Board of Directors.

The Company had stock options outstanding to acquire common shares as follows:

	Weighted Average Remaining Life (Years)	Number of options	Weighted Average Exercise Price
<b>Balance, December 31, 2008</b>	<b>3.59</b>	<b>5,775,000</b>	<b>\$ 0.53</b>
Granted		1,000,000	1.25
Exercised		(800,000)	0.36
Forfeited		(400,000)	0.96
<b>Balance, December 31, 2009</b>	<b>3.64</b>	<b>5,575,000</b>	<b>\$ 0.65</b>
Granted		1,665,000	1.09
Exercised		(644,000)	0.38
Forfeited		(650,000)	0.94
<b>Balance, December 31, 2010</b>	<b>3.26</b>	<b>5,946,000</b>	<b>\$ 0.77</b>

The number of options exercisable at December 31, 2010 is 3,856,000 at prices ranging from \$0.10 to \$1.35 per share (2009 – 3,141,666 at exercise prices ranging from \$0.10 to \$1.35 per share), as follows:

Range of exercise price	Options Outstanding	Weighted Average Exercise Price	Options Exercisable	Weighted Average Remaining Life (Years)
\$0.10 - \$0.50	1,806,000	\$ 0.10	1,806,000	2.89
\$0.51 - \$1.00	2,065,000	\$ 0.79	925,000	3.60
\$1.01 - \$1.50	1,500,000	\$ 1.24	1,125,000	2.83
\$1.51 - \$1.64	575,000	\$1.64	-	4.33
	5,946,000	\$0.77	3,856,000	3.26

The fair value of the stock options granted during the year ended December 31, 2010 for which the exercise price was equal to the share's market price was estimated at \$1,563,303 (2009 - \$1,124,822). These amounts will be recognized as stock based compensation expense over the vesting period of the options. The stock based compensation expense related to the stock options for the year ended December 31, 2010 was \$1,188,707 (2009 - \$614,844), of which \$233,771 (2009 – nil) has been capitalized.

The fair value of the stock options granted was determined at the dates of granting the options using the Black-Scholes option pricing model based on the following assumptions: a risk free rate of between

**Eaglewood Energy Inc.****Notes to the Consolidated Financial Statements**

Year ended December 31, 2010 and 2009, Canadian dollars unless otherwise stated

2.14% and 2.79%, an expected term of 4 years, a volatility of between 145% and 146% and a future dividend yield of nil.

**(d) Warrants**

In 2008, the Company granted performance warrants to certain employees. The performance warrants entitle the employees to purchase an equivalent number of common shares of the Company if the common shares close at or above pre-determined prices for specified periods of time. The performance warrants vest in four equal tranches over a two year period and expire three years from the date of grant. The exercise price of the performance warrants escalates with each tranche and ranges from \$0.75 to \$1.75.

	<b>Number of warrants</b>	<b>Weighted Average Exercise Price</b>
<b>Balance, December 31, 2008 and December 2009</b>	<b>8,000,000</b>	<b>\$ 1.19</b>
Exercised	(50,000)	0.75
Forfeited	(150,000)	1.33
<b>Balance, December 31, 2010</b>	<b>7,800,000</b>	<b>\$1.19</b>

The number of warrants exercisable at December 31, 2010 is 5,850,000 at prices ranging from \$0.75 to \$1.25 per share (2009 – 4,000,000 at exercise prices ranging from \$0.75 to \$1.00 per share), as follows:

	<b>Warrants</b>	
<b>Exercise price</b>	<b>Outstanding</b>	<b>Warrants Exercisable</b>
\$ 0.75	1,950,000	1,950,000
\$1.00	1,950,000	1,950,000
\$1.25	1,950,000	1,950,000
\$1.75	1,950,000	-
	<b>7,800,000</b>	<b>5,850,000</b>

**(e) Contributed surplus**

<b>Balance, December 31, 2008</b>	<b>\$1,953,154</b>
Stock based compensation	614,844
Less: Stock compensation expense of options exercised	(227,803)
<b>Balance, December 31, 2009</b>	<b>2,340,195</b>
Stock based compensation	1,188,707
Less: Stock compensation expense of options exercised	(137,073)
Less: Stock compensation expense of warrants exercised	(1,803)
<b>Balance, December 31, 2010</b>	<b>3,390,026</b>

**8. Financial instruments**

The carrying amounts of financial instruments comprising cash and cash equivalents, restricted cash, accounts receivable and accounts payable and accrued liabilities approximate their fair values due to the immediate or short term nature of these financial instruments.

In accordance with adopted amendments to CICA 3862, *Financial Instruments – Disclosures*, the Company's assets and liabilities recorded at fair value have been categorized based upon the following fair value hierarchy:

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

The level in the fair value hierarchy within which the fair value measurement is categorized in its entirety is determined on the basis of the lowest level input that is significant to the fair value measurement in its entirety. The fair value of the financial instruments classified as held for trading (cash and cash equivalents and restricted cash) corresponds to a Level 1 classification.

The carrying value and fair value of financial assets and liabilities as at December 31, 2010 are summarized below:

<b>Classification</b>	<b>Carrying Value</b>	<b>Fair Value</b>
Held-for-trading (Cash and cash equivalents and Restricted cash)	\$ 15,608,464	\$ 15,608,464
Loans and receivables (Accounts receivable)	\$ 10,137,259	\$ 10,137,259
Held-to-maturity	-	-
Available-for-sale	-	-
Other liabilities (Accounts payable and accrued liabilities)	\$ 10,224,459	\$ 10,224,459

Eaglewood is exposed to normal financial risks inherent within the oil and gas industry, including foreign currency exchange risk, credit risk and liquidity risk. The nature of the financial risks and the Company's strategy for managing these risks has not changed significantly from the prior year. The Company does not utilize derivative instruments to manage risks.

*(a) Foreign currency exchange risk*

The Company is exposed to risk arising from fluctuations in foreign currency exchange rates and the volatility of those rates. This exposure primarily relates to: (i) certain expenditure commitments, deposits and accounts payable which are denominated in foreign currencies including US dollars, Australian dollars and Papua New Guinea kina; and (ii) its operations in Papua New Guinea.

The Company's foreign currency exchange risk arises from cash and cash equivalents and current liabilities. With a 10% strengthening or weakening of the Canadian dollar against all exchange rates, the net loss for the year ended December 31 would reduce by \$0.5 million or increase by \$0.6 million.

*(b) Credit Risk*

Credit risk is the risk that a third party fails to meet its contractual obligations that could result in the Company incurring a loss. The Company's accounts receivable are primarily with joint venture partners and federal governments. Receivables from joint partners arise when the Company conducts joint operations on behalf of its partners and invoices them for their share of costs. Receivables from federal governments arise from input tax credits for Goods and Services taxes. As at December 31, 2010, there



was no allowance for doubtful accounts for the joint venture receivables or federal government receivables as all amounts receivable were current.

**(c) Liquidity Risk**

Liquidity risk is the risk that the Company will not have sufficient funds to meet its liabilities. The Company has no liabilities, other than routine current accounts payable, incurred in the normal course of business.

In 2010, the Company entered into two equity financing deals and one farm-out arrangement (see notes 5 and 7). Management believes there is the opportunity for the Company to raise additional equity and/or enter into further farm-out or joint venture arrangements in 2011.

The outcome of these matters cannot be determined at this time.

**9. Capital management**

The Company's objective when managing its capital structure is to maintain adequate levels of available working capital, including cash and cash equivalents, to meet its license commitments in PNG.

The Company funds its share of expenditures of all commitments from existing cash and cash equivalent balances received primarily from fees from farming out its Licenses and issuances of shareholders' equity. In order to maintain positive working capital, the Company may issue new shares. The Company does not utilize debt and is not subject to any financial covenants.

The Board of Directors regularly reviews the Company's cash and cash equivalents against the expenditure commitments and assesses the timing and need for additional equity financing. The Company's results will impact its access to the capital necessary to meet these expenditure commitments. There can be no assurance that equity financing will be available or sufficient to meet those requirements, or for other corporate purposes, or if equity financing is available, that it will be on terms acceptable to the Company.

**10. Related party transactions**

The Company has entered into transactions with related parties in the normal course of business, which were valued at the exchange amount established and agreed to by the related parties. During the year ended December 31, 2010, the related party transactions were as follows:

(a) the Company paid \$12,000 (2009 - \$12,000) to a company controlled by a director. These fees were paid for management services which were provided by the director of the parent company and an officer of the Company's subsidiary. At December 31, 2010, \$nil (December 31, 2009 - \$nil) was included in accounts payable and accrued liabilities.

(b) the Company paid \$221,776 (2009 - \$70,795) for legal services to a law firm of which an officer of the Company is a partner. At December 31, 2010, \$38,240 (December 31, 2009 - \$1,491) was included in accounts payable and accrued liabilities.

**Eaglewood Energy Inc.****Notes to the Consolidated Financial Statements**

Year ended December 31, 2010 and 2009, Canadian dollars unless otherwise stated

**11. Supplementary cash flow information**

The following table details the components of non-cash working capital:

	<b>For the year ended,</b>	
	<b>December 31, 2010</b>	<b>December 31, 2009</b>
Provided by (used in):		
Accounts receivable	\$ (9,742,606)	\$ (210,452)
Prepaid expenses	(21,727)	-
Accounts payable and accrued liabilities	9,800,277	99,950
	<b>\$ 35,944</b>	<b>\$ (110,502)</b>
Operating	\$ (50,834)	\$ 3,740
Investing	(15,846)	(114,242)
Financing	102,624	-
	<b>\$ 35,944</b>	<b>\$ (110,502)</b>

**12. Income taxes**

The following tables reconcile income taxes calculated at the Canadian statutory rate with recorded income taxes:

<b>Year ended December 31, 2010</b>			
	<b>Canada</b>	<b>Papua New Guinea</b>	<b>Total</b>
Loss before taxes	\$ (2,615,711)	\$ (604,435)	\$ (3,220,146)
Statutory income tax rate	28%	28%	28%
	\$ (732,399)	\$ (169,242)	\$ (901,641)
Stock-based compensation	267,382	-	267,382
Change in valuation allowance	(138,647)	181,331	42,684
Loss subject to tax in foreign jurisdictions	-	(12,089)	(12,089)
Tax pool True-ups	551,536	-	551,536
Other	2,582	-	2,582
Change in tax rates	49,546	-	49,546
Tax expense	\$ -	\$ -	\$ -



**Eaglewood Energy Inc.****Notes to the Consolidated Financial Statements**

Year ended December 31, 2010 and 2009, Canadian dollars unless otherwise stated

<b>Year ended December 31, 2009</b>				
	Canada	Papua New Guinea		Total
Loss before taxes	\$ (2,654,242)	\$ (891,648)	\$	(3,545,890)
Statutory income tax rate	29.0%	29.0%		29.0%
	\$ (769,730)	\$ (258,578)	\$	(1,028,308)
Stock-based compensation	178,305	-		178,305
Foreign exchange losses	-	9,266		9,266
Change in valuation allowance	515,933	5,197,576		5,713,509
Loss subject to tax in foreign jurisdictions	-	(170,183)		(170,183)
Non-taxable farm-out proceeds	-	(4,685,993)		(4,685,993)
Other	(6,084)	(92,088)		(98,172)
Change in tax rates	81,576	-		81,576
Tax expense	\$ -	\$ -	\$	-

The components of future income tax assets are as follows:

<b>Year ended December 31, 2010</b>				
	Canada	Papua New Guinea		Total
Property, plant and equipment	\$ 40,582	\$ 4,788,079	\$	<b>4,828,661</b>
Share issue costs	136,259	-		<b>136,259</b>
Non-capital losses	1,520,295	930,875		<b>2,451,170</b>
ECE	83	-		<b>83</b>
Valuation allowance	(1,697,219)	(5,718,954)		<b>(7,416,173)</b>
Future tax asset	\$ -	\$ -	\$	-

The Company has losses to carry forward in Canada and Papua New Guinea of \$9,184,095 (2009 - \$7,094,702) that expire from 2013 to 2030.

<b>Year ended December 31, 2009</b>				
	Canada	Papua New Guinea		Total
Property, plant and equipment	\$ 36,679	\$ 4,847,754	\$	4,884,433
Share issue costs	95,573	-		95,573
Non-capital losses	1,140,343	760,000		1,900,342
Capital losses	472,492	-		472,492
ECE	100	-		100
Valuation allowance	(1,745,186)	(5,607,754)		(7,352,940)
Future tax asset	\$ -	\$ -	\$	-

**13. Contingencies and commitments****(a) Lease payments**

The future minimum lease payments as at December 31, 2010 are as follows:

2011	\$	2,950,103
2012		116,322
2013		32,523
Total future minimum lease payments		3,098,948

**(b) Transeuro back in right**

Pursuant to the acquisition of a 100 percent interest in four exploration prospecting licenses granted by the Government of PNG and all related geological, seismic and technical data (the "Licenses"), the vendor has the right to acquire a 10 percent interest in all, but not less than all, of the Licenses exercisable within 60 days from the date that the Company completes the drilling and testing of a third well on the Licenses by paying to the Company 10 percent of all costs incurred in respect of the Licenses up to the election date and by agreeing to pay 10 percent of the ongoing costs with respect to the exploration and development of the Licenses.

**(c) License commitments**

Pursuant to the terms of the Licenses, the Company has assumed certain financial and work commitments relating to the licenses as described below:

License	Commitment
PPL 257	There was a commitment to drill one exploration well by October 20, 2009 which was not met. The Company estimates that the cost of drilling one exploration well is approximately US \$60,000,000. On March 18, 2010, the Company submitted a request for a five year extension of the license upon its expiry in October 2010. Under the PNG Oil and Gas Act, the license is deemed to still be in effect while the Company awaits review of its extension request by the Minister. In accordance with the terms of the license extension, the Company will relinquish 50 percent of the area for PPL 257 when, and if, the extension is granted. The area to be relinquished was determined by the Company after an extensive review of seismic and aero/gravity magnetic surveys done on the license. The Company expects that PPL 257 will be extended and that the previous drilling commitment will be added to future work commitments.
PPL 258	There was a commitment to drill one exploration well by October 20, 2009 which was not met. The Company estimates that the cost of drilling one exploration well is approximately US \$30,000,000. On March 18, 2010, the Company submitted a request for a five year extension of the license upon its expiry in October 2010. Under the PNG Oil and Gas Act, the license is deemed to still be in effect while the Company awaits review of its extension request by the Minister. In accordance with the terms of the license renewal, the Company will relinquish 50 percent of the area for PPL 258 when, and if, the extension is granted. The area to be relinquished was determined by the Company after an extensive review of seismic and aero/gravity magnetic surveys done on the license. For PPL 258, there is a risk that the Petroleum Advisory Board may recommend against extension to the PNG



	government. In the event that PPL 258 is not extended, the Company would be advised and would be provided the opportunity to appeal such decision.
PPL 259	There was originally a commitment to drill one exploration well by June 29, 2009. On September 21, 2010 the Minister for Petroleum and Energy approved a variation to the drilling commitment moving it to year five of the license term which is 2010. Drilling of the Ubuntu-1 well commenced in December 2010. On February 7, 2011, Eaglewood announced that it was suspending the Ubuntu-1 well as a gas and gas condensate discovery. The estimated gross cost of the well is approximately US \$39,800,000. (net cost to the Company approximately US \$15,920,000). In the event of a discovery there is a requirement to drill an appraisal well by June 30, 2011. An appraisal well is not currently warranted until further seismic is acquired. On March 7, 2011 a variation application was submitted to the Department of Petroleum and Energy requesting the requirement to drill an appraisal well be replaced by a seismic acquisition programme.
PPL 260	There was a commitment to drill one exploration well by March 13, 2010. Pre-drilling activities for the first exploration well, Korka-1, began in March and drilling was underway during April 2010. Unfortunately, the exploration well encountered no hydrocarbons and was plugged and abandoned. The gross cost of the exploration well was approximately US \$57,000,000 (net cost to the Company estimated at approximately US \$6,600,000). PPL 260 has other prospects and timing and location for drilling a second well is under review but there are no commitments to do so. In December 2010, the Operator of the license submitted a request for a five year extension of the license upon its expiry in March 2011. Under the PNG Oil and Gas Act, the license is deemed to still be in effect while the extension request is under review by the Minister. In accordance with the terms of the license renewal, 50 percent of the area for PPL 260 will be relinquished when, and if, the extension is granted. The area to be relinquished was determined by the Operator after an extensive review of seismic and aero/gravity magnetic surveys done on the license.

The Company has issued bank guarantees totaling approximately \$160,000 (100,000 Papua New Guinea dollars for each license) as security against the capital requirements associated with the Licenses. If the Company does not fulfill its commitments under a License and has not applied for and been granted an extension, it could potentially lose its guarantee and the applicable License could be revoked by the PNG government.

**(d) PNG government back in right**

The PNG government retains a 22.5 percent back-in right which can be exercised at the time a development license is granted. If the PNG government exercises its back-in right, it would be required to pay the Company 22.5 percent of all costs incurred in respect of the Licenses up to the election date and to pay 22.5 percent of the ongoing production and development costs of the Licenses.

**(e) Reclamation**

The Company has a commitment to obtain a reclamation certificate relating to an abandoned well site in Alberta which relates to a predecessor company. The cost of any reclamation work relating to the site is not determinable at this time.

**14. Segmented Information**

The Company has one reportable business segment, that being oil and gas exploration and development. The Company's operations were carried on in the following geographic locations:

Year ended December 31, 2010			
	Canada	Papua New Guinea	Consolidated
Total revenues	\$ 53,900	\$ 3,430	\$ 57,330
Expenses	2,669,610	607,866	3,277,476
Net loss	\$ (2,615,710)	\$ (604,436)	\$ (3,220,146)
Segment assets	\$ 15,004,219	\$ 55,965,123	\$ 70,969,342
Segment petroleum and natural gas properties	\$ -	\$ 44,897,595	\$ 44,897,595
Capital additions	\$ 19,586	\$ 28,761,698	\$ 28,781,284

Year ended December 31, 2009			
	Canada	Papua New Guinea	Consolidated
Total revenues	\$ 21,211	\$ -	\$ 21,211
Expenses	2,675,453	891,648	3,567,101
Net loss	\$ 2,654,242	\$ 891,648	\$ 3,545,890
Segment assets	\$ 13,636,062	\$ 16,852,454	\$ 30,488,516
Segment petroleum and natural gas properties	\$ -	\$ 16,402,822	\$ 16,402,882
Capital additions	\$ 1,071	\$ 4,586,166	\$ 4,587,237

**15. Subsequent events****(a) Ubuntu-1 well results**

On February 7, 2011, Eaglewood announced that it was suspending the Ubuntu-1 well as a gas and gas condensate discovery. On February 11, 2011, Eaglewood further announced that wireline logging and data acquisition programs had been completed in Ubuntu-1 including the recovery of down-hole hydrocarbon samples and sidewall cores. New seismic data acquisition is planned in PPL 259 over the Ubuntu discovery area.



**(b) Rig assignment**

In April 2010, the Company entered into an Agreement of Assignment in relation to Rig 103 for the purpose of drilling two wells. On February 18, 2011, the Company assigned its second rig slot and is no longer obligated to drill a second well with this rig.

**(c) Over-allotment**

On January 20, 2011, the Company closed the over-allotment option pursuant to its December 2010 equity financing in which the Underwriters purchased an additional 710,000 common shares at \$0.75 per common share for aggregate gross proceeds of \$532,500.

**(d) License extension application**

On March 29, 2011, the Company submitted to the Department of Petroleum and Energy of PNG, an application for a five year extension on the PPL 259 license. Under the PNG Oil and Gas Act, the license is deemed to still be in effect while the extension request is under review by the Minister. In accordance with the terms of the license renewal, 50 percent of the area for PPL 259 will be relinquished when, and if, the extension is granted.