

ARCAN RESOURCES LTD.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Basis of Presentation

Arcan Resources Ltd. ("**Arcan**" or the "**Corporation**") is engaged in the exploration for, and the development and production of, petroleum and natural gas in Western Canada. Arcan was incorporated on October 9, 2003 and conducted operations as a private company until January 1, 2007, maintaining a June 30 year end. On January 1, 2007 Arcan amalgamated with Desco Energy Ltd. with the amalgamated entity's year end established as December 31. The amalgamation resulted in Arcan becoming a public company and a reporting issuer, with its shares trading on the TSX Venture Exchange under the symbol 'ARN' beginning on January 9, 2007.

This management's discussion and analysis ("**MD&A**") is an explanation, through the eyes of management, of how Arcan performed during the periods covered by the annual audited financial statements of Arcan filed concurrently with this MD&A, and of Arcan's financial condition and future prospects. This MD&A is for the three months and year ended December 31, 2009, as compared to the same periods ended December 31, 2008. The MD&A complements and supplements the financial statements of Arcan. For a full understanding of the financial position and results of operations of the Corporation, the MD&A should be read in conjunction with the audited financial statements for the years ended December 31, 2009 and 2008, together with the notes related thereto as well as the interim financial statements and related notes thereto and documents to be filed on SEDAR, including historical financial statements, the information circular relating to the Corporation's annual general and special meeting to be held on May 25, 2010 and the Corporation's annual information form for the year ended December 31, 2009. These documents will be available at www.sedar.com under the Corporation's SEDAR profile.

The financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("**GAAP**") in Canadian dollars. Estimates of reserves and future net revenue from Arcan's oil and natural gas reserves are based on the independent oil and gas reserve report described in Arcan's annual information form. Estimates of future net revenue and net asset value do not represent fair market value. Readers should read the section "Non-GAAP Measurements" below and the sections "Legal Advisories" and "Forward-Looking Information and Statements" at the end of this MD&A.

Arcan's management is responsible for the integrity of the information contained in this report and for the consistency between the MD&A and financial statements. In the preparation of these statements, estimates are necessary. Management believes these estimates have been based on careful judgments and have been properly presented. The financial statements have been prepared using policies and procedures established by management and fairly reflect Arcan's financial position, results of operations and funds from operations.

Arcan's Board of Directors and Audit Committee have reviewed and approved the financial statements and MD&A. This MD&A is dated April 22, 2010.

Non-GAAP Measurements

Readers are cautioned that this MD&A contains the term "funds from operations", which should not be considered an alternative to, or more meaningful than, cash provided by operating activities or net earnings as determined in accordance with GAAP as an indicator of Arcan's performance. Arcan also presents "funds from operations per share", whereby funds from operations is divided by the basic weighted average number of common shares outstanding to determine per share amounts. Operating and corporate netbacks are also presented. Operating netbacks represent Arcan's revenue, less royalties and operating expenses, and corporate netbacks represent Arcan's operating netback, less realized economic hedging losses, general and administrative ("**G&A**") and interest expense, in order to determine the amount of funds generated by production. Operating and corporate netbacks have been presented on a per barrels of oil equivalent ("**boe**") basis, as well.

These measures do not have any standardized meaning prescribed by GAAP and therefore are unlikely to be comparable to similar measures presented by other companies. Management believes that funds from

operations and operating and corporate netbacks are useful supplemental measures as they provide an indication of the ability of Arcan to fund future growth through capital investment and/or repay debt. These measures have been described and presented in this MD&A in order to provide shareholders and potential investors with additional information regarding Arcan's liquidity and its ability to generate funds to finance its operations. Arcan's method of calculating funds from operations may differ from that of other companies, and, accordingly, may not be comparable.

Arcan determines funds from operations as cash flow from operating activities before changes in non-cash working capital as follows:

Funds from Operations (\$000's)	Quarter Ended December 2009	Quarter Ended December 2008	Year Ended December 2009	Year Ended December 2008
Cash flow from (used in) operating activities (per GAAP)	(371)	4,590	4,327	23,969
Change in non-cash working capital	1,038	(2,603)	1,018	584
Funds from operations	667	1,987	5,345	24,553

2009 Highlights

- Despite a 27 percent increase in the number of shares outstanding during the year, net asset value decreased 18 percent at December 31, 2009 to \$3.08 per diluted share from \$3.77 per diluted share in 2008 (proved plus probable ("**P+P**"), discounted at 10 percent);
- Restricted capital spending to \$11.5 million, of which \$5.0 million was in the fourth quarter, due to the challenging year in the global markets. Low capital investment translated into average 2009 production of 1,375 boe per day, within the targeted 1,300 – 1,700 boe per day range, but below the average 1,498 boe per day for 2008;
- Created a 1.7 times recycle ratio on operating netbacks of \$24.10 per boe and a \$14.29 per boe finding, development and acquisition ("**FD&A**") cost, providing the Corporation with a 19 year reserve life index based on the fourth quarter 2009 average production rate;
- Raised \$12.8 million in equity in the fourth quarter to fund the drilling of Arcan's first horizontal multi-stage fracture well in the Swan Hills area;
- Drilled six (3.2 net) wells and continued to increase water injection in both Hamburg and Swan Hills;
- Drilled in the first quarter of 2010, two (1.8 net) successful horizontal multi-stage fractured light oil wells in Arcan's Swan Hills light oil play and commenced drilling six (4.8 net) more;
- Raised \$65 million in equity and purchased an adjoining property to the Deer Mountain Unit #2 (the "**Unit**") for \$53.3 million (the "**Acquisition**"), both of which closed on March 31, 2010; and
- Started the process to increase bank lines of credit from \$50 million to \$70 million.

Highlights	Year Ended December 31, 2009	Year Ended December 31, 2008	Year Ended December 31, 2007
Financial (\$000's, except per share amounts)			
Petroleum and natural gas revenues	27,290	48,657	27,505
Cash provided by operating activities	4,328	23,969	11,429
Funds from operations ⁽¹⁾	5,345	24,553	10,927
Per share – basic ⁽¹⁾	0.14	0.65	0.33
Net income (loss)	(5,743)	7,001	(910)
Per share - basic	(0.15)	0.19	(0.03)
- diluted	(0.15)	0.18	(0.03)
Bank loan	28,586	29,633	13,906
Total assets	151,251	149,724	123,285
Total liabilities	55,784	61,493	43,815
Shareholders' equity	95,468	88,231	79,471
Capital expenditures, net – cash	11,495	34,922	50,272
Common shares outstanding	47,940	37,869	36,492
Weighted average – basic	39,502	37,543	32,724
Weighted average – diluted ⁽³⁾	39,502	38,525	32,724
Sales Volumes			
Crude oil and NGLs (barrels per day)	1,021	1,128	798
Natural gas (mcf per day)	2,124	2,220	2,278
Barrels of oil equivalent (boe per day) ⁽²⁾	1,375	1,498	1,178

Notes:

- (1) The reader is referred to the section - "Non-GAAP Measurements" in this MD&A.
- (2) The reader is referred to the section - "Oil, NGLs and Natural Gas Conversions to BOEs" in this MD&A.
- (3) Basic and diluted weighted average shares are the same in 2009 and 2007 as the Corporation incurred a loss in these periods. In 2008, 982,107 shares were included as dilutive securities as the remainder of the warrants, stock options, and performance options were anti-dilutive.

The Acquisition – Completed March 31, 2010

On March 31, 2010 Arcan closed a \$65.0 million financing, pursuant to which Arcan issued 26,000,000 common shares. The proceeds were primarily applied to the Acquisition costing \$53.3 million for interests in 102 gross (81 net) sections of land with approximately 500 boe per day of existing production. Following the closing of the Acquisition, Arcan owns a consolidated 100 percent interest in over 70 sections of land immediately adjacent and to the south of its existing infrastructure in the Unit and a total of over 150 gross (140 net) sections of land on the Swan Hills reef play. None of the tables or calculations contained herein include the metrics of the Acquisition.

Net Asset Value

As detailed in the table below, the net asset value ("NAV") of \$3.08 per diluted share at December 31, 2009 (on the basis of P+P reserves discounted at 10 percent has decreased by 18 percent over December 31, 2008. The decrease in net asset value can be mainly attributed to the dilutive impact related to the 10 million shares issued in October 2009. Those funds were used to drill the new horizontal multi-stage fracture well in the Swan Hills reef play. In 2009, Arcan invested \$11.5 million and grew the present value of the Corporation's reserves by \$17.1 million (P+P discounted at 10 percent) (\$176.4 million closing reserves plus \$12.1 million in operating netbacks less \$171.5 million opening reserves). Arcan expects that its investment in horizontal multi-stage acid fracture wells and waterfloods will continue to add value for 2010 and beyond from its current 19 year reserve life. These values and opening numbers have not been adjusted to include the impact of the changes to the Alberta royalty framework announced in March 2010.

This NAV calculation is presented for December 31, 2009 and December 31, 2008 and incorporates estimates that may not be comparable year-over-year and are only at one point in time. An independent evaluation was performed for reserves; however, land values and seismic values are based on management's estimates of costs. The reader is cautioned that the presentation does not reflect all aspects of the Corporation. Reserve estimates are derived from reserve reports prepared by Arcan's independent reserve engineers GLJ Petroleum Consultants Ltd. ("GLJ").

Net Asset Value (\$000s except number of shares and per share)	December 31, 2009		December 31, 2008	
	(P+P discounted at 5%)	(P+P discounted at 10%)	(P+P discounted at 5%)	(P+P discounted at 10%)
Present value of reserves	236,782	176,410	226,925	171,457
Undeveloped acreage (2009 - \$169 per acre)	10,220	10,220	11,062	11,062
Seismic	600	600	800	800
Working capital deficit	(34,779)	(34,779)	(40,406)	(40,406)
Dilution proceeds *	2,745	2,745	0	0
Estimated value	215,568	155,196	198,381	142,913
Shares (thousands)	50,331*	50,331*	37,869*	37,869*
Estimated NAV per share *	4.28	3.08	5.24	3.77

* Share figures for 2009 include all dilutive securities namely: 47,940,060 common shares; 750,000 performance warrants exercisable at \$1.00 per share; and 1,641,000 stock options that are in the money at their average exercise price of \$1.23 (these were all dilutive securities exercisable below the \$1.45 December 31, 2009 share trading price). For 2008, share figures include the 37,868,560 common shares of Arcan outstanding, as all other convertible securities were non-dilutive to the \$0.41 December 31, 2008 share trading price. Dilution proceeds for 2009 include 750,000 performance warrants exercisable at \$1.00, 462,500 stock options exercisable at \$1.00, and 1,178,500 stock options exercisable at \$1.30.

FD&A Costs

For the year ended December 31, 2009, Arcan added 0.1 million boe ("**mmboe**") of P+P reserves in 2009 (9.4 mmboe closing reserves plus 0.5 mmboe production less 9.8 mmboe opening reserves) on a \$1.1 million capital program (\$11.5 million capital per the December 31, 2009 financial statements plus \$34.8 million of closing future capital in the December 31, 2009 reserve report (P+P) less \$45.2 million closing future capital in the December 31, 2008 reserve report (P+P)) to calculate a \$14.29 FD&A cost per P+P boe. The aggregate of the exploration and development costs incurred in the most recent fiscal year and the change during that year in estimated future development costs generally will not reflect total FD&A costs related to reserves additions for that year.

The FD&A costs below were based on a very restricted capital spending program. It is anticipated that the full impact of the horizontal development of the Swan Hills reef play and the related shift in reserves will be realized over the next few years.

P+P FD&A Costs	2009	2008	3 year average	LTD
Capital expended (\$millions)	11.5	38.4	109.2	184.3
Change in future capital (\$millions)	(10.4)	15.0	5.8	34.8
Total Capital (\$millions)	1.1	53.4	115.0	219.1
Reserve additions (mmboe)	0.1	3.3	5.9	11.1
P+P FD&A (\$ per boe)	\$14.29	\$16.18	\$19.49	\$19.73
Proven FD&A Costs	2009	2008	3 year average	LTD
Capital expended (\$millions)	11.5	38.4	109.2	184.3
Change in future capital (\$millions)	(10.5)	14.8	6.0	27.6
Total Capital (\$millions)	1.0	53.2	115.2	211.9
Reserve additions (mmboe)	0.1	3.2	5.2	8.8
Proven FD&A (\$ per boe)	\$8.48	\$16.63	\$22.15	\$24.01

Arcan invested substantially in infrastructure in prior years through facilities, drilling water source wells, and converting some of its best producing wells into injector wells (typically, the best producers also make the best injectors). In waterflood projects the majority of the capital is invested at the front end to produce results over the long term. Arcan's previous investments in two waterfloods are starting to pay off, which is reflected in the 2009 FD&A costs. Going forward, Arcan expects to see a higher ratio of investments in drilling development wells to fully capture the resources related to the Swan Hills light oil property. For 2010, Arcan expects an upward transition in revenues and netbacks as commodity prices related to oil have risen and Arcan is investing in horizontal multi-stage fracture oil wells in the Swan Hills reef play.

Recycle Ratio

The recycle ratio is a measure for evaluating the effectiveness of a Corporation's reinvestment program. The ratio measures how well the Corporation replaced every boe of production. The table below depicts that Arcan received a net \$24.10 per boe sold and it cost \$14.29 to find a replacement boe. Arcan strives for a recycle ratio of 2.0 or better but only achieved a ratio of 1.7 based on a very restricted capital program and low commodity prices.

For the year ended December 31, 2009, Arcan estimated that it had a 1.7 times recycle ratio on 0.1 mmboe proved plus probable reserve additions and a \$14.29 FD&A cost (using a 10 percent discount factor) with a 19 year reserve life index. With proved reserve additions of 0.1 mmboe, Arcan estimated a proved FD&A cost of \$8.48 per boe (using a 10 percent discount factor) for the year ended December 31, 2009. Life to date ("**LTD**"), Arcan estimates it has a recycle ratio of 2.0 times based on a \$19.73 P+P FD&A (discounted at 10 percent) and a \$38.95 operating netback.

Recycle Ratio	2009	2008	3 year average	LTD
Operating netback (\$/boe)	24.10	53.98	38.95	38.85
Proven finding and development costs (\$/boe)	8.48	16.63	22.15	24.01
Proven reinvestment efficiency ratio	2.8	3.2	1.8	1.6
Proven plus probable finding and development costs (\$/boe)	14.29	16.18	19.49	19.73
Proven plus probable reinvestment efficiency ratio	1.7	3.3	2.0	2.0

Reserve Life Index

Using the fourth quarter ended December 31, 2009 average production of 1,352 boe per day and December 31, 2009 year-end proved plus probable reserves, Arcan has a reserve life of 19 years. Arcan anticipates the reserve life index to decline as production rates are anticipated to elevate.

Production (fourth quarter ended December 31, 2009 average boe per day)	1,352
Proved reserves (mboe)	7,136
Proved reserve life index (years)	14.5
Proved plus probable reserves (mboe)	9,416
Proved plus probable reserve life index (years)	19.1

Corporate Overview – The Swan Hills Reef

Arcan's new horizontal wells demonstrate the potential that the multi-stage fracture technology is expected to have on the revival of the Swan Hills reef complex and the ability to significantly enhance the recovery of the large volume of oil in place. The multi-stage fracture wells represent a shift in the exploitation of the Swan Hills reef complex. Horizontal multi-stage fracture wells exhibit productive capability of up to 8 times that of an average vertical producer at only two times the cost.

The application of the multi-stage acid fracture technology was one of the first wells of its kind in the region and revived Alberta's Swan Hills reef complex creating a technology-driven light oil resource play. In 2008, Arcan's technical team recognized a potentially game-changing new development approach: exploiting the model of horizontal wells completed with multiple hydraulic fractures that had proved so successful in other light oil and natural gas resource plays, but adapted through acid fracturing to the Swan Hills reef's soluble carbonate rock. By late 2009, following a comprehensive evaluation of area vertical well control and new geological mapping, Arcan prepared to test this approach. Arcan's first multi-stage acid-fractured horizontal well at 12-29-68-8W5 ("**12-29**") was tested in early February 2010. Its results signalled the revival of the nearly 60-year-old Swan Hills reef reservoir, which had been considered in terminal decline – and an all-new oil resource play. The well was brought on-production in February 2010 at greater than 600 barrels ("**bbls**") per day of light, 40° API sweet oil. Arcan's second horizontal well, drilled five miles away, was fractured on April 13, 2010. Testing equipment is on site and Arcan intends to release the results of this well as data becomes available. At this time Arcan has three rigs in operation. By the third quarter of 2010, Arcan plans to have drilled and tested a total of eight gross multi-stage acid-fractured horizontal wells.

Arcan's activities in the Swan Hills area started in September 2005, when Arcan purchased a 10 percent interest in the Unit and purchased a further 65 percent in August 2006 as well as additional interests later

in 2006 to bring it to 81 percent. Arcan also purchased interests in the connecting 50 section complimentary land block in April of 2008, entered into a farm-in on a portion of those lands and subsequently purchased the balance of those lands on March 31, 2010 through the Acquisition. Arcan now has 150 gross (140 net) sections of land on the Swan Hills play.

On December 9, 2009 Arcan spudded its first multi-stage fracture horizontal well in the Swan Hills oil reef play at 12-29. This is a carbonate reservoir in the Beaverhill Lake formation. The well was fractured on January 31, 2010 using 10 separately staged acid fracture treatments and tested at over 600 boe per day of 40 API sweet oil. Arcan tied the well into Arcan's operated production facility on February 23, 2010. On February 9, 2010, the 5-34-67-8W5 ("**5-34**") well was drilled to a vertical depth of 2,450 meters and was logged with core indicating over 14 net meters of oil bearing reef. Arcan subsequently decided to whipstock the 5-34 well and drill it horizontally. The horizontal leg was drilled approximately 1,165 meters in oil bearing reef and on April 13, 2010 the 5-34 well was multi-stage acid fractured utilizing a 10 stage stimulation treatment. Arcan anticipates releasing the results of this test in the next few weeks. Arcan has built a road to this new well and intends to truck oil from this well until it can be connected to its existing infrastructure. The drilling rig was subsequently moved to a pad at 15-29-68-8W5 where it is currently in the process of drilling the first of two horizontal wells during this break-up period. The first of these two wells has been drilled and cased with an approximately 1,100 meter horizontal leg and the second well has commenced drilling.

A second rig is currently in the process of drilling two horizontal wells on the pad at 10-17-68-8W5. The first of these two wells has been drilled and cased with an approximately 1,100 meter horizontal leg and the second well has commenced drilling. A third rig was moved onto the pad at 10-29-68-8W5 and is currently in the process of drilling two horizontal wells. The first of these two wells has been drilled and cased with an approximately 1,100 meter horizontal leg and the second well will commence drilling shortly.

The horizontal drilling and multi-stage fracture completion capital along with associated equipment and tie-in costs is expected to be approximately \$4.7 million per well. Arcan has existing operated pipelines and facilities in place to accommodate 4,000 bbls per day with room for expansion to approximately 8,000 bbls per day for an estimated cost of \$1 million.

For 2010, Arcan is implementing plans based on ongoing drilling success and expect to follow-up with significant water injection turning its large land block into a growing production base with solid reserve bookings, allowing Arcan to continue to solidify its value. Based on results to date, Arcan anticipates average production of 2,500 to 3,000 boe per day in 2010 and an estimated exit production of 3,500 to 4,000 boe per day. Arcan's initial budget indicated 7-9 horizontal wells for 2010. Arcan will re-evaluate that forecast through break-up, as an estimated eight wells will have been drilled by the end of the third quarter of 2010.

Going forward, field-wide development is envisioned at three horizontal wells plus one vertical water injection well per land section. Overall recovery at the Unit through vertical development, 57 years after the pool's discovery, is at ten percent of an estimated 39 million barrels of original-oil-in-place. Arcan hopes to achieve an increase in the overall recovery factor through horizontal drilling and is targeting at least 40 percent recovery over the longer term at the Unit and larger, recently acquired lands.

As of December 31, 2009, Arcan had \$34.8 million in debt and working capital and for 2010 anticipates remaining within cash flow and its bank lines. Arcan is evaluating the growth of its production base in 2010 through a prudent level of investment based on anticipated cash flow.

As at December 31, 2009, Arcan had 13 full time office employees and 9 full time field employees.

Overview of Arcan's Core Areas

Swan Hills –The Complex

The Swan Hills complex is located in north central Alberta approximately 200 kilometres northwest of Edmonton. The main portion of the Swan Hills complex was discovered and developed through vertical drilling in the 1950's and 1960's. The reef complex is over 50 miles long covering over 24 townships of

land and is recognized as having a very large accumulation of 41° API light sweet oil in place. The main portion of the reef has undergone extensive waterflood operations and recovered over 40 percent of the oil in place. As announced by the Alberta Government, the reef is now to be developed under CO₂ flood as part of its \$2 billion carbon capture and storage fund, through the Swan Hills Synfuels project. Because the Swan Hills pools hold such large volumes of original-oil-in-place, each percentage point increase in the overall recovery factor represents significant incremental production and reserves at low geological risk.

Swan Hills - The Land

Arcan's land base extends over 15 miles north/south along the Swan Hills reef trend. Over 50 sections of Arcan's land base has already been proven productive through vertical well control. Production on the Unit commenced in 1964 and unitization occurred in 1984. In September 2005, Arcan purchased a net 10.4 percent interest in the Unit when total production was approximately 250 boe per day. In August 2006, Arcan acquired an additional 65.4 percent working interest, with a further 5 percent purchased in 2006 bringing Arcan's working interest in the Unit to the current 81 percent. Through 2007 Arcan built a new 4,000 barrel battery as well as a 5,000 psi water injection system covering the Unit.

In 2008, Arcan acquired interests in over 50 sections of adjacent lands south of the Unit. Through an understanding of the old well bores drilled into the Beaverhill Lake formation, Arcan mapped a continuous reef structure extending from the Unit over 15 kilometres through the newly acquired lands to other producing wells to the south. Arcan has not yet booked reserves to these lands except for approximately one section stemming from its first two wells drilled on these lands. Historically, vertical wells were drilled and supported by an injection well to establish long-life producing injection/production pods.

On March 31, 2010, Arcan acquired interests in 102 gross (81 net) sections of land with approximately 500 boe per day of existing production for a cash purchase price of \$53.25 million. An important part of the Acquisition was that these lands were additive to Arcan's current working interests and they were adjacent to Arcan's existing land base. As a result of the closing the Acquisition, Arcan has a consolidated 100 percent interest in over 70 sections of land immediately adjacent and to the south of its existing infrastructure in the Unit and a total of over 150 gross (140 net) sections of land on the Swan Hills reef play.

Swan Hills - The Reserves

As Arcan has drilled its horizontal multi-stage fracture wells after year-end, none of the related impacts are reflected in the proved producing year end reserves report. Furthermore, newly announced royalty regime changes are also not reflected in the December 31, 2009 year end reserves report.

To date, the Unit has recovered approximately 3.9 mmmboe. This is approximately 10 percent of GLJ's estimate for original oil-in-place of approximately 39 mmmboe or approximately 4 mmmboe per section. Offsetting units with over 40 years of production history have proven over 6 mmmboe of oil-in-place per section and have recovered more than 35 percent of their estimated original oil in place, and are believed capable of 45 percent ultimate recovery under vertical well development and waterflood. These units have significant further upside potential from the application of multi-stage horizontal fracturing and future possible carbon dioxide injection schemes.

On the Acquisition, which closed on March 31, 2010, Arcan acquired 1.4 mmmboe of proven reserves valued at \$39.3 million (present value discounted at 10 percent) or 1.7 mmmboe of proven plus probable reserves valued at \$43.3 million (present value discounted at 10 percent) (see Arcan's press release dated March 17, 2010 regarding reserves acquired in the Acquisition as filed on SEDAR for further details). Arcan estimates that additional horizontal wells could add up to \$18 million per well to Arcan's net present value and could increase Arcan's reserves after undertaking a large scale development program on its Swan Hills reef play.

Swan Hills - The Drilling

Arcan has drilled and completed two horizontal multi-stage fracture wells to date. With three drilling rigs Arcan anticipates it may drill up to six (4.9 net) additional horizontal wells during the break-up period with all six (4.9 net) completions to follow in the second or third quarter of 2010, depending on weather

conditions. Arcan has a further 15 (12 net) horizontal wells at the drill ready stage to continue the drilling program.

<u>Well</u>	<u>Spud Date</u>	<u>Production Test Start Date</u>	<u>Initial Production (boe per day)</u>
12-29-68-8W5	December 9, 2009	February 10, 2010	600
5-34-67-8W5	February 9, 2010	April 13, 2010	TBA
8-30-68-8W5	March 10, 2010	Drilled and Cased	TBA
5-28-68-8W5	April 18, 2010	Drilling	TBA
1-17-68-8W5	March 15, 2010	Drilled and Cased	TBA
6-20-68-8W5	April 11, 2010	Drilling	TBA
10-32-68-8W5	April 5, 2010	Drilled and Cased	TBA
16-30-68-8W5	Estimated May 2010	Estimated third quarter of 2010	TBA

Arcan has utilized 10 separately staged acid fracture treatments on its first two wells. The horizontal drilling and multi stage fracture completion capital along with associated equipment and tie-in costs is expected to be approximately \$4.7 million per well. Seven of the eight planned wells are in the Unit where Arcan already has existing operated pipelines and facilities in place to accommodate 4,000 barrels per day with room for expansion to 8,000 barrels per day for a cost of approximately \$1 million. Arcan anticipates that it will develop the land base utilizing three horizontal producing wells per section. Arcan is also reviewing results from other industry participants with lands on the Swan Hills play and Arcan is monitoring their drilling results as two horizontal multi-stage wells have recently been drilled by a competitor in an adjoining section.

Swan Hills - The Consolidated Outlook

The initial production of the first two horizontal wells and approximately 500 boe per day on the 102 (81 net) sections of land in the Swan Hills area that were obtained from a third party vendor (the "**Acquired Assets**") increases the productive capacity on Arcan's lands in the Swan Hills play from approximately 800 bbls per day at December 31, 2009. This base production has declined to 400 bbls per day as numerous vertical wells that were producing have been shut-in to accommodate the new horizontal drilling. Arcan anticipates that most of the current vertical wells will serve as water source wells or water injection wells in the future.

Arcan estimates oil-in-place of four to ten mmboe per section and up to a 40 percent recovery under waterflood. Utilizing 3 horizontal wells per section for development would translate into over 600,000 boe of recoverable reserves per well. The expected repeatability of the horizontal drilling and multi-stage fracturing technology is expected to convert the Swan Hills play from a long life light oil legacy resource play to a significant legacy growth opportunity. Vertical well control combined with geological mapping increases Arcan's confidence in its development program.

Production in the Swan Hills averaged 623 boe per day with \$28.93 per boe operating netbacks for the year ended December 31, 2009 up from 528 boe per day with \$54.71 per boe operating netbacks in the year ended December 31, 2008.

Hamburg, Alberta

In February 2006, Arcan discovered the Hamburg GG oil. In November 2008, Arcan acquired a 50 percent working interest in and became operator of the oil battery serving oil wells located in the GG pool area. These wells are prolific, producing 41° API sweet oil and natural gas.

On February 13, 2009, the Alberta Energy Resources Conservation Board modified the pool enhanced oil recovery ("**EOR**") boundary definition, resulting in the majority of the wells being located within the EOR scheme.

In March 2010 Arcan drilled one (0.5 net) exploration well in the Hamburg area, incurring 20 percent of the drilling costs. Initial indications did not indicate economic quantities of hydrocarbons and therefore the well was not completed and remains standing.

Arcan enhanced its water injection in the pool in March of 2010 by converting a third well to an injector and plans to add a free water knock out to enhance water and production capabilities. Arcan currently has two to four infill development opportunities to drill in the GG pool and will evaluate this program as economic conditions warrant. Longer-term plans call for additional exploration tests that have been selected based on 3D seismic. Additional 3D seismic could be shot and the possibility of drilling up-hole Bluesky and Monteny natural gas targets is being considered, which competitors are producing in offsetting sections.

Production averaged 675 boe per day on \$22.20 per boe operating netbacks for the year ended December 31, 2009, down from 765 boe per day and \$60.44 per boe operating netbacks in the year ended December 31, 2008.

McLeod, Alberta

The McLeod property is characterized by medium-risk natural gas targets largely focused in Mannville Group and Jurassic-aged strata at depths of 1,800 – 2,200 metres. Arcan has drilled seven (5.2 net) Gething natural gas wells with 90 percent success at McLeod, and sold its interests in one well at the end of December 2008. The McLeod wells were producing approximately 500 thousand cubic feet ("mcf") per day net, or approximately 100 boe per day in total as of year-end 2009, which is down from 2008 due to the normal declines of natural gas wells. Arcan has reduced capital allocations to this area as natural gas prices have remained weak compared to oil.

McLeod is a multi-zone liquids rich gas prone area. Arcan will continue to evaluate land opportunities for growth in the area.

Annual and Fourth Quarter Results of Operations

Volumes

Sales Volumes	Quarter Ended December 2009	Quarter Ended December 2008	Year Ended December 2009	Year Ended December 2008
Crude oil and NGLs (bbls per day)	1,001	1,102	1,021	1,128
Natural gas (mcf per day)	2,105	2,199	2,124	2,220
Total oil equivalent (boe per day)	1,352	1,468	1,375	1,498
Oil as a percent of total volumes	74%	75%	74%	75%

Arcan produced 1,352 boe per day in the fourth quarter of 2009, an eight percent decrease from 1,468 recorded in the fourth quarter of 2008. Production for the year ended December 31, 2009 averaged 1,375 boe per day, down eight percent from the 1,498 boe per day for the year ended December 31, 2008. Production from McLeod was down approximately 63 percent while production from Hamburg and Deer Mountain were relatively flat for the 2009 year versus the year ended December 31, 2008.

Arcan anticipates its production for 2010 will increase to average 2,500 to 3,000 boe per day based on the successful results of the Swan Hills horizontal drilling activity and the Acquired Assets.

Arcan has a substantial inventory of development wells to drill in its Swan Hills oil property. For the balance of 2010, Arcan may consider additional expansions based on the business and economic climate and a favourable commodity price environment.

Netbacks

The Corporation considers corporate netbacks to be an indication of its ability to produce oil and natural gas profitably and to earn a return on capital invested. Netbacks are also one of three possible sources of funding, the others being utilizing available debt and issuing new equity. The largest impact to Arcan's netbacks was commodity price declines as Edmonton Par decreased 35 percent from an average of \$102.16 per barrel for 2008 to an average of \$66.30 per barrel for 2009. To provide stability and protection for corporate netbacks, Arcan entered into a fixed price oil swap contract to receive \$64.40 per barrel in exchange for Canadian dollar WTI on oil production of 500 barrels per day for the period from April 1 to December 31, 2009. This contract cost Arcan \$1.4 million of which \$0.7 million was in the

fourth quarter of 2009 in realized losses on settlement. The contract has now expired and no additional contracts have been entered into. While Arcan expects commodity price fluctuations over the upcoming year, overall price levels are expected to remain relatively stable in 2010 and in 2011. On a boe basis, royalties are expected to decrease (due to the latest announced adjustments to the Alberta royalty structures) and operating costs are expected to reduce into the \$8-12 per boe range. These factors and growing production are expected to increase the netbacks received by Arcan for 2010 after a softer 2009.

Netbacks \$ thousands	Quarter Ended December 2009	Quarter Ended December 2008	Year Ended December 2009	Year Ended December 2008
Revenue	7,804	8,099	27,290	48,657
Royalties	2,554	1,881	7,116	10,819
Operating expenses	2,672	2,416	8,082	8,235
Operating netbacks	2,578	3,802	12,092	29,603
Realized economic hedging loss	737	-	1,440	-
G&A	788	1,307	3,674	3,500
Interest expenses	379	291	1,540	1,238
Corporate netbacks	674	2,205	5,438	24,865
\$ per boe				
Revenue	62.74	59.95	54.39	88.73
Royalties	20.53	13.93	14.18	19.73
Operating expenses	21.48	17.88	16.11	15.02
Operating netbacks	20.73	28.15	24.10	53.98
Realized economic hedging loss	5.92	-	2.87	-
G&A	6.34	9.67	7.32	6.39
Interest expenses	3.05	2.15	3.07	2.26
Corporate netbacks	5.42	16.32	10.84	45.33

Arcan's operating netback, defined as revenue, less royalties and operating expenses, was \$2.6 million in the fourth quarter of 2009, a 32 percent decrease from \$3.8 million recorded in the fourth quarter of 2008. The decrease in operating netback over 2008 was based on a combination of a 5 percent increase in price, an 8 percent decrease in volumes, a 36 percent increase in royalties and an 11 percent increase in operating costs. Operating netbacks for the year ended December 2009 were \$12.1 million, down 59 percent from \$29.6 million for the year ended December 31, 2008. The decrease in the operating netback in total for the year ended December 31, 2009 over 2008 is due to a 9 percent decrease in volumes and a 39 percent decrease in prices more than offsetting the decreased royalty and operating costs.

Arcan's operating netback on a per boe basis was \$20.73 in the fourth quarter of 2009, a 26 percent decrease from \$28.15 recorded in the fourth quarter of 2008. The decrease in operating netback related to a 47 percent increase in royalties and a 20 percent increase in operating costs partially offset by a 5 percent increase in price on a per boe basis in the fourth quarter of 2009 as compared to the same period of 2008. Operating netbacks per boe for the year ended December 31, 2009 were \$24.10, down 55 percent from \$53.98 for the year ended December 31, 2008. The decrease in the operating netback per boe for the year ended December 31, 2009 versus the prior period is due to a 38 percent decrease in prices combined with a 7 percent increase in operating costs more than offsetting the 28 percent decrease in royalties. The move to oil weighting has increased Arcan's exposure to price upside both in 2008 and 2009, and is expected to continue in 2010. However, oil properties do present additional operating costs which can be large on a boe basis in the early stages of a waterflood. The net effect to Arcan was significantly higher netbacks from oil in 2009 than would have been achieved through natural gas.

Operating netbacks from oil were \$20.92 per boe and from natural gas were \$15.25 per boe in the fourth quarter of 2009 versus \$28.69 for oil and \$24.29 for natural gas in the fourth quarter of 2008. Operating netbacks from oil were \$25.43 per boe and from natural gas were \$4.56 per boe during the year ended December 31, 2009 versus operating netbacks from oil of \$58.10 per barrel and from natural gas of \$29.69 per boe during the year ended December 31, 2008. Arcan's oil netbacks were stronger than natural gas netbacks for all periods in both 2008 and 2009 due mainly to commodity pricing.

Arcan's corporate netback, defined as operating netback, less realized economic hedging losses, G&A and interest (income less expense), was down to \$0.7 million in the fourth quarter of 2009 as compared to \$2.2 million in the fourth quarter of 2008 due mainly to decreased operating netbacks and a \$0.7 million economic hedging loss for the fourth quarter of 2009. The corporate netback was \$5.4 million for the year ended December 31, 2009 versus \$24.9 million for the year ended December 31, 2008. The large

decreases for 2009 related mainly to a 39 percent decrease in commodity prices. On a per boe basis, the corporate netback was \$5.42 in the fourth quarter of 2009 as compared to \$16.32 in the fourth quarter of 2008 and \$0.28 in the third quarter of 2009. On a per boe basis, the corporate netback was \$10.84 in 2009 as compared to \$45.33 in 2008. Changes in netbacks and the components thereof are detailed by category in the above table.

Operations by area for the years ended December 31, 2009 and 2008 are as follows:

Operating Netbacks by Area (Per Boe) Area	Year ended December 31, 2009			Year ended December 31, 2008		
	Deer			Deer		
	Hamburg	Mountain	McLeod	Hamburg	Mountain	McLeod
Daily Production	675	623	75	765	528	202
Revenue	48.28	63.75	32.37	91.74	96.87	56.59
Royalties	10.93	19.42	(3.09)	18.02	26.27	8.75
Operating Costs	15.15	15.40	30.90	13.28	15.90	18.15
Operating Netbacks	22.20	28.93	4.56	60.44	54.71	29.69

Arcan focused on its oil properties in 2008 and 2009 as netbacks from its oil properties provided higher margins than the natural gas properties. Arcan shut in the majority of its production from McLeod during the very low priced summer months of July and August.

Revenues

Petroleum and Natural Gas Revenues (\$)	Quarter Ended December 2009	Quarter Ended December 2008	Year Ended December 2009	Year Ended December 2008
Oil and liquids (000's)	6,797	6,442	23,798	40,889
Per barrel	73.80	63.55	63.89	99.02
Natural gas (000's)	1,007	1,657	3,492	7,768
Per mcf	5.20	8.19	4.50	9.56
Oil and liquids as a percent of total revenue	87%	75%	87%	75%
Benchmark Prices				
WTI (U.S.\$ per barrel)	76.03	59.06	61.99	93.04
Edmonton Light Sweet (\$Cdn. per barrel)	76.73	63.21	66.30	102.16
Alberta Plant Gate (per mcf)	4.50	6.42	3.85	7.83
Cdn\$ per U.S.\$	0.95	0.83	0.88	0.99

Arcan posted lower production revenues for the year ended December 31, 2009. Production decreases, combined with the 39 percent decrease in prices Arcan received for its products, resulted in a decrease in revenue for the year ended December 31, 2009 as compared to the year ended December 31, 2008. In the fourth quarter of 2009, revenues decreased 4 percent to \$7.8 million from the \$8.1 million recorded in the fourth quarter of 2008 and decreased to \$27.3 million from \$48.7 million for the year over year comparison. Revenues increased in the fourth quarter from \$6.5 million in the third quarter of 2009 due mainly to price and volume increases. Based on estimated production volume and prices, Arcan expects to have approximately the same revenues in the first quarter of 2010. With improvements in volumes after the first quarter of 2010, Arcan anticipates that 2010 will be higher than 2009.

Commodity Prices

All of Arcan's production is currently sold on the spot market. Oil continues to grow as a percentage of Arcan's total revenues as Arcan invests in increasing its oil production. Arcan's revenue would have been higher except for the impact of the increase of the Canadian dollar versus the U.S. currency. The average price for WTI gained 29 percent in the fourth quarter of 2009 versus the same quarter in 2008 and lost 33 percent on average for the year ended December 31, 2009 over the year ended December 31, 2008. Meanwhile, Edmonton par has only increased 21 percent in the fourth quarter of 2009 versus the same quarter in 2008 and lost 35 percent in the year ended December 31, 2009 over the year ended December 31, 2008 due to the impact of the weakening U.S. currency against the Canadian dollar.

In the fourth quarter of 2009 Arcan realized average revenue per boe of \$62.74 as compared to \$59.95 recorded in the fourth quarter of 2008 and \$55.85 in the third quarter of 2009. Arcan realized an average

of \$73.80 per barrel of oil and NGL in the fourth quarter of 2009, an increase of 16 percent from the \$63.55 per barrel realized in the fourth quarter of 2008 and up from the \$70.18 per barrel received in the third quarter of 2009. The increase in Arcan's oil price for the fourth quarter of 2009 compared to 2008 is consistent with the increase in the Edmonton Light Sweet price for the same period as is the change from the third quarter of 2009 to the fourth. The Corporation realized an average natural gas price of \$5.20 per mcf in the fourth quarter of 2009, a 37 percent decrease from the \$8.19 per mcf averaged in the fourth quarter of 2008 and an increase from the \$3.27 per mcf received in the third quarter of 2009. This is consistent with the price changes at the Alberta Plant gate for the same periods. The changes in Arcan's oil and gas prices for the year ended December 31, 2009 compared to the year ended December 2008 are also consistent with the changes shown in the Edmonton Light Sweet price and the Alberta Plant Gate price. Arcan anticipates oil prices will remain in the U.S.\$65 to U.S.\$95 WTI range for 2010 and that gas prices may soften into the summer of 2010 from current levels. However, commodity prices realized by Arcan are being lowered by the significant and continued appreciation of the Canadian dollar.

Royalty Expense (\$ 000's except per boe)	Quarter Ended December 2009	Quarter Ended December 2008	Year Ended December 2009	Year Ended December 2008
Total	2,554	1,881	7,116	10,819
Per boe	20.53	13.93	14.18	19.73
Royalties as a percent of revenue	32.7%	23.2%	26.1%	22.2%

Royalty expense in the fourth quarter of 2009 was \$2.6 million, compared to \$1.9 million in the fourth quarter of 2008, and for the year ended December 31, 2009 was \$7.1 million, compared to \$10.8 million for the year ended December 31, 2008. These royalty rates are higher on a percentage of revenue basis from the prior year due to increases in royalties in Alberta for 2009 under the new royalty framework. The decrease in the gross royalty amounts, year over year, was primarily the result of decreased revenues based on lower commodity prices. On a per boe basis, changes were attributable to increases in royalties in Alberta for 2009 even though prices declined 39 percent. Royalties were \$2.0 million or 31 percent of revenue in the third quarter of 2009 compared to \$2.6 million or 33 percent of revenue in the fourth quarter. Royalties have increased on a percentage of revenue basis from the third quarter as a result of higher commodity prices. Recent announcements regarding royalty reductions in Alberta suggest that royalties as a percentage of revenue may decline in 2010.

Royalty rates fluctuate with the price of oil and gas as well as when higher rates of production are experienced. On October 25, 2008 the Alberta Government released the New Royalty Framework for Alberta ("NRF") increasing royalties effective January 1, 2009. Subsequently, the province has modified and reduced the royalties a number of times with the latest announcement of changes being made in March 2010. Only the impact of royalties enacted by December 31, 2009 are factored into Arcan's reserves and bank lines. Arcan continues to monitor and plan for the impact of the NRF and subsequent modifications. Based on fluctuating commodity prices and fluctuating modifications to the NRF it is challenging to predict future royalty rates. Accordingly, Arcan anticipates its royalty rates for 2010 to be 20 percent to 40 percent depending on production volumes, prices and possible future royalty changes.

Operating Expenses (\$ 000's except per boe)	Quarter Ended December 2009	Quarter Ended December 2008	Year Ended December 2009	Year Ended December 2008
Total	2,672	2,416	8,082	8,235
Per boe	21.48	17.88	16.11	15.02

In the fourth quarter of 2009, Arcan incurred operating costs of \$21.48 per boe or \$2.7 million, up from the \$17.88 per boe or \$2.4 million recorded in the fourth quarter of 2008. The operating cost increase was as a result of operating workovers. Operating costs decreased to \$8.1 million or \$16.11 per boe for the year ended December 31, 2009, from \$8.2 million or \$15.02 per boe for the year ended December 31, 2008. A significant portion of the overall increase per boe decrease related to lower volumes. Operating costs on a per boe basis increased modestly from the \$21.03 per boe experienced in the third quarter of 2009.

Arcan expects that its per boe operating expenses will decrease in 2010 through higher volumes. Going forward through 2010, Arcan's continued transition towards oil-weighted production, including costs to operate the enhanced recovery, is anticipated to result in \$8 - \$12 per boe average operating costs per unit of production.

Realized loss on commodity contracts and financial instruments (\$ 000's except per boe)	Quarter Ended December 2009	Quarter Ended December 2008	Year Ended December 2009	Year Ended December 2008
Total	737	-	1,440	-
Per boe	5.92	-	2.87	-

The realized loss on commodity contracts was \$0.7 million for the quarter and \$1.4 million for the year ended December 31, 2009, respectively. There are no realized amounts in the prior year's periods as this is Arcan's first commodity contract and it commenced on April 1, 2009. In March 2009, Arcan entered into a fixed price oil swap contract to receive \$64.40 per barrel in exchange for Canadian dollar WTI on oil production of 500 barrels per day for the period from April 1 to December 31, 2009 totalling 137,500 barrels. The purpose of the contract was to protect a portion of Arcan's cash flows until the end of the year. Arcan purchased this contract from its bankers, the Alberta Treasury Branches ("ATB").

Cash G&A (\$ 000's except per boe)	Quarter Ended December 2009	Quarter Ended December 2008	Year Ended December 2009	Year Ended December 2008
Total	788	1,087	3,674	3,529
Per boe	6.34	8.04	7.32	6.44

Cash G&A for 2009 of \$3.7 million was primarily comprised of wages of \$1.8 million, bonuses of \$0.1 million, rent of \$0.5 million, software of \$0.3 million, legal of \$0.1 million, and audit fees of \$0.2 million. The twelve month period of 2009 had higher cash G&A expenses than the twelve month period ended December 31, 2008 and higher cash G&A per boe numbers resulting from the decreased production volumes.

Cash G&A expenses for the fourth quarter of 2009 decreased on a per boe basis to \$6.34 per boe from \$8.04 per boe in the fourth quarter of 2008 and decreased from \$9.07 per boe in the third quarter of 2009 due mainly to decreased legal, insurance, consulting, and reserve evaluation costs. Cash G&A expense is expected to increase overall, but is expected to decline on a per boe basis on average for 2010 due to significant increases in activity levels. Arcan does not capitalize any G&A. In its role as operator of its oil and natural gas properties, the standard industry operating agreements provide for the charging of certain administrative costs to its joint venture capital expenditure programs and well operations.

Interest Expense (\$ 000's)	Quarter Ended December 2009	Quarter Ended December 2008	Year Ended December 2009	Year Ended December 2008
Total	380	291	1,543	1,238
Per boe	3.05	2.15	3.08	2.26

Historically, Arcan's management increased debt levels based on operational success and has subsequently reduced those debt levels through equity issuances. As Arcan has grown its asset base, the related borrowing capacity and Arcan's ability to carry and service higher debt levels has increased. Arcan expects that the debt to 2010 cash flow ratio will be lower as raising equity has been easier and less expensive in the current environment than in prior periods. Arcan estimates that interest expense will increase with higher debt levels and possible rate increases.

Interest expense in the fourth quarter of 2009 of \$0.4 million was modestly lower than the third quarter of 2009 of \$0.5 million. This was due to lower debt levels in the fourth quarter of 2009 compared to the third quarter of 2009. The increase in interest expense from the prior year resulted from an increase in average debt levels. Arcan had an effective interest rate of 4.75 percent on its debt facility at December 31, 2009 compared to 4.50 percent at December 31, 2008.

Subsequent to the 2009 year end, Arcan has continued to increase its draws on its bank facility and expects to carry bank debt as required as part of routine operations on an ongoing basis. Based on Arcan's assets, the bank line was increased from \$40 million at the start of 2008 to \$50 million at the start of 2009 with the potential to increase to \$70 million in 2010, subject to completion of bank review and approval.

Stock-Based Compensation (\$ 000's except per boe)	Quarter Ended December 2009	Quarter Ended December 2008	Year Ended December 2009	Year Ended December 2008
Total	391	337	942	873
Per boe	3.14	2.50	1.88	1.59

Stock-based compensation is a non-cash expense, which represents the estimated fair value of performance and other stock options granted to employees as a motivational incentive. Arcan expects stock-based compensation to increase as new options are issued, but decrease on a per unit basis as volumes increase. No stock-based compensation is capitalized.

Arcan recorded stock-based compensation expense of \$0.4 million in the fourth quarter of 2009, calculated using the Black-Scholes option-pricing model. During the fourth quarter of 2009 Arcan granted 1,183,500 options, no options were exercised and Arcan cancelled 48,334 options that were forfeited. The stock-based compensation expense increases for the three month period and year ended December 2009 compared to the same periods in 2008 were due to option grants in the fourth quarter of 2009, and a greater number of options being issued in the fourth quarter of 2009 versus 2008.

Depletion, Depreciation and Accretion ("DD&A") (\$ 000's except per boe)	Quarter Ended December 2009	Quarter Ended December 2008	Year Ended December 2009	Year Ended December 2008
Total	2,899	3,135	11,707	14,582
Per boe	23.31	23.20	23.34	26.59

Depletion and depreciation are calculated based upon capital expenditures, production rates and reserves. Arcan recorded \$2.9 million or \$23.31 per boe in DD&A expense in the fourth quarter of 2009 based on production volumes of 124,385 boe. The consistency in DD&A expense per boe as compared to the fourth quarter of 2008 is due to the production, reserves, and capital not changing significantly over the two periods. The 12 percent decrease to \$23.34 per boe for the year ended December 31, 2009 versus the \$26.59 in the same period in 2008 is a result of increased capital efficiencies on investments in 2009. DD&A per boe in the fourth quarter of 2009 increased only slightly over the third quarter of 2009, where Arcan recorded \$22.87.

Arcan's DD&A rate reflects proportionately higher cumulative capital expenditures, including significant facility investments, relative to recognized reserves. Arcan's two main properties are in the early stages of enhanced recovery schemes and substantial amounts of capital have been invested in infrastructure. The Corporation expects to decrease the depletion per boe amount in future years by adding reserves through a development program that has a lower capital intensity as a large portion of infrastructure investments have already been incurred.

The Corporation excluded from its depletion and depreciation calculation costs associated with undeveloped land and seismic of \$9.8 million and included future development costs of \$27.6 million.

Arcan uses the asset retirement obligation method to record the present value of estimated clean-up and restoration costs for all of its facilities, including well sites and pipelines. The liability amount is increased each reporting period due to the passage of time and the amount of accretion is charged to earnings in the period.

Income Taxes (\$ 000's)	Quarter Ended December 2009	Quarter Ended December 2008	Year Ended December 2009	Year Ended December 2008
Future income tax reduction (expense)	354	496	1,469	(2,410)

The difference between the expected income tax provision based on the combined federal and provincial statutory tax rate and the amount actually provided for is as follows:

(\$ 000's)	Year Ended December 2009	Year Ended December 2008
Combined federal and provincial statutory rate	29.0%	29.5%
Expected future income tax (recovery) expense	(2,091)	2,776
Stock-based compensation	273	258

Future tax rate reductions and other	349	(624)
Future income tax (reduction) expense	(1,469)	2,410

A future tax reduction of approximately \$0.4 million has been recognized in the financial statements for the fourth quarter of 2009, which relates to the Corporation experiencing a pre-tax loss of \$1.7 million for the quarter. The provision for income taxes differs from the amount obtained by applying the combined federal and provincial income tax rate for 2009, which was 29.0 percent and is calculated on the loss before income taxes. The difference is mainly due to non-deductible stock-based compensation and future tax rate differences.

The future income tax liability on the balance sheet decreased by \$1.7 million during 2009 due to the future income tax reduction of \$1.5 million and a future income tax asset from share issue costs of \$0.2 million. Prior to the December 31, 2010 deadline, Arcan intends to complete the \$1.5 million of qualifying expenditures required to meet its 2010 flow-through share obligations based on the 1,071,500 flow-through shares Arcan issued on November 20, 2009 at \$1.40 per flow-through share.

The components of the future income taxes are as follows:

(\$ 000's)	Year Ended December 2009	Year Ended December 2008
Share issue costs	(389)	(440)
Asset retirement obligations	(1,343)	(1,196)
Non-capital losses	(7,552)	(3,469)
Property, plant and equipment	13,971	11,521
Future income taxes	4,687	6,416

Arcan has not paid any cash taxes since inception and has accumulated sufficient tax deductions such that it does not anticipate paying any taxes for 2010. However, Arcan is not able to forecast future possible changes in federal and provincial tax regimes. Arcan estimates its tax pools as follows:

Estimated Tax Pools

(\$ 000's)	December 31, 2009	Rate of Claim (%)
Type		
Canadian exploration expense	16.2	100
Non-capital losses	30.2	100
Canadian development expense	25.6	30
UCC	25.1	20 - 100
Share issue	1.5	20
Canadian oil and natural gas property expense	17.3	10
Total	115.9	

With estimated capital spending in 2010 and 2011, Arcan does not believe it will be in a taxable position until late 2012 at the earliest.

Net Income (Loss), Funds From Operations and Cash Flow From Operating Activities

(\$ 000's except per share)	Quarter Ended December 2009	Quarter Ended December 2008	Year Ended December 2009	Year Ended December 2008
Net income (loss)	(1,730)	(772)	(5,743)	7,001
Per share	(0.04)	(0.02)	(0.15)	0.19
Funds from operations	667	1,987	5,345	24,553
Per share	0.02	0.05	0.14	0.65
Cash flow from (used in) operating activities (per GAAP)	(371)	4,590	4,328	23,969
Per share	(0.01)	0.12	0.11	0.64

Arcan is generating funds from the operations of its three core properties. Net loss has been realized in 2009 due to lower commodity prices and volumes and increased royalties as well as non-cash items such as stock-based compensation and DD&A charges. As Arcan continues to develop these properties, it anticipates that additional revenues will be generated resulting in additional funds from operations as well as additional net earnings.

Summary of Quarterly Operating and Financial Results for the Eight Most Recent Quarters

Fiscal quarter ended	2009				2008			
	Dec.	Sept.	June	March	Dec.	Sept.	June	March
Operating								
Oil and NGLs (barrels per day)	1,001	913	1,061	1,110	1,102	1,087	1,241	1,083
Price (\$/barrel)	73.80	70.18	63.98	49.36	63.55	118.63	118.48	93.32
Natural gas (mcf per day)	2,105	2,166	2,772	1,444	2,199	2,144	2,174	2,366
Price (\$/mcf)	5.20	3.27	4.09	6.17	8.19	9.26	12.17	8.72
Barrels of oil equivalent (boe per day)	1,352	1,274	1,523	1,350	1,468	1,444	1,604	1,477
Financial (\$000's, except per share amounts)								
Revenues								
Petroleum and natural gas	7,804	6,546	7,209	5,731	8,099	13,690	15,793	11,075
Royalties	(2,554)	(2,010)	(1,275)	(1,277)	(1,881)	(3,681)	(2,876)	(2,380)
Interest and other income	1	-	2	1	(220)	207	14	28
Realized loss on commodity contracts	(737)	(481)	(222)	-	-	-	-	-
Unrealized gain (loss) on commodity contracts	531	1,228	(1,115)	(644)	-	-	-	-
Net revenues	5,045	5,283	4,599	3,810	5,998	10,216	12,931	8,723
Expenses								
Operating	2,672	2,465	1,593	1,352	2,416	2,482	1,832	1,506
General and administrative	788	1,063	959	863	1,086	672	1,089	682
Stock-based compensation	391	166	193	193	337	159	187	189
Interest	380	494	398	272	291	311	337	298
Accretion	103	104	105	101	99	88	85	83
Depletion and depreciation	2,795	2,680	3,098	2,720	3,036	3,553	3,960	3,679
Total Expenses	7,130	6,972	6,346	5,501	7,265	7,265	7,490	6,437
Income (loss) before income taxes	(2,085)	(1,689)	(1,747)	(1,690)	(1,269)	2,951	5,441	2,286
Future income tax expense (reduction)	(354)	(281)	(433)	(400)	(495)	806	1,458	641
Net income (loss)	(1,730)	(1,408)	(1,314)	(1,290)	(772)	2,145	3,983	1,645
Net income (loss) per share- basic	(0.04)	(0.04)	(0.03)	(0.03)	(0.02)	0.06	0.11	0.04
Net income (loss) per share- diluted	(0.04)	(0.04)	(0.03)	(0.03)	(0.02)	0.05	0.10	0.04
Funds from operations	667	32	2,680	1,966	1,987	6,747	9,617	6,203
Per share – basic	0.02	0.00	0.07	0.05	0.05	0.18	0.25	0.17
Cash flow from (used in) operating activities (per GAAP)	(371)	1,235	2,102	1,361	4,590	7,150	9,665	2,564
Operating Netbacks (\$/boe)								
Petroleum and natural gas revenues	62.74	55.85	52.01	47.16	59.95	103.03	108.21	82.37
Royalties	20.53	17.15	9.20	10.51	13.93	27.71	19.71	17.70
Operating and transportation expenses	21.48	21.03	11.50	11.12	17.88	18.68	12.55	11.20
Operating Netbacks	20.73	17.67	31.31	25.53	28.15	56.64	75.95	53.47
Total assets (\$000's)	151,251	146,130	145,729	150,398	149,724	143,006	132,263	133,213
Capital expended (\$000's)	4,979	3,111	229	3,177	9,980	11,323	4,062	9,556
Debt and working capital (\$000's)	(34,779)	(42,622)	(40,414)	(42,073)	(40,406)	(32,412)	(27,835)	(33,495)
Shares (000's)	47,940	37,869	37,869	37,869	37,869	37,869	37,869	37,827

Liquidity and Capital Resources

Arcan incurred \$11.5 million on its properties during the year ended December 31, 2009, down significantly from \$34.9 million for the year ended December 31, 2008. Arcan generated \$5.3 million in funds from operations in 2009, and at December 31, 2009 had borrowed \$28.6 million from its bank loan facility and had a working capital deficit including bank debt of \$34.8 million as at December 31, 2009. With its solid asset base Arcan estimates that it has the ability to generate short-term and long-term cash flow to meet obligations as they become due. Arcan's management decreased debt levels from the fourth quarter of 2008 through reduced capital expenditures in 2009 and through issuing equity. Arcan's 2009 funds from operations to net debt was 13.0 to one. The ratio is expected to decrease to under 2:1 by the end of 2010.

As at the date hereof, the Corporation has a \$50.0 million revolving credit facility with a Canadian chartered bank, based on a December 31, 2008 reserves report, and is in compliance with its banking covenants. The renewal date for the loan is April 30, 2010. As previously announced, Arcan has entered into an agreement to potentially expand to a \$70 million credit facility (the "New Credit Facility"). It is expected that the New Credit Facility will consist of a \$60 million syndicated revolving credit facility and a \$10 million revolving operating facility. The New Credit Facility will replace Arcan's existing \$50 million credit facilities with ATB, of which approximately \$32 million is currently drawn. The borrowing base for the New Credit Facility will be determined by the lenders prior to the closing of the facilities. The New Credit Facility will have a revolving period of 364 days from the closing date, extendible annually. If not extended, the New Credit Facility will automatically convert to a one year non-revolving term loan.

The New Credit Facility will be secured by a charge on all of Arcan's assets. The New Credit Facility will include customary positive and negative covenants by Arcan in favour of the lenders. The New Credit Facility is subject to syndication of a portion of the commitment to other lenders by ATB, the completion of customary definitive documentation (including security documents) and the completion of the acquisition of the Acquired Assets in a manner satisfactory to the lenders. Closing of the New Credit Facility is expected to occur in early May, 2010.

On March 24, 2010 Arcan issued 26,000,000 subscription receipts at \$2.50 per subscription receipt for gross proceeds of \$65.0 million. Each subscription receipt entitled the holder to receive, without payment of additional consideration, one common share of Arcan on the exercise or deemed exercise of the subscription receipt. All of the subscription receipts were exercised on March 31, 2010. The proceeds of this equity deal were primarily used to fund the Acquisition (at a cost of \$53.3 million). The balance of the \$11.7 million is to be applied to the capital program.

Arcan was previously engaged in a substantial capital expenditure program to develop its two core oil and one natural gas property. Arcan anticipates that future capital requirements will be funded through a combination of internal cash flow, debt and/or equity financing.

Arcan estimates that at April 22, 2010, due to capital expenditures in the Swan Hills, its debt and working capital deficiency is approximately \$48 million, which is below its current and anticipated potential debt facility. Arcan estimates that it will have cash flow in excess of capital expended in the second and possibly the third quarter of 2010. Arcan expects to be in a net debt position of \$35 - \$70 million throughout 2010.

Arcan expects its capital expenditure program to be significantly higher in 2010 than in 2009 and expects the expenditures to be financed through its bank facility and available funds from operations. Additional equity may be available later in 2010 if the condition of equity markets permit; however, the Corporation does not forecast requiring this cash inflow to complete its capital program. The capital program can be curtailed with no fixed commitments to ensure management of net debt levels.

The components of Arcan's working capital deficiency are as follows:

(\$ 000's)	Year Ended December 2009	Year Ended December 2008
Current assets	10,947	9,886
Less:		
Accounts payable and accrued liabilities	17,140	20,659
Bank loan	28,586	29,633
Working capital (deficiency)	<u>(34,779)</u>	<u>(40,406)</u>

Arcan issued 9,000,000 common shares at a price of \$1.25 per share for gross proceeds of \$11,250,000 and 1,071,500 flow-through shares at a price of \$1.40 per share for gross proceeds of \$1,500,100, during 2009.

Capital Expenditures (\$ 000's)	Quarter Ended December 2009	Quarter Ended December 2008	Year Ended December 2009	Year Ended December 2008
Geological and geophysical	130	72	243	509
Land	33	760	504	961
Acquisitions	-	(1,650)	-	2,318
Drilling and completions	3,526	7,822	6,497	24,435
Equipment and facilities	1,286	2,932	4,167	9,337
Corporate assets	4	45	84	245
Total	<u>4,979</u>	<u>9,980</u>	<u>11,495</u>	<u>37,805</u>

Arcan decreased its capital expenditure program for the year ended December 31, 2009. During the period, Arcan drilled six (3.7 net) wells. In addition, Arcan converted one (0.5 net) well to an injector, converted one (0.8 net) oil well to a source well and worked over several wells. Arcan has, as with 2009, budgeted capital expenditures to remain within cash flow and bank line limitations for 2010. This budget will be reviewed during the break-up period based on Arcan's success in the Swan Hills reef light oil play.

Capital expenditures for the fourth quarter of 2009 were \$5.0 million. This was down from the \$10.0 million spent in the fourth quarter of 2008. At the end of the fourth quarter of 2008 Arcan sold its interests in one gas well in the McLeod area for \$1.7 million. During the fourth quarter Arcan expended \$3.5 million drilling three (1.7 net) wells and \$1.3 million on completing tie-in operations on these wells.

Capital Expenditure Summary

(\$ millions)	Q4 2009	Q3 2009	Q2 2009	Q1 2009	YTD December 31, 2009
Land and seismic	0.2	0.3	0.2	0.2	0.9
Drilling and intangibles	3.5	1.9	-	1.1	6.5
Facilities and equipment	1.3	0.9	-	1.9	4.1
Total Capital	5.0	3.1	0.2	3.2	11.5

2009 Drilling Activity

2009	Exploration		Development		Total		Success Rate %	Working interest %
	Gross	Net	Gross	Net	Gross	Net		
Q1	1	0.5	-	-	1	0.5	100	50
Q2	-	-	-	-	-	-	-	-
Q3	1	0.5	1	0.5	2	1.0	50	50
Q4	-	-	3	1.7	3	1.7	100	56
Total	2	1.0	4	2.2	6	3.2	83	53

During the three month period ended December 31, 2009, Arcan drilled three (1.7 net) wells, which resulted in one (0.5 net) source well, one (0.5 net) Hamburg oil well and one (0.7 net) vertical Swan Hills oil well.

During the three months ended March 31, 2010 Arcan drilled two (1.8 net) successful horizontal multi-stage fracture wells on its Swan Hills reef light oil play.

Insurance

Arcan purchases insurance to protect corporate assets from catastrophic events. There are many factors to consider when determining appropriate insurance levels, including risks, probability and costs. Arcan carries \$25 million in per well drilling, \$11 million in production insurance for each of its two main properties, \$60 million in general corporate liability insurance, as well as \$15 million in director's and officer's insurance. Insurance levels are reviewed annually in December and modified as required to maintain reasonable coverage for a range of possible situations. Arcan's insurance levels are similar to coverage levels maintained by its peer groups.

Related Party Transactions

In conjunction with the equity issuance in October 2009, certain officers and directors acquired 340,000 common shares at \$1.25 per share.

In conjunction with the equity issuance in March 2010, certain officers and directors acquired 68,000 common shares at \$2.50 per share.

A share purchase loan of \$100,000 is due from an officer of the Corporation for the purchase of 40,000 common shares at a price of \$2.50 per common share. This loan is repayable, with interest calculated at the "Prescribed Rate" as determined by the Canada Revenue Agency, currently 1 percent, on or before April 3, 2012. This loan is secured by the underlying common shares.

Contractual Obligations

The Corporation has entered into farm-in agreements in the normal course of its business in 2009.

Arcan has the following commitments:

(a) Future minimum lease payments relating to operating lease commitments are:

	\$
2010	238,500
2011	244,125
2012	249,750
2013	249,750
2014	249,750
2015 and thereafter	374,625

(b) As a requirement of a sublease for office premises, Arcan has provided a letter of guarantee in favour of the lessor for a three year period on a declining basis as follows:

	\$
March 2009 to February 2010	120,000
March 2010 to February 2011	60,000

Off-Balance Sheet Arrangements

There were no off-balance sheet obligations at December 31, 2009.

Outstanding Share Data

Arcan's issued share capital consists of:	Year Ended December 2009	Year Ended December 2008	April 22, 2010
Common shares	47,940,060	37,868,560	75,058,571
Warrants	586,631	586,631	328,120
Performance warrants	750,000	1,500,000	-
Stock options	4,671,166	3,638,500	7,359,000

In 2009, the number of issued and outstanding common shares increased by 10,071,500 shares. The number of issued and outstanding common shares increased as a result of an equity deal for 9.0 million shares in October and a flow-through equity deal for 1.1 million shares in November of 2009. The number of outstanding performance warrants decreased during 2009 as 750,000 of them expired during the year. The number of outstanding stock options changed due mainly to 1.2 million options issued on November 19, 2009 to officers, directors and employees of the Corporation. Since the end of 2009, Arcan has issued 26 million common shares at \$2.50 per common share for gross proceeds of \$65.0 million on March 31, 2010. The main proceeds of this equity deal were used to fund the Acquisition. The number of outstanding stock options changed since the end of 2009 due mainly to 2.7 million options issued on April 1, 2010 to officers, directors and employees of the Corporation and the remaining 750,000 performance warrants were exercised before expiry on March 1, 2010.

None of the officers or directors of Arcan at December 31, 2009 exercised any options or sold any shares of Arcan during the year ended December 31, 2009. Two officers and one employee of the Corporation exercised 750,000 performance warrants prior to their expiry on March 1, 2010. One of these officers sold 250,000 shares on January 22, 2010 at \$2.10 per share. There were no other sales or exercises of options since the end of the year by officers or directors. Officers of the Corporation purchased 340,000 common shares in the October financing and directors and employees purchased 68,000 common shares in the March 31, 2010 equity deal.

Outlook

The application of the horizontal multi-stage acid fracture wells to the Swan Hills reef property is changing Arcan's asset base. The Acquisition and drilling, combined with water injection are expected to generate significantly increased production and recoveries creating significantly enhanced reserves and NAV. With significant investments in infrastructure in place, Arcan now looks to continue to rapidly take advantage of its deep development inventory to continue to increase NAV per share through horizontal multi-stage acid fracture wells in the Swan Hills reef play. Arcan's plans for 2010 and beyond include:

- significant expansion of drilling horizontal multi-stage fracture wells in the Swan Hills reef light oil play on its 140 net sections of land. Arcan also intends to increase capacity at the battery and increase and expand the existing water injection scheme;
- continued development and water injection in the Hamburg GG pool; and
- ongoing review of opportunities at in the McLeod area.

Arcan's 2010 capital program is expected to remain within cash flow and expanded debt capacities and will continue to focus mainly on rapid growth through in the Swan Hills. Arcan is currently developing a strategy to best exploit its land base over the long term. The Corporation's strengths include over \$170 million of tax pools, a strong slate of directors, experienced staff, excess productive capacity for tie-in, recently initiated and growing waterfloods, new drilling plans and significant growth potential.

Industry Trends

There are a number of trends that have been developing in the oil and gas industry during the past several years that appear to be shaping the near future of the business.

The first trend currently affecting the oil and gas industry, as well as many other industries, is the impact on capital markets caused by investor uncertainty in the credit markets and the global economy through 2009 and into 2010. Global economics ultimately dictate commodity demand and therefore prices. Arcan realizes that it is dependent on price fluctuations, is a price taker and therefore must maintain financial flexibility to deal with uncertain commodity prices. The competitive nature of the oil and gas industry has resulted in selective opportunities for equity financings. Arcan is unable to estimate the timing or magnitude of stock market corrections in the context of the current global economic situation.

A second trend is the volatility of commodity prices. Natural gas is a commodity increasingly influenced by liquified natural gas coming from outside of North America and intensive shale gas drilling within North America. In addition, North American fluctuations in supply, influenced by drilling activity, natural gas storage levels, imports and demand (which is impacted both by weather and by economic factors) has resulted in significant volatility in the price of natural gas in Canada and the United States.

Crude oil is influenced by the world economy and the ability of the Organization of Petroleum Exporting Countries to adjust supply to world demand. Recently, crude oil prices have been kept high by increased demand from growing economies in China and India as well as the ongoing political events causing disruptions in the supply of oil, and concern over potential supply disruptions triggered by unrest in the Middle East. More recently, volatility has increased over short term demand concerns as a result of the slowing economy in the United States as well as globally.

The impact on the oil and gas industry from commodity price volatility is significant. Historically, during periods of high prices, producers generated higher cash flows and conducted active exploration programs without external capital. Higher commodity prices frequently translate into very busy periods for service suppliers triggering premium costs for their services. Purchasing land and properties similarly increase in price during these periods. More recently the significant negative impact of regulatory changes combined with a period of lower natural gas prices and oil prices has dramatically reduced activity as all producers have little or no access to capital. With decreased activity, the prices charged by the various service suppliers has and will continue to decline.

A third trend has been the pronounced lack of equity capital available to the sector partially as a result of the Province of Alberta's continued amendments to the provincial royalty program. Drilling incentive programs are aimed at stimulating drilling activity and newly announced modifications are aimed at reducing maximum royalties to 40 percent on January 1, 2011. It is expected that equity capital will continue to be volatile as issues surrounding these announcements are clarified and the market fully corrects for the potential implications of the modifications to the Alberta royalty system. As a result of proposed changes and the instability related to risks of numerous future modifications, it may continue to be more difficult for junior oil and gas companies to find equity financing which may continue to impact the liquidity and valuation of securities of such companies.

Arcan's need for capital will be both short-term and long-term in nature. Short-term working capital will be required to finance accounts receivable, drilling deposits and other similar short-term assets, while the acquisition, exploration and development of oil and natural gas properties requires substantial amounts of long-term capital. In addition to equity financing, Arcan uses several sources of financing, including internally generated cash flow and bank debt. Current economic conditions including the negative global impact on credit and equity markets have elevated the risks associated with this aspect of Arcan's business. To mitigate capital risks, Arcan has raised equity and is in the process of re-negotiating and syndicating its loan to remain within its projected cash flow and available bank lines.

A fourth trend has been the Government of Canada's alteration of the taxation of publicly traded royalty trusts. On October 31, 2006, the Government of Canada announced its intention to begin taxing income trusts, including trusts that hold oil and gas properties. This announcement has caused significant volatility in the unit prices of these trusts as the market corrected for this announcement and as the clarification of the rules surrounding the implementation of trust taxation continues to unfold. As oil and gas trusts have been significant acquirers of junior exploration and production companies, the volatility of the trust market has been mirrored by junior exploration and production companies. Prior to the announcement regarding the new legislation, many junior oil and gas companies were able to divest themselves to the larger income trusts entities when there was a business advantage to do so. As a result of the proposed changes, trusts are converting back to corporations and it may be more difficult for junior oil and gas companies to find an efficient route for divestment which may impact the liquidity and valuation of securities of such companies.

A fifth trend, and one that will continue to garner heightened attention and consequently increased governmental intervention, is an increasing call for carbon capture due to greenhouse gas emissions. Capital requirements to meet emission standards could be enormous and is directly impacted by events such as the Kyoto Protocol. Arcan realizes that it will be required to meet governmental standards as they are introduced and must maintain the financial flexibility to do so. A longer term advantage may be derived from the waterflood activities and related increased recoveries in the Swan Hills property, as it is likely a leading candidate for carbon dioxide flooding.

A sixth trend, has been the rapid adoption of the use of horizontal drilling, employing multiple stage fracturing techniques for completions. Significant but less producing previously discovered oil and natural gas reservoirs in tight formations such as the Baken, Montney, Doig, Cardium, Pekisoko and the Beaverhill Lake are being revitalized based on the tremendous increases in productive rates. Arcan has been positively impacted through drilling its first horizontal well and announcing those results and as well as the Acquisition and related financing. Arcan plans to continue to develop and expand its current acreage and drilling inventory position.

Business Risks

Arcan is engaged in the business of exploration, development, production and acquisition of crude oil and natural gas. This business has many risks that even a combination of knowledge, experience and careful evaluation may not be able to overcome. These risks may cause Arcan's actual performance and financial results in future periods to differ materially from any estimates or projections of future performance or results expressed or implied by forward-looking information in this MD&A.

Arcan's principal business risks are related to finding and developing economic hydrocarbon reserves efficiently and its ability to fund the capital expenditure program. Without the ongoing addition of new oil and natural gas reserves, any existing reserves Arcan has, and the production therefrom, will decline over time as the existing reserves are produced. A future increase in Arcan's reserves will depend not only on its ability to explore and develop any properties it has, but also on its ability to acquire suitable producing properties or prospects. No assurance can be given that further commercial quantities of oil and natural gas will be discovered or acquired by Arcan.

In addition to the risks outlined above with respect to commodity prices, financial risks associated with the petroleum industry include fluctuations in interest rates, and currency exchange rates. Arcan may use hedging instruments to manage these risks at the direction and under the supervision of the Board of Directors. Operational risks include competition, environmental factors, reservoir performance uncertainties, a complex regulatory and taxation environment and safety concerns.

The supply of service and production equipment at competitive prices is critical to the ability to add reserves at a competitive cost and produce the reserves in an economic and timely fashion. In periods of increased activity, these services and supplies can become difficult to obtain. Arcan attempts to mitigate this risk by developing strong long-term relationships with suppliers and contractors, and by maintaining an appropriate inventory of production equipment.

Arcan's longest producing Swan Hills horizontal well has been on since February 23, 2010. This limited time frame for data creates risks for unexpected production profiles. Arcan has confidence that it can, due to production history through vertical well control, mitigate some of this operational risk.

Arcan attempts to manage its business risks. Firstly, Arcan has an experienced, talented, and highly motivated staff of oil and natural gas professionals. Arcan also operates almost all of its properties. This enables Arcan to control the timing, direction and costs related to exploration and development opportunities. Arcan's geological focus is on areas in which the prospects are well understood by management. Technological tools are regularly used to reduce risk and increase the probability of success. Arcan closely follows all government regulations and has an up-to-date emergency response plan that has been communicated to field operations by management. Arcan also carries insurance coverage to attempt to minimize potential losses.

Application of Critical Accounting Estimates

The significant accounting policies used by Arcan are disclosed in note 2 to the audited Consolidated Financial Statements for the years ended December 31, 2009 and 2008. Certain accounting policies require that management make appropriate decisions with respect to the formulation of estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Management reviews its estimates on a regular basis. The emergence of new information and changed circumstances may result in actual results or changes to estimated amounts that differ materially from current estimates. The following discussion identifies the critical accounting policies and practices of the Corporation and helps assess the likelihood of materially different results being reported.

Reserves

Under the National Instrument 51-101 – *Standards of Disclosure for Oil and Gas Activities* ("**NI 51-101**"), "Proved" reserves are defined as those reserves that can be estimated with a high degree of certainty to be recoverable. The level of certainty should result in at least a 90 percent probability that the quantities actually recovered will equal or exceed the estimated Proved reserves. It does not mean that there is a 90 percent probability that the Proved reserves will be recovered; it means there must be at least a 90 percent probability that the given amount or more will be recovered.

"Proved plus Probable" reserves are the most likely case and are based on a 50 percent certainty that they will equal or exceed the reserves estimated.

These oil and gas reserve estimates are made using all available geological and reservoir data, as well as historical production data. All of the Corporation's reserves were evaluated and reported on by an independent qualified reserves evaluator. However, revisions can occur as a result of various factors including: actual reservoir performance, changes in price and cost forecasts or, a change in the Corporation's plans. Reserve changes will impact the financial results as reserves are used in the calculation of depletion and are used to assess whether asset impairment occurs. Reserve changes also affect other non-GAAP measurements such as finding and development costs, recycle ratios and net asset value calculations.

Depletion and Depreciation

The Corporation follows the full cost method of accounting for oil and natural gas properties. Under this method, all costs related to the acquisition of, exploration for and development of oil and natural gas reserves are capitalized whether successful or not. Depletion of the capitalized oil and natural gas properties and depreciation of production equipment which includes estimated future development costs less estimated salvage values are calculated using the unit-of-production method, based on production volumes in relation to estimated proven reserves.

An increase in estimated proved reserves would result in a reduction in depletion expense. A decrease in estimated future development costs would also result in a reduction in depletion expense.

Unproved Properties

The cost of acquisition and evaluation of unproved properties are initially excluded from the depletion calculation. An impairment test is performed on these assets to determine whether the carrying value exceeds the fair value. Any excess in carrying value over fair value is an impairment. When proved reserves are assigned or a property is considered to be impaired, the cost of the property or the amount of the impairment will be added to the capitalized costs for the calculation of depletion.

Ceiling Test

The ceiling test is a cost recovery test intended to identify and measure potential impairment of the value of assets relative to the cost of those assets as carried on the Corporation's balance sheet. An impairment loss is recorded if the sum of the undiscounted cash flows (assuming certain commodity prices, operating costs, royalty rates and other deductions) expected from the production of the proved reserves and the lower of cost and market of unproved properties does not exceed the values of the petroleum and natural gas assets as carried in the Corporation's balance sheet. An impairment loss is recognized to the extent that the carrying value exceeds the sum of the discounted cash flows expected from the production of proved and probable reserves and the lower of cost and market of unproved properties. The cash flows are estimated using the future product prices and costs and are discounted using the risk free rate. By their nature, these estimates are subject to measurement uncertainty and the impact on the financial statements could be material. Any impairment as a result of this ceiling test will be charged to operations as additional depletion and depreciation expense.

A ceiling test was performed quarterly by the Corporation and at each testing period, the Corporation had sufficient value of the Corporation's proved and probable reserves under the formula to cover the value of the petroleum and natural gas assets as carried on the Corporation's balance sheet.

Asset Retirement Obligations

The Corporation records a liability for the fair value of legal obligations associated with the retirement of petroleum and natural gas assets. The liability is equal to the discounted fair value of the obligation in the period in which the asset is recorded with an equal offset to the carrying amount of the asset. The liability then accretes to its fair value with the passage of time and the accretion is recognized as an expense in the financial statements. The total amount of the asset retirement obligation is an estimate based on the Corporation's net ownership interest in all wells and facilities, the estimated costs to abandon and reclaim the wells and facilities and the estimated timing of the costs to be incurred in future periods. The total amount of the estimated cash flows required to settle the asset retirement obligation, the timing of those cash flows and the discount rate used to calculate the present value of those cash flows are all estimates subject to measurement uncertainty. Any change in these estimates would impact the asset retirement liability and the accretion expense.

Income Taxes

The determination of income and other tax liabilities requires interpretation of complex laws and regulations. All tax filings are subject to audit and potential reassessment after the lapse of considerable time. In addition, the Corporation estimates when its temporary differences are expected to reverse and recognizes its tax assets and liabilities based on the legislated tax rate in those periods. Accordingly, the actual income tax liability may differ significantly from that estimated and recorded by management.

Stock-Based Compensation

The Corporation applies the fair value method for valuing stock option grants. This method requires the Corporation to make estimates of expected stock volatility, the expected hold period prior to exercising options, expected forfeitures of options and expected dividends to be declared by the Corporation. The calculation of the fair value of stock based compensation is not adjusted for the value actual received by the optionees. The stock-based compensation expense will not represent the actual fair value received by

the optionees as the fair value is estimated at the time of grant and is not adjusted. Due to the time period and the number of estimates involved, it is likely that the actual value of the options will differ from what has been recorded in the financial statements.

Other Estimates

The accrual method of accounting requires management to incorporate certain estimates including estimates of revenues, royalties and operating costs as at a specific reporting date, but for which actual revenues and costs have not yet been received. In addition, estimates are made on capital projects which are in progress or recently completed where actual costs have not been received by the reporting date. The Corporation obtains the estimates from the individuals with the most knowledge of the activity and from all project documentation received. The estimates are reviewed for reasonableness and compared to past performance to assess the reliability of the estimates. Past estimates are compared to actual results in order to make informed decisions on future estimates.

Changes in Accounting Policies

Goodwill and Intangible Assets

In February 2008, the Canadian Institute of Chartered Accountants (the "CICA") issued Section 3064, Goodwill and Intangible Assets. Effective for fiscal years beginning on or after October 1, 2008, this section provides guidance on the recognition, measurement, presentation and disclosure for goodwill and intangible assets, other than the initial recognition of goodwill or intangible assets acquired in a business combination. The Corporation adopted the new standard for the year ended December 31, 2009. Adoption of the standard did not have any impact on the Corporation's results of operations or financial position.

Financial Instruments – Disclosures

In June 2009, the CICA amended Section 3862, "Financial Instruments – Disclosures." These amendments include a hierarchy of methods used to determine the fair value of financial instruments at the balance sheet date. Level 1 inputs are based on quoted prices in active markets the Corporation has the ability to access at the measurement date. Level 2 inputs are based on quoted prices in markets that are not active or based on prices that are observable for the asset or liability. Level 3 inputs are based on unobservable inputs for the asset or liability. These additional disclosures, effective December 31, 2009, are included in note 11 and did not have a significant impact on the Corporation's financial statements.

Future Accounting Policies

International Financial Reporting Standards

Effective January 1, 2011, Canadian public companies are required to adopt International Financial Reporting Standards ("IFRS"). In the time leading up to the conversion date, some existing Canadian standards will change to converge with IFRS. Arcan's financial statements up to and including the December 31, 2010 financial statements will continue to be reported in accordance with Canadian GAAP as it exists on each reporting date. Financial statements for the quarter ended March 31, 2011, including comparative amounts, will be prepared on an IFRS basis.

A transition plan is in place to convert the financial statements to IFRS. Training has been provided to key employees and the Corporation continues to assess the effect of the transition on information systems, internal controls over financial reporting and disclosure controls and procedures. Systems and controls are being updated as IFRS accounting processes are implemented. Analysis and quantification of differences between IFRS and Arcan's current accounting policies is continuing. Some accounting policies may change on adoption of IFRS even though Arcan's current accounting policies are acceptable under IFRS. Changes in accounting policy may materially impact the financial statements.

There are several significant accounting policy changes anticipated on adoption of IFRS. Changes in IFRS prior to adoption may result in other accounting policy changes which could significantly impact the financial statements. Numerous accounting policy changes will be made under IFRS, with the most

significant changes expected to include accounting for petroleum and natural gas ("P&NG"), assets and equipment accounting for business combinations and accounting for future taxes.

Petroleum and Natural Gas Assets

IFRS standards require that a company choose to report their P&NG assets either at the amount which would have been recorded had the company always followed current IFRS standards or at fair value on the date of adoption of IFRS. Alternatively, IFRS standards allow for a conversion exemption whereby companies can choose to record opening petroleum and natural gas properties at a deemed cost equal to historic cost as calculated under Canadian GAAP. Arcan currently intends to elect to record P&NG assets at historic cost as calculated under Canadian GAAP on January 1, 2010.

Under Canadian GAAP, all P&NG assets are accounted for under the full cost accounting guideline. Under IFRS, P&NG assets will be divided into exploration and evaluation properties ("**E&E assets**") and petroleum and natural gas properties and equipment ("**development assets**"). E&E assets will initially be capitalized and accumulated pending determination of technical feasibility and economic viability. E&E assets will not be depreciated and will be carried at cost less any accumulated impairment losses. Development assets will be measured at cost less accumulated depletion and depreciation and any accumulated impairment losses.

Both E&E assets and development assets will be assessed to determine whether impairment losses exist under IFRS as at January 1, 2010. These impairment tests will differ from the current Canadian GAAP full cost ceiling test in several significant ways. Assets (including goodwill) will be allocated to Cash Generating Units ("**CGU's**") and a separate impairment test will be completed for each CGU identified. Under current Canadian GAAP the ceiling test is a two step test. The carrying value of assets is first compared to the undiscounted future cash flows. If the carrying value of the assets exceeds the undiscounted future cash flows, then the second step of the test is required whereby the assets are written down to the value of the discounted future cash flows. Under IFRS, the impairment test compares the carrying value of the assets to the greater of the fair value of the assets and the value-in-use of the assets, which is a discounted cash flow measure. As a result, impairments will be recorded more frequently under IFRS. Future impairment tests may be required when management determines that indicators of impairment exist. Should impairment losses be recorded in accordance with IFRS, certain of those losses can reverse in the future if facts and circumstances change.

Depreciation under Canadian GAAP is calculated using a unit-of-production method based on total proved reserves for all accumulated costs (excluding unproved properties). Under IFRS, the net carrying value of development assets will still be depleted using a unit of production method; however, significant components with different useful lives will be accounted for as separate items and depreciated separately. In addition, IFRS allows depreciation to be calculated using either proved reserves or proved plus probable reserves. Arcan has not yet determined whether depreciation will be calculated using proved or proved plus probable reserves.

Under the full cost accounting guideline, gains or losses are not recognized upon the disposition of P&NG assets unless the disposition results in a significant change in the depletion rate. Under IFRS, gains and losses are recognized in net income on the disposal of an item of P&NG assets. The amount of the gain or loss is determined by comparing the proceeds from disposal with the carrying amount of the item. This will include transactions such as sales of assets, farm-outs, asset swaps and other non-monetary transactions which typically did not result in gains or losses being recorded under Canadian GAAP.

The quantitative impact to Arcan of these changes to accounting for P&NG assets has not been determined.

Business Combinations

Accounting for business combinations also differs under IFRS. Arcan intends to elect not to restate business combinations recorded prior to January 1, 2010 in accordance with IFRS standards. Any goodwill recognized in business combinations after January 1, 2010 recorded under IFRS will represent the excess of the cost of the acquisition over the net fair value of the identifiable assets, liabilities and contingent liabilities of the acquired entity. When the excess is negative, it will be recognized

immediately in profit and loss. In addition, transaction costs which are included in the cost of the acquisition under Canadian GAAP will be expensed under IFRS. The Corporation has the option to early adopt the IFRS standard for business combinations. The Corporation will assess this option if the Corporation enters into a business combination in 2010.

Deferred Income Taxes

Deferred income taxes are calculated under IFRS using a liability approach which is conceptually similar to Canadian GAAP however there are differences in the manner in which deferred income taxes are calculated. The impact of these changes is being assessed and has not been quantified.

Other Items

There are other accounting policy changes with potentially material impacts, including accounting for asset retirement obligations ("**ARO**") and accounting for Stock Based Compensation. The ARO calculation differs under IFRS in some respects. On initial adoption of IFRS, the ARO liability will be recorded at its revised amount and the difference from the amount recorded under Canadian GAAP will be recorded as an adjustment to retained earnings at January 1, 2010. Under IFRS – Stock Based Compensation, Arcan's options that vest in three instalments must be accounted for as though each instalment is a separate option issue. This will result in front end loading of compensation expense. In addition, an estimate of forfeitures must be taken into consideration in the expense.

Business Combinations

In January 2009, the CICA issued Section 1582, Business Combinations. This section is effective January 1, 2011 and applies prospectively to business combinations for which the acquisition date is on or after the first annual reporting period beginning on or after January 1, 2011 for the Corporation. Early adoption is permitted. This section replaces Section 1581, Business Combination and harmonizes the Canadian standards with IFRS.

Consolidated Financial Statements and Non-Controlling Interest

In 2009, Section 1601 and Section 1602 were issued which replace the existing guidance under Section 1600, Consolidated Financial Statements. These standards provide guidance for preparing consolidated financial statements and for accounting for non-controlling interest in a subsidiary to a business combination. These standards are effective for business combinations occurring on or after January 1, 2011, with early adoption permitted.

Legal Advisor

*The calculation of barrels of oil equivalent ("**boe**") is based on a conversion ratio of six thousand cubic feet of natural gas to one barrel of oil based on an energy conversion primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. Boes may be misleading, particularly if used in isolation.*

*Please refer to the "**Abbreviations**" in the Corporation's annual information form for meanings of certain abbreviations used in this MD&A.*

Arcan plans to continue mainly investing funds in its two core oil areas, as can be seen from the ongoing growth in total assets. It will re-evaluate its growth in natural gas when commodity conditions warrant it.

Additional information about the Corporation, including the Corporation's annual information form, is available on SEDAR at www.sedar.com.

Forward-Looking Information and Statements

*This management's discussion and analysis ("**MD&A**") contains certain forward-looking information and statements within the meaning of applicable securities laws. The use of any of the words "expect", "anticipate", "continue", "estimate", "guidance", "objective", "ongoing", "may", "will", "project",*

"should", "believe", "plans", "intends" and similar expressions are intended to identify forward-looking information or statements. In particular, but without limiting the foregoing, this MD&A contains forward-looking information and statements pertaining to the following: Arcan's income taxes, tax liabilities and tax pools; the volume and product mix of Arcan's oil and gas production; oil and natural gas prices and Arcan's risk management programs; recovery; the timing and results of drilling operations; the impact of the Acquisition; the amount of asset retirement obligations; future liquidity and financial capacity and resources; cost and expense estimates; results from operations and financial ratios; cash flow sensitivities; royalty rates and their impact on Arcan's operations and results; future growth including development, exploration, and acquisition and development activities and related expenditures.

The forward-looking information and statements contained in this MD&A reflect several material factors and expectations and assumptions of Arcan including, without limitation: that Arcan will continue to conduct its operations in a manner consistent with past operations; the general continuance of current or, where applicable, assumed industry conditions; availability of debt and/or equity sources to fund Arcan's capital and operating requirements as needed; the continuance of existing and, in certain circumstances, proposed tax and royalty regimes; the accuracy of the estimates of Arcan's reserve volumes; and certain commodity price and other cost assumptions. Arcan believes the material factors, expectations and assumptions reflected in the forward-looking information and statements are reasonable at this time but no assurance can be given that these factors, expectations and assumptions will prove to be correct. The forward-looking information and statements included in this MD&A are not guarantees of future performance and should not be unduly relied upon. Such information and 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 information or statements including, without limitation: changes in commodity prices; unanticipated operating results or production declines; changes in tax or environmental laws or royalty rates; increased debt levels or debt service requirements; inaccurate estimation of Arcan's oil and gas reserves volumes; limited, unfavourable or no access to debt or equity capital markets; increased costs and expenses; the impact of competitors; reliance on industry partners; and certain other risks detailed from time to time in Arcan's public disclosure documents including, without limitation, those risks identified in this MD&A, and in Arcan's annual information form, copies of which are available on Arcan's SEDAR profile at www.sedar.com.

The forward-looking information and statements contained in this MD&A speak only as of the date of this MD&A, and Arcan does not assume any obligation to publicly update or revise them to reflect new events or circumstances, except as may be required pursuant to applicable laws.

Financial Statements of

ARCAN RESOURCES LTD.

Years ended December 31, 2009 and 2008

MANAGEMENT'S REPORT

To the Shareholders of Arcan Resources Ltd.

Management is responsible for the preparation of the financial statements and for the consistency of all other financial and operating data presented in this annual report. Management maintains a system of internal controls to provide reasonable assurance that all assets are safeguarded and to facilitate the preparation of relevant, reliable and timely financial information.

Arcan's external auditors, KPMG LLP, Chartered Accountants, have audited the financial statements. The Audit Committee has reviewed the financial statements with management and the auditors and has recommended their approval to the Board of Directors. The Board of Directors has subsequently approved the financial statements.

(signed)
"Ed Gilmet"
President and Chief Executive Officer

(signed)
"Douglas N. Penner"
Chief Financial Officer and Vice President
Finance

Calgary, Alberta, Canada
April 22, 2010

AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the balance sheets of Arcan Resources Ltd. as at December 31, 2009 and 2008 and the statements of operations, comprehensive income (loss) and retained earnings (deficit) and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2009 and 2008 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

(signed) "*KPMG LLP*"

Chartered Accountants

Calgary, Canada

April 22, 2010

ARCAN RESOURCES LTD.

Balance Sheets

As at December 31,

	2009	2008
Assets		
Current assets:		
Accounts receivable	\$ 10,011,769	\$ 9,067,668
Prepays and deposits	935,313	817,944
	<u>10,947,082</u>	<u>9,885,612</u>
Property, plant, and equipment (note 4)	140,304,312	139,838,263
	<u>\$ 151,251,394</u>	<u>\$ 149,723,875</u>
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 17,140,125	\$ 20,658,604
Bank loan (note 5)	28,585,629	29,632,687
	<u>45,725,754</u>	<u>50,291,291</u>
Asset retirement obligations (note 6)	5,370,818	4,785,428
Future income taxes (note 7)	4,687,265	6,415,927
	<u>55,783,837</u>	<u>61,492,646</u>
Shareholders' equity:		
Share capital (note 8)	93,714,116	81,677,404
Share purchase loan (note 8)	(100,000)	(100,000)
Contributed surplus (note 9)	4,080,040	3,137,804
Retained earnings (deficit)	(2,226,599)	3,516,021
	<u>95,467,557</u>	<u>88,231,229</u>
Commitments (notes 8 and 12)		
Subsequent events (note 13)		
	<u>\$ 151,251,394</u>	<u>\$ 149,723,875</u>

See accompanying notes to financial statements.

Approved by the Board of Directors:

(signed) "Ed Gilmet" Director

(signed) "Andy Fisher" Director

ARCAN RESOURCES LTD.

Statements of Operations, Comprehensive Income (Loss) and Retained Earnings (Deficit)

For the years ended December 31,

	2009	2008
Revenue:		
Petroleum and natural gas	\$ 27,289,747	\$48,657,100
Interest and other revenue	3,348	28,993
Royalties	(7,116,429)	(10,819,016)
Realized loss on commodity contracts (note 11)	(1,439,613)	—
	<u>18,737,053</u>	<u>37,867,077</u>
Expenses:		
Operating	8,081,714	8,235,329
General and administrative	4,616,176	4,402,105
Interest	1,543,357	1,237,580
Accretion	414,170	354,657
Depletion and depreciation	11,293,062	14,227,178
	<u>25,948,479</u>	<u>28,456,849</u>
Income (loss) before income taxes	(7,211,426)	9,410,228
Future income tax reduction (expense) (note 7)	1,468,806	(2,409,612)
Net income (loss) and comprehensive income (loss)	(5,742,620)	7,000,616
Retained earnings (deficit), beginning of year	3,516,021	(3,484,595)
Retained earnings (deficit), end of year	<u>\$ (2,226,599)</u>	<u>\$ 3,516,021</u>
Net income (loss) per share (note 8):		
Basic	\$ (0.15)	\$ 0.19
Diluted	\$ (0.15)	\$ 0.18

See accompanying notes to financial statements.

ARCAN RESOURCES LTD.

Statements of Cash Flows

For the years ended December 31,

	2009	2008
Cash provided by (used in):		
Operating:		
Net income (loss)	\$(5,742,620)	7,000,616
Items not involving cash:		
Depletion and depreciation	11,293,062	14,227,178
Stock-based compensation	942,236	872,653
Accretion	414,170	354,657
Future income tax expense (reduction)	(1,468,806)	2,409,612
Reclamation costs	(92,714)	(311,338)
	5,345,328	24,553,378
Change in non-cash working capital	(1,017,653)	(584,146)
	4,327,675	23,969,232
Financing:		
Bank loan	(1,047,058)	15,726,856
Issue of common shares, net of costs	11,776,856	103,845
	10,729,798	15,830,701
Investing:		
Property, plant and equipment	(11,495,177)	(35,510,856)
Property acquisition (note 4)	—	(1,060,767)
Disposition of properties (note 4)	—	1,650,000
Change in non-cash working capital	(3,562,296)	(4,878,310)
	(15,057,473)	(39,799,933)
Change in cash	—	—
Cash, beginning of year	—	—
Cash, end of year	\$ —	—
Supplementary disclosure:		
Interest paid	\$ 1,562,197	\$ 1,255,273

Cash is defined as cash and cash equivalents.

See accompanying notes to financial statements.

ARCAN RESOURCES LTD.

Notes to Financial Statements

Years ended December 31, 2009 and 2008

1. Basis of presentation:

Arcan Resources Ltd. ("Arcan" or the "Company") is a publicly listed company involved in the business of oil and natural gas exploration, development and production in western Canada.

2. Significant accounting policies:

The financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles. The preparation of these financial statements, in conformity with generally accepted accounting principles, requires management to make estimates and assumptions that affect the amounts reported in the statements and accompanying notes. As a result, actual amounts could differ from estimated amounts.

Specifically, the amounts recorded for depletion and depreciation of petroleum and natural gas properties and the provision for asset retirement obligations and abandonment costs are based on estimates. The ceiling test is based on estimates of reserves, production rates, oil and natural gas prices, future costs and other relevant assumptions. The amounts for stock-based compensation are based on estimates of risk-free rates, expected lives and volatility. Future income taxes are based on estimates as to the timing of the reversal of temporary differences and tax rates currently substantively enacted. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future periods could be significant.

(a) Property, plant and equipment:

The Company's activities are related to the acquisition of, exploration for and development of petroleum and natural gas properties. The Company follows the full cost method of accounting for petroleum and natural gas operations.

All costs of exploring for and developing petroleum and natural gas properties and related reserves are capitalized into a cost centre. Such costs include those related to lease acquisition, geological and geophysical activities, lease rentals on non-producing properties, drilling of productive and non-productive wells, tangible production equipment, asset retirement costs, and that portion of general and administrative expenses directly attributable to exploration and development activities. Proceeds received from the disposal of properties are normally deducted from the full cost pool without recognition of a gain or loss. When a significant portion of properties is sold, resulting in a change to the depletion rate of 20 percent or more, a gain or loss is recorded and reflected in the statement of operations.

Depletion of petroleum and natural gas properties and depreciation of production equipment, excluding costs related to unproved properties, are calculated using the unit-of-production method based upon estimated proved reserves, before royalties, as determined by independent petroleum engineers. For purposes of the calculation, natural gas reserves and production are converted to equivalent volumes of petroleum based upon relative energy content.

2. Significant accounting policies (continued):

(a) Property, plant and equipment (continued):

Costs of acquiring unproved properties are initially excluded from the full cost pool and are assessed each reporting period to ascertain whether impairment has occurred. When proved reserves are assigned to the property or the property is considered to be impaired, the cost of the property or the amount of impairment is added to the full cost pool.

Petroleum and natural gas properties are evaluated in each reporting period to determine whether the carrying amount in a cost centre is recoverable and does not exceed the fair value of the properties in the cost centre.

The carrying amounts are assessed to be recoverable when the sum of the undiscounted cash flows expected from the production of proved reserves, the lower of cost and market of unproved properties and the cost of major development projects exceeds the carrying amount of the cost centre. When the carrying amount is not assessed to be recoverable, an impairment loss is recognized to the extent that the carrying amount of the cost centre exceeds the sum of the discounted cash flows expected from the production of proved and probable reserves, the lower of cost and market of unproved properties and the cost of major development projects of the cost centre. The cash flows are estimated using expected future product prices and costs and are discounted using a risk-free interest rate.

Computer and office equipment are recorded at cost and amortized on a declining balance basis using rates of 30% and 20%, respectively per annum.

(b) Interests in joint operations:

A portion of the Company's exploration and development activities are conducted jointly with others and, accordingly, the financial statements reflect only the Company's proportionate interest in such activities.

(c) Cash and cash equivalents:

Cash and cash equivalents are comprised of cash and all investments that are highly liquid in nature and generally have a maturity date of three months or less.

2. Significant accounting policies (continued):

(d) Asset retirement obligations:

The Company uses the asset retirement obligation method of recording the future cost associated with removal, site restoration and asset retirement costs. The fair value of the liability for the Company's asset retirement obligations is recorded in the period in which it is incurred, discounted to its present value using the Company's credit-adjusted, risk-free interest rate and the corresponding amount is recognized by increasing the carrying amount of petroleum and natural gas properties. The liability amount is increased each reporting period due to the passage of time and the amount of accretion is charged to earnings in the period. Revisions to the estimated timing of cash flows or to the original estimated undiscounted cost could also result in an increase or decrease to the obligation. Actual costs incurred upon settlement of the retirement obligations are charged against the obligation to the extent of the liability recorded.

(e) Financial instruments:

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument to another entity. Upon initial recognition all financial instruments, including all derivatives, are recognized on the balance sheet at fair value. Subsequent measurement is then based on the financial instruments being classified into one of five categories: held for trading, held to maturity, loans and receivables, available for sale and other liabilities. The Company has designated its cash and cash equivalents as held for trading which are measured at fair value. Accounts receivable are classified as loans and receivables which are measured at amortized cost. Accounts payable and accrued liabilities and bank debt are classified as other liabilities which are measured at amortized cost, which is determined using the effective interest method.

The Company will assess at each reporting period whether a financial asset is impaired with any impairment recorded in earnings.

The Company is exposed to market risks resulting from fluctuations in commodity prices, foreign exchange rates and interest rates in the normal course of operations. A variety of derivative instruments may be used by the Company to reduce its exposure to fluctuations in commodity prices, foreign exchange rates, and interest rates. The Company does not use these derivative instruments for trading or speculative purposes. The Company considers all of these transactions to be economic hedges, however, the majority of the Company's contracts do not qualify or have not been designated as hedges for accounting purposes. As a result, all derivative contracts are classified as held for trading and are recorded on the balance sheet at fair value, with changes in the fair value recognized in net income, unless specific hedge criteria are met. The fair values of these derivative instruments are based on an estimate of the amounts that would have been received or paid to settle these instruments prior to maturity given future market prices and other relevant factors.

2. Significant accounting policies (continued):

(e) Financial instruments (continued):

The Company has elected to account for its physical delivery sales contracts, which were entered into and continue to be held for the purpose of receipt or delivery of non-financial items in accordance with its expected purchase, sale or usage requirements as executory contracts on an accrual basis rather than as non-financial derivatives.

The Company measures and recognizes embedded derivatives separately from the host contracts when the economic characteristics and risks of the embedded derivative are not closely related to those of the host contract, when it meets the definition of a derivative and when the entire contract is not measured at fair value. Embedded derivatives are recorded at fair value.

The Company nets all transaction costs incurred, in relation to the acquisition of a financial asset or liability, against the related financial asset or liability. Bank debt is presented net of deferred interest payments, with interest recognized in earnings on an effective interest basis.

The Company applies trade-date accounting for the recognition of a purchase or sale of cash equivalents and derivative contracts.

(f) Future income taxes:

The Company uses the asset and liability method for calculating future income taxes. Temporary differences arising from the differences between the tax basis of an asset or liability and the carrying amount on the balance sheet are used to calculate future income tax assets or liabilities. Future income tax assets or liabilities are calculated using the currently enacted, or substantively enacted, tax rates anticipated to apply in the periods that the temporary differences are expected to reverse. A valuation allowance is recorded against any future income tax assets if it is more likely than not that the asset will not be realized.

(g) Flow-through shares:

The resource expenditure deductions for income tax purposes related to exploratory and development activities funded by flow-through share arrangements are renounced to investors in accordance with tax legislation. The future tax liability and share capital are adjusted by the estimated cost of the renounced tax deductions when the expenditures are renounced.

2. Significant accounting policies (continued):

(h) Stock-based compensation:

The Company uses the fair value method for valuing stock option grants and warrants. Under this method, compensation cost attributable to all share options and warrants granted is measured at fair value at the grant date and expensed over the vesting period with a corresponding increase to contributed surplus. Upon the exercise of the stock options and warrants, consideration received together with the amount previously recognized in contributed surplus is recorded as an increase to share capital.

(i) Revenue recognition:

Petroleum and natural gas revenues are recognized when the title and risks pass to the purchaser.

(j) Per share amounts:

Basic per share information is computed by dividing earnings by the weighted average number of common shares outstanding for the period. The weighted average shares that are issued in consideration for a share loan agreement are deducted from the weighted average common shares outstanding for the period. The treasury stock method is used to determine the diluted per share amounts, whereby any proceeds from the stock options, warrants or other dilutive instruments are assumed to be used to purchase common shares at the average market price during the period. The weighted average number of shares outstanding is then adjusted by the net change.

(k) Comparative figures:

Certain comparative figures have been reclassified to conform to the current year's presentation.

3. Changes in Accounting Policies:

(a) Goodwill and intangible assets:

In February 2008, the CICA issued Section 3064, Goodwill and Intangible Assets. Effective for fiscal years beginning on or after October 1, 2008, this section provides guidance on the recognition, measurement, presentation and disclosure for goodwill and intangible assets, other than the initial recognition of goodwill or intangible assets acquired in a business combination. The Company adopted the new standard for the year ended December 31, 2009. Adoption of the standard did not have any impact on the Company's results of operations or financial position.

3. Changes in Accounting Policies (continued):

(b) Financial instruments - disclosures:

In June 2009, the CICA amended Section 3862, "Financial Instruments – Disclosures." These amendments include a hierarchy of methods used to determine the fair value of financial instruments at the balance sheet date. Level 1 inputs are based on quoted prices in active markets the Company has the ability to access at the measurement date. Level 2 inputs are based on quoted prices in markets that are not active or based on prices that are observable for the asset or liability. Level 3 inputs are based on unobservable inputs for the asset or liability. These additional disclosures, effective December 31, 2009, are included in note 11 and did not have an impact on the Company's financial statements.

Future Accounting Policies:

(a) Business combinations:

In January 2009, the CICA issued Section 1582, Business Combinations. This section is effective January 1, 2011 and applies prospectively to business combinations for which the acquisition date is on or after the first annual reporting period beginning on or after January 1, 2011 for the Company. Early adoption is permitted. This section replaces Section 1581, Business Combination and harmonizes the Canadian standards with IFRS.

(b) Consolidated financial statements and non-controlling interest:

In 2009 Section 1601 and Section 1602 were issued which replace the existing guidance under Section 1600, Consolidated Financial Statements. These standards provide guidance for preparing consolidated financial statements and for accounting for non-controlling interest in a subsidiary to a business combination. These standards are effective for business combinations occurring on or after January 1, 2011, with early adoption permitted.

4. Property, plant and equipment:

	2009	2008
Petroleum and natural gas properties	\$ 184,436,802	\$ 172,677,691
Accumulated depletion and depreciation	(44,132,490)	(32,839,428)
	<u>\$ 140,304,312</u>	<u>\$ 139,838,263</u>

At December 31, 2009, petroleum and natural gas properties included undeveloped properties of \$9.8 million (2008 - \$11.5 million), which have been excluded from the depletion calculation. Future development costs of proved reserves of \$27.6 million (2008 - \$38.2 million) have been included in the depletion calculation.

4. Property, plant and equipment (continued):

During the year ended December 31, 2008, the Company acquired certain working interests in petroleum and natural gas properties for cash of \$1,060,767. The Company disposed of certain

interests in petroleum and natural gas properties for cash of \$1,650,000, with associated asset retirement obligations of \$41,152.

During the year ended December 31, 2008, the Company converted 6,550,400 performance shares, which were related to the January 1, 2007 amalgamation of Arcan and Desco Energy Ltd., into 1,335,005 common shares. Arcan recorded \$2.1 million to share capital, \$0.8 million to future income taxes and \$2.9 million to property, plant and equipment as a result of the conversion.

The Company applied the ceiling test to its capitalized assets at December 31, 2009 and determined that there was no impairment of costs requiring a write-down. For the purposes of the December 31, 2009 impairment test of petroleum and natural gas properties, the following benchmark prices were used:

	WTI Oil (\$US/bbl)	Foreign Exchange Rate	WTI Oil (\$Cdn/bbl)	Arcan Price Oil & NGL	AECO Gas (\$Cdn/mcf)	Arcan Price Gas
2010	\$ 80.00	0.950	\$ 84.21	\$ 79.63	\$ 5.96	\$ 6.10
2011	83.00	0.950	87.37	81.88	6.79	7.18
2012	86.00	0.950	90.53	85.00	6.89	7.38
2013	89.00	0.950	93.68	88.09	6.95	7.42
2014	92.00	0.950	96.84	91.18	7.05	7.53
2015	93.84	0.950	98.78	93.07	7.16	7.64
2016	95.72	0.950	100.75	95.00	7.42	7.93
2017	97.64	0.950	102.77	96.95	7.95	8.52
2018	99.59	0.950	104.83	98.95	8.52	9.16
2019	101.58	0.950	106.93	101.02	8.69	9.31
2020	+2.0%/yr	0.950	+2.0%/yr	103.12	+2.0%/yr	9.41

5. Bank loan:

	2009	2008
Bank loan	\$ 28,585,629	\$ 29,632,687

Arcan has a \$50 million operating revolving loan facility. This facility is with a Canadian chartered bank. Interest on the facility is calculated at the bank prime rate of interest, plus an applicable facility margin depending upon certain ratios. A re-determination of the borrowing base will occur on or before April 30, 2010. As the available lending limits of the facility is based on the bank's interpretation of the Company's reserves and future commodity prices, there can be no assurance as to the amount of the facility that will be determined at each scheduled review. The loan facility is secured by a general security agreement and is payable in full on demand. Pursuant to the terms of the credit facilities, the Company has provided the covenant that at all times its working capital ratio shall be not less than 1 to 1. The working capital ratio is defined under the terms of the facilities as current assets, including the undrawn portion of the revolving credit facility, to current liabilities, excluding any current bank indebtedness. The Company is compliant with this covenant at December 31, 2009. This facility had an effective interest rate of 4.75% at December 31, 2009 (2008 – 4.50%).

6. Asset retirement obligations:

The Company's asset retirement obligations result from net ownership interests in petroleum and natural gas assets including well sites, gathering systems and processing facilities. The Company estimates the total undiscounted amount of cash flows required to settle its asset retirement obligations at December 31, 2009 is \$11.4 million (2008 - \$11.1 million), which will be incurred between 2011 and 2019. The majority of the costs will be incurred between 2011 and 2016. An inflation rate of 2% (2008 – 2%) was used to inflate the costs, and a credit-adjusted risk-free rate of 8% - 10% (2008 – 8% - 10%) was used to calculate the fair value of the asset retirement obligations.

	2009	2008
Balance, beginning of year	\$ 4,785,428	\$ 4,169,384
Liabilities incurred	230,818	613,877
Liabilities eliminated on disposal (note 4)	—	(41,152)
Accretion expense	414,170	354,657
Changes in estimates	33,116	—
Reclamation costs	(92,714)	(311,338)
Balance, end of year	\$ 5,370,818	\$ 4,785,428

7. Taxes:

The difference between the expected income tax provision based on the combined federal and provincial statutory tax rate and the amount actually provided for is as follows:

	2009	2008
Income (loss) before income taxes	\$(7,211,426)	\$ 9,410,228
Combined federal and provincial statutory rate	29.0%	29.5%
Expected future income tax (reduction) expense	\$(2,091,314)	\$ 2,776,017
Stock-based compensation	273,248	257,433
Future tax rate reductions and other	349,260	(623,838)
Future income tax (reduction) expense	\$(1,468,806)	\$ 2,409,612

The components of the future income tax liability are as follows:

	2009	2008
Share issue costs	\$ (388,813)	\$ (439,740)
Asset retirement obligations	(1,342,705)	(1,196,357)
Non-capital losses	(7,552,350)	(3,469,353)
Property, plant and equipment	13,971,133	11,521,377
Future income tax	\$ 4,687,265	\$ 6,415,927

The Company has recognized the benefit of \$30.2 million of non-capital losses which are available for carry forward to reduce future taxable income in future years. These losses expire between 2026 and 2029.

8. Share capital:

(a) Authorized:

Unlimited number of common shares without nominal or par value.

(b) Common shares issued and outstanding:

	Number of Shares	Amount
Balance, December 31, 2007	36,491,555	\$ 80,761,100
Issued pursuant to performance share conversion (note 4)	1,335,005	2,136,008
Exercise of warrants	12,000	24,000
Exercise of stock options	30,000	80,000
Stock-based compensation on exercise of warrants and stock options	—	28,913
Share issue costs	—	(155)
Tax effect of share issue costs	—	40
Tax effect of flow-through shares issued in 2007	—	(1,352,502)
Balance, December 31, 2008	37,868,560	\$ 81,677,404
Issued pursuant to prospectus	9,000,000	11,250,000
Issued pursuant to flow-through private placement	1,071,500	1,500,100
Share issue costs	—	(973,244)
Tax effect of share issue costs	—	259,856
Balance, December 31, 2009	47,940,060	\$ 93,714,116

(c) Warrants:

The Company has outstanding warrants that were issued to investors and agents, as commission, in certain equity financings. Each warrant is exercisable into one common share of the Company.

	Weighted average Exercise Price (\$)	Number of Warrants
Balance, at December 31, 2007	1.93	598,631
Exercise of warrants	2.00	(12,000)
Balance, December 31, 2009 and 2008	1.93	586,631

8. Share capital (continued):

The following table indicates the number of exercisable warrants with exercise prices:

	Exercise Price (\$)	Number of Warrants
Issued July 2004	2.00	481,000
Issued April 2005	1.60	105,631
	1.93	586,631

The warrants issued in July 2004 expire on October 22, 2010 and the warrants issued in April 2005 expire on April 22, 2010.

(d) Flow-through shares:

On November 20, 2009, the Company issued 1,071,500 flow-through common shares for gross proceeds of \$1,500,100. Under the terms of the flow-through share agreements, the Company is required to renounce the \$1,500,100 of qualifying petroleum and natural gas expenditures effective December 31, 2009 and has until December 31, 2010 to incur the expenditures. As at December 31, 2009, the Company has \$1,237,000 of qualifying expenditures remaining to incur.

(e) Share purchase loan:

A share purchase loan of \$100,000 (2008 - \$100,000) is due from an officer of the Company for the purchase of 40,000 common shares at a price of \$2.50 per common share. This loan is repayable, with interest calculated at the "Prescribed Rate" as determined by the Canada Revenue Agency, currently 1%, on or before April 3, 2012. This loan is secured by the underlying shares.

8. Share capital (continued):

(f) Stock options:

The Company's stock option plan provides for granting of options to directors and employees to a maximum of ten percent of the total issued and outstanding common shares of the Company. These options have a term of five years to expiry. Some of the options vest immediately, others vest one-third as of the date of grant, and one-third on each of the first two anniversary dates, and others vest one-third on each of the first three anniversary dates. The Company has reserved common shares for issuance under the stock option plan in the amount of the stock options outstanding from time to time.

	2009		2008	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Stock options outstanding, beginning of year	3,638,500	\$ 2.27	3,265,000	\$ 2.51
Granted	1,183,500	1.30	1,039,000	1.95
Exercised	—	—	(30,000)	2.67
Forfeited	(150,834)	2.94	(58,500)	2.83
Cancelled	—	—	(577,000)	2.95
Stock options outstanding, end of year	4,671,166	\$ 2.01	3,638,500	\$ 2.27
Exercisable at year-end	2,854,166	\$ 2.12	2,034,000	\$ 2.04

Range of Exercise prices	Outstanding		Exercisable options		
	Number of options outstanding	Weighted average remaining contractual life (years)	Weighted average exercise price	Number of options exercisable	Weighted average exercise price
\$1.00 – \$1.30	1,646,000	4.08	\$ 1.22	593,500	\$ 1.07
\$1.50 – \$2.02	1,455,500	2.86	1.66	1,075,833	1.65
\$2.50 – \$3.05	1,054,833	2.36	2.69	837,166	2.66
\$4.00 – \$4.15	514,833	2.34	4.11	347,667	4.11
Balance, end of year	4,671,166	3.12	\$ 2.01	2,854,166	\$ 2.12

8. Share capital (continued):

(g) Stock-based compensation:

The fair value of each option granted is estimated on the date of grant using the Black- Scholes option pricing model with the following weighted average assumptions:

	2009	2008
Fair value of options granted (\$/option)	\$ 0.95	\$ 1.00
Expected life of options (years)	5	5
Expected volatility (%)	95	60
Risk free rate of return (%)	2.62	3.15
Expected dividend yield (%)	Nil	Nil

(h) Performance options:

	2009	2008
Number outstanding	750,000	1,500,000
Exercisable	750,000	1,500,000
Weighted average remaining contractual life (years)	0.16	0.75
Weighted average exercise price (\$/share)	1.00	1.00

During the year ended December 31, 2009, 750,000 performance options exercisable at \$1.00 per performance option expired unexercised. Subsequent to year end the remaining performance options were exercised for total proceeds of \$750,000.

(i) Per share amounts:

The following table summarizes the basis for the determination of basic and diluted per share amounts:

	2009	2008
Weighted average number of shares – basic	39,502,345	37,543,286
Effect of dilutive securities	–	982,107
Weighted average number of shares – diluted	39,502,345	38,525,393

In computing diluted per share amounts at December 31, 2009, 4,671,166 options (2008 – 2,495,560 options), 750,000 performance options (2008 – 377,049 performance options), and 586,631 warrants (2008 – 270,036 warrants) were excluded for the calculation as their effect was anti-dilutive.

9. Contributed surplus:

	2009	2008
Balance, beginning of year	\$ 3,137,804	\$ 2,294,064
Stock-based compensation	942,236	872,653
Transfer to share capital on exercise of warrants and options	—	(28,913)
Balance, end of year	\$ 4,080,040	\$ 3,137,804

10. Related party transactions:

In conjunction with the equity issuance pursuant to the prospectus during 2009, certain officers and directors acquired 340,000 common shares at \$1.25 per share.

11. Financial instruments:

Overview

The Company has exposure to the following risks from its use of financial instruments:

- Credit risk
- Liquidity risk
- Market risk

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

The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework. The Board has implemented and monitors compliance with risk management policies.

The Company's risk management policies are established to identify and analyze the risks faced by the Company, to set appropriate risk limits and controls, and to monitor risks and adherence to market conditions and the Company's activities.

Credit Risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Company's receivables from joint venture partners and petroleum and natural gas marketers. As at December 31, 2009 the Company's receivables consisted of \$5.0 million (2008 - \$6.6 million) from joint venture partners, \$2.0 million (2008 - \$1.9 million) of receivables from petroleum and natural gas marketers and \$3.0 million (2008 - \$0.6 million) of other trade receivables.

11. Financial instruments (continued):

Receivables from petroleum and natural gas marketers are normally collected on the 25th day of the month following production. The Company attempts to mitigate credit risk by establishing marketing relationships with a variety of purchasers. In 2008 the Company experienced a collection issue with

one of its marketers of natural gas who sold to SemCanada Energy Company. SemCanada Energy Company is a Canadian subsidiary of SemGroup, L.P., which, in 2008, filed a voluntary petition for reorganization under Chapter 11 of the Bankruptcy Code in the United States. As of December 31, 2009, the Company has a receivable owing from its natural gas marketer indirectly related to SemCanada Energy Company of \$0.1 million. In 2008 the Company provided an allowance for doubtful accounts against this amount the offset of which was included in general and administrative expenses. It is not certain what portion, if any, of this receivable will be collectible.

Joint venture receivables are typically collected within one to three months of the joint venture bill being issued to the partner. The Company attempts to mitigate the risk from joint venture receivables by obtaining partner approval of significant capital expenditures prior to the expenditure. However, the receivables are from participants in the petroleum and natural gas sector, and collection of the outstanding balances is dependent on industry factors such as commodity price fluctuations, escalating costs and the risk of unsuccessful drilling. In addition, further risk exists with joint venture partners as disagreements occasionally arise that increase the potential for non-collection. The Company does not typically obtain collateral from petroleum and natural gas marketers or joint venture partners; however the Company does have the ability to withhold production from joint venture partners in the event of non-payment.

The carrying amount of accounts receivable represents the maximum credit exposure. The Company has an allowance for doubtful accounts as at December 31, 2009 of \$0.1 million (2008 – \$0.1 million).

As at December 31, 2009 and 2008 the Company considers its receivables to be aged as follows:

Aging	2009	2008
Not past due (less than 120 days)	\$ 9,048,157	\$ 6,993,229
Past due (over 120 days)	963,612	2,074,439
Total	\$ 10,011,769	\$ 9,067,668

11. Financial instruments (continued):

Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they come due. The Company's approach to managing liquidity is to ensure, as far as possible, that it will have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions without incurring unacceptable losses or risking harm to the Company's reputation.

The Company prepares annual capital expenditure budgets, which are regularly monitored and updated as considered necessary. Further, the Company utilizes authorizations for expenditures on both operated and non-operated projects to further manage capital expenditures. To facilitate the capital expenditure program, the Company has a revolving reserve based credit facility, as outlined in note 5, that is at least reviewed annually by the lender. The Company also attempts to match its payment cycle with collection of petroleum and natural gas revenues on the 25th of each month.

Accounts payable are considered due to suppliers in one year or less while bank debt, which is subject to renewal after a 364-day revolving period, could be potentially due within the next year if the facility is not renewed for a further 364-day period.

Market risk

Market risk is the risk that changes in market prices, such as foreign exchange rates, commodity prices, and interest rates will affect the Company's net income or the value of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable limits, while maximizing returns.

The Company utilizes financial derivative contracts to manage market risks. All such transactions are conducted in accordance with the risk management policy that has been approved by the Board of Directors.

Foreign currency exchange rate risk

Foreign currency exchange rate risk is the risk that the fair value or future cash flows will fluctuate as a result of changes in foreign exchange risks. Although substantially all of the Company's petroleum and natural gas sales are denominated in Canadian dollars, the underlying market prices in Canada for petroleum and natural gas are impacted by changes in the exchange rate between the Canadian and United States dollar.

The Company had no forward exchange rate contracts in place as at or during the years ended December 31, 2009 and 2008.

11. Financial instruments (continued):

Commodity price risk

Commodity price risk is the risk that the fair value or future cash flows will fluctuate as a result of changes in commodity prices. Commodity prices for petroleum and natural gas are impacted by not only the relationship between the Canadian and United States dollar, as outlined above, but also world economic events that dictate the levels of supply and demand.

During the year ended December 31, 2009 the Company entered into a fixed price oil swap contract to receive \$64.40 per barrel in exchange for Canadian dollar WTI on oil production of 500 barrels per day for the period from April 1 to December 31, 2009. The Company realized a loss on the contract of \$1,439,613 for the year ended December 31, 2009.

The Company had no derivative contracts in place as at or during the year ended December 31, 2008.

Interest rate risk

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. The Company is exposed to interest rate fluctuations on its bank debt which bears a floating rate of interest. As at December 31, 2009, if interest rates had been one hundred basis points lower with all other variables held constant, net income for the year ended would have been approximately \$268,000 (2008 - \$176,000) higher due to lower interest expense. An equal and opposite impact would have occurred to net income had interest rates been one hundred basis points higher. The sensitivity is higher in 2009 as compared to 2008 because of an increase in outstanding bank debt, slightly offset by a decrease in interest rates.

The Company has no interest rate swap or financial contracts in place as at or during the years ended December 31, 2009 and 2008.

Capital management

The Company's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain the future development of the business.

The Company manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of the underlying petroleum and natural gas assets. The Company considers its capital structure to include shareholder's equity of \$95.5 million (2008 - \$88.2 million), bank debt of \$28.6 million (2008 - \$29.6 million) and a working capital deficiency excluding bank debt of \$6.2 million (2008 - \$10.8 million). In order to maintain or adjust the capital structure, the Company may from time to time issue shares and adjust its capital spending to manage current and projected debt levels.

11. Financial instruments (continued):

The Company monitors capital based on the ratio of net debt to quarterly annualized funds from operations. In this ratio, net debt is defined as outstanding bank debt plus or minus working capital, divided by funds from operations for the most recent calendar quarter, annualized (multiplied by four). Funds from operations is defined as cash flow from operating activities before changes in non-cash working capital. The Company's strategy is to maintain a ratio of less than 2 to 1. This ratio may increase at certain times as a result of acquisitions. In order to facilitate the management of this ratio, the Company prepares annual capital expenditure budgets, which are updated as necessary depending on varying factors including current and forecast prices, successful capital deployment and general industry conditions. The annual and updated budgets are approved by the Board of Directors.

As at December 31, 2009 and 2008, the Company's ratio of net debt to quarterly annualized funds from operations was 13.0 to 1 and 5.1 to 1, respectively. The Company's ratio of net debt to quarterly annualized funds from operations at December 31, 2009 was above the 2 to 1 ratio that management targets to maintain due to unusually low funds from operations due to high operating costs from a number workovers and a 13th month adjustment received from a joint venture partner during the quarter. The Company raised \$65.0 million subsequent to the end of the year (note 13) of which \$53.3 million was used to acquire certain working interests in petroleum and natural gas properties with the balance going to reduce debt levels.

The Company's bank completed its semi-annual borrowing base review on March 27, 2009, and the bank credit facility has been established at \$50 million. The next scheduled renewal is on or before April 30, 2010. The Company continually monitors its financing alternatives, and expects to finance its 2010 cash capital expenditures program from internally generated funds from operations, bank debt, and equity.

11. Financial instruments (continued):

The net debt to quarterly annualized funds from operations has been calculated as follows:

	2009	2008
Working capital deficiency (including bank debt)	\$ 34,778,672	\$ 40,405,679
Cash flow from operating activities	130,393	4,590,366
Change in non-cash operating working capital	537,141	(2,603,621)
Funds from operations	667,534	1,986,745
Annualizing factor	x4	x4
Annualized funds from operations	\$ 2,670,136	\$ 7,946,980
Ratio	13.0 to 1	5.1 to 1

The Company's share capital is not subject to external restrictions, however the bank debt facility is based on petroleum and natural gas reserves and a financial covenant (see note 5). The Company has not paid or declared any dividends since the date of incorporation, nor are any contemplated in the foreseeable future.

There were no changes in the Company's approach to capital management during the year.

Fair value of financial instruments

The Company's financial instruments as at December 31, 2009 and 2008 includes accounts receivable, accounts payable and accrued liabilities and bank debt. The fair value of accounts receivable and accounts payable and accrued liabilities approximate their carrying amounts due to their short-terms to maturity.

Bank debt bears interest at a floating market rate and is due on demand and accordingly the fair market value approximates the carrying value.

12. Commitments:

(a) Future minimum lease payments relating to operating lease commitments are:

2010	\$ 238,500
2011	244,125
2012	249,750
2013	249,750
2014	249,750
2015 and thereafter	374,625

(b) As a requirement of a sublease for office premises, the Company has provided a letter of Guarantee in favour of the lessor for a three year period on a declining basis as follows:

March 2009 to February 2010	\$ 120,000
March 2010 to February 2011	60,000

13. Subsequent events:

On March 31, 2010 the Company issued 26,000,000 common shares at a price of \$2.50 per share for gross proceeds of \$65,000,000. The proceeds were partially used to acquire certain working interests in petroleum and natural gas properties for cash of \$53,250,000, subject to closing adjustments.

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Independent Director

Andy Fisher
Executive Vice President, Arcan Resources Ltd.

Ed Gilmet
President and CEO, Arcan Resources Ltd.

Michael J. Laffin
Independent Director

J. Terry McCoy
Independent Director

Officers

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President and CEO

Andy Fisher
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Doug Penner
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Banker

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