

## 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' 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 unaudited 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 ended March 31, 2010 as compared to the three months ended March 31, 2009 and the three months ended December 31, 2009. The MD&A complements and supplements the unaudited interim financial statements of Arcan. For a full understanding of the financial position and results of operations of the Corporation, this MD&A should be read in conjunction with the unaudited interim financial statements for the three months ended March 31, 2010 and 2009, together with the notes thereto, as well as the audited financial statements for the years ended December 31, 2009 and 2008, together with the notes thereto and other documents filed on SEDAR, including historical financial statements, the information circular dated April 22, 2010 relating to the Corporation's annual general and special meeting to be held on May 25, 2010 and the Corporation's annual information form dated April 22, 2010 for the year ended December 31, 2009. These documents are available at [www.sedar.com](http://www.sedar.com) under the Corporation's SEDAR profile.

The unaudited financial statements to which this MD&A relates have been prepared in accordance with Canadian Generally Accepted Accounting Principles ("**GAAP**"). In this MD&A, unless otherwise indicated, all monetary amounts disclosed herein are in Canadian dollars and all references to "\$" are to Canadian dollars.

Arcan's management is responsible for the integrity of the information contained in this report and for the consistency between the MD&A and the unaudited interim 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 unaudited interim 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 unaudited interim financial statements and MD&A for the three months ended March 31, 2010. This MD&A is dated May 20, 2010.

Readers are advised to read the legal advisories at the end of this MD&A.

#### 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 are 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 barrel of oil equivalent ("**boe**") basis, as well.

The measures referenced above 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

\$ thousands	Quarter ended		
	March 31, 2010	March 31, 2009	December 31, 2009
Cash flow from (used in) operating activities (per GAAP)	2,548	1,361	(371)
Change in non-cash working	278	605	1,038
Funds from operations	2,826	1,966	667

#### First Quarter 2010 Highlights

- Completed and tied in Arcan's first horizontal multi-stage fractured light oil well (81% interest) (12-29) 9-29-68-8W5 ("**9-29**") in its Swan Hills light oil play. This well tested approximately 600 boe per day and is currently producing at a rate of approximately 350 boe per day.
- Drilled Arcan's second horizontal multi-stage fractured light oil well (100% interest) (5-34) 10-27-67-8W5 ("**10-27**") in Arcan's Swan Hills light oil play. The well tested at approximately 700 boe per day, had a pump jack installed and is currently producing at a rate of approximately 500 boe per day.
- Commenced drilling on three new horizontal multi-stage fractured wells (81% interest) during the quarter and four additional horizontal wells following the end of the first quarter. Drilling has been finished on six of the new wells incremental wells. Completion operations have commenced on the first two of these new wells.
- Raised \$65 million in equity and purchased a property adjoining the Deer Mountain Unit #2 (the "**Unit**") for \$52.8 million (the "**Acquisition**"), both of which closed on March 31, 2010. The Acquisition added approximately 500 boe per day to Arcan's production and raised Arcan's undeveloped land base to over 140 net sections on the Swan Hills play.
- Production increased to 1,468 boe per day for the three months ended March 31, 2010, up 9% from the 1,350 boe per day for the three months ended March 31, 2009 and the 1,352 boe per day in the fourth quarter of 2009. There were no volumes included in the operating results in the first quarter from the Acquisition.
- Funds from operations increased 44% to \$2.8 million (\$0.06 per diluted share) in the first quarter of 2010 from \$2.0 million (\$0.05 per diluted share) in the first quarter of 2009 and 324% from \$0.7 million (\$0.02 per diluted share) in the fourth quarter of 2009.

- Operating netbacks of \$32.18 per boe (revenue of \$68.07 per boe and operating cost of \$18.08 per boe) were up 26% from \$25.53 per boe in the first quarter of 2009 and 55% from \$20.73 per boe in the fourth quarter of 2009.
- Completed the free water knock-out, drilled one well, converted one well to a water injection well and tied-in a source well in Arcan's Hamburg area.
- Increased Arcan's bank lines of credit from \$50 million to \$70 million and syndicated Arcan's revolving credit facility.

## Financial and Operating Summary

	Quarter Ended				
	March 31, 2010	March 31, 2009	% Change period over period	December 31, 2009	% Change period over period
<b>Financial</b> (\$000s except per share amounts)					
Oil and NGL sales	7,953	4,929	61	6,797	17
Natural gas sales	<u>1,039</u>	<u>802</u>	30	<u>1,007</u>	3
Total petroleum and natural gas revenue	8,992	5,731	57	7,804	15
Cash provided by operating activities	2,548	1,361	87	(371)	(787)
Funds from operations <sup>(1)</sup>	2,826	1,966	44	667	323
Per share basic and diluted <sup>(1)</sup>	0.06	0.05	20	0.02	200
Net loss	(804)	(1,290)	(38)	(1,730)	(54)
Per share basic and diluted	(0.02)	(0.03)	33	(0.04)	50
Capital expenditures – cash	70,835	3,177	2,130	4,979	1,323
Total assets	227,067	150,398	51	151,251	50
Total liabilities	69,351	63,264	10	55,784	24
Shareholders' equity	157,715	87,133	81	95,468	65
Bank loan	26,760	41,194	(35)	28,586	(6)
Net debt and working capital	40,908	42,073	(3)	34,779	17
<b>Operating</b>					
Production:					
Crude oil (barrels per day)	1,142	1,110	3	1,001	14
Natural gas (mcf per day)	<u>1,951</u>	<u>1,444</u>	35	<u>2,105</u>	(7)
Total (boe per day) (6:1)	1,468	1,350	9	1,352	9
Average realized price:					
Crude oil (\$ per barrel)	77.35	49.36	57	73.80	5
Natural gas (\$ per mcf)	<u>5.91</u>	<u>6.17</u>	(4)	<u>5.20</u>	14
Combined average (incl. processing revenue) (\$ per boe)	68.07	47.16	44	62.74	8
<b>Netback (\$ per boe)</b>					
Petroleum and natural gas revenues	68.07	47.16	44	62.74	8
Royalties	(17.81)	(10.51)	69	(20.53)	(13)
Operating and transportation expenses	<u>(18.08)</u>	<u>(11.12)</u>	62	<u>(21.48)</u>	(16)
Operating netback	32.18	25.53	26	20.73	55
G&A expenses – cash	(7.83)	(7.11)	10	(6.34)	24
Realized economic hedging loss	–	–	–	(5.92)	–
Interest expense – net	<u>(2.87)</u>	<u>(2.23)</u>	29	<u>(3.05)</u>	(6)
Corporate netback	21.48	16.19	33	5.42	296
<b>Common Shares</b> (000s)					
Shares outstanding, end of period	74,928	37,869	98	47,940	56
Weighted average shares – basic and diluted <sup>(2)</sup>	48,320	37,829	28	39,502	22

### Notes:

1. The reader is referred to the section – "Non-GAAP Measurements" in this MD&A.
2. In computing the net loss per diluted share in the respective periods, nil shares were added to the weighted average number of shares outstanding because they were anti-dilutive.

## Overview

During the first quarter of 2010, Arcan closed a \$65 million equity offering and the Acquisition and tested its first horizontal multi-stage fracture well. The Acquisition added approximately 500 boe per day of productive capacity and raised Arcan's undeveloped land base to over 140 net sections on the Swan Hills play. Arcan's activities in the Swan Hills area commenced in September 2005 and developed until December 9, 2009 when Arcan spudded its first multi-stage fracture horizontal well in the Swan Hills oil reef play at 9-29. The well was fractured 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 its operated production facility on February 23, 2010. This well is currently producing at a rate of approximately 350 boe per day.

In February 2010, the 10-27 well was drilled vertically and logged with core indicating over 14 net meters of oil bearing reef. After acquiring the lands, Arcan whipstocked the 10-27 well and drilled an approximately 1,200 meter horizontal leg. This well tested at approximately 700 boe per day. Subsequent to testing, Arcan installed a pump jack and is producing at a rate of approximately 500 boe per day from the 10-27 well. Arcan has built a road to this new well and intends to truck oil from this well until it can be connected to Arcan's existing infrastructure. In addition to these two wells, Arcan has spudded seven more horizontal wells, six of which have finished drilling and completion operations have commenced on the first two wells at (10-17) 1-17-68-8W5 and (10-29) 8-30-68-8W5.

After completing its first horizontal multi-stage fractured well in February 2010 Arcan continued drilling with three drill rigs through the break-up period. This logistical success will allow Arcan to have drilled and completed nine horizontal multi-stage fractured wells early into the third quarter of 2010 and set up a significant drilling inventory for the remainder of the year and well into 2011. Arcan estimates that, after completing nine wells, it will be able to drill approximately one or two additional horizontal wells per month inside of its existing cash flow base and will evaluate expanding its drilling activities based on expanding the banking facilities and reserves going into the fourth quarter. Arcan's published December 31, 2009 net asset value, banking facilities and reserves do not include the results of the Corporation's horizontal multi-stage fractured wells and only includes 22 cents of value attributed to land and seismic values. Reserves are booked to only eight net sections of land on the Swan Hills reef out of the over 140 net sections of land which Arcan controls.

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 low and Arcan hopes to achieve an increase in the overall recovery factor through horizontal drilling and is targeting greater than 40 percent recovery within the Unit and recently acquired lands.

As of May 20, 2010, Arcan estimates that it has \$56 million in debt and working capital and is drawn \$38 million on its \$70 million New Credit Facility (as defined below). Arcan is evaluating the growth of its production base in 2010 through a prudent level of investment based on anticipated cash flow.

As at March 31, 2010, Arcan had 13 full-time office employees and 5 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 40° API light sweet oil-in-place. The main portion of the reef has undergone extensive waterflood operations and recovered over 40% of the oil-in-place. As announced by the Alberta Government, the reef is now to be developed under CO<sub>2</sub> 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 a relatively 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 have 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% interest in the Unit when total production was approximately 250 boe per day. In August 2006, Arcan acquired an additional 65.4% working interest, with a further 5% purchased in 2006 bringing Arcan's working interest in the Unit to the current 81%. Through 2007 Arcan built a new 4,000 barrel battery as well as a 5,000 pounds per square inch water injection system covering the Unit.

In 2009, 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 productive capacity for a net cash purchase price of \$52.8 million. An important part of the Acquisition was that these lands were additive to Arcan's current working interests and adjacent to Arcan's existing land base. As a result of the Acquisition, Arcan has a consolidated 100% 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 which covers 9.5 sections of land, has recovered approximately 3.9 million boe ("**mmboe**"). This amount represents approximately 10% of the original oil-in-place estimate of GLJ Petroleum Consultants Ltd. of approximately 39 mmboe or approximately four mmboe per section. Arcan estimates that original oil-in-place is approximately 60 mmboe. Offsetting units with over 40 years of production history have proven over six mmboe of oil-in-place per section and have recovered more than 35% of their estimated original oil-in-place, and are believed capable of 45% ultimate recovery under vertical well development and waterflood.

As a result of the Acquisition, Arcan acquired 1.4 mmboe of proven reserves valued at \$39.3 million (present value discounted at 10%) or 1.7 mmboe of proven plus probable reserves valued at \$43.3 million (present value discounted at 10%). 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*

To date, Arcan has drilled and completed two horizontal multi-stage fracture wells. Arcan has finished drilling an additional six horizontal wells, is currently drilling the ninth well and expects to start drilling the tenth well shortly. Arcan has commenced completion operations on both the 1-17-68-8W5 and the 8-30-68-8W5 wells and depending on weather conditions, Arcan anticipates that it will be completing the remaining drilled wells in succession approximately every week or two finalizing early into the start of the third quarter of 2010. Arcan has a further 15 (12 net) horizontal wells at the drill-ready stage to continue the drilling program and in the near term will focus on continuing to develop wells within the unit. These wells all have approximately 1,000 meter horizontal legs planned and will be completed using a ten stage acid fracture.

<b>Well</b>	<b>Surface Location</b>	<b>Spud Date</b>	<b>Comments</b>
9-29-68-8W5	12-29-68-8W5	December 9, 2009	On Stream on February 23, 2010
10-27-67-8W5	05-34-67-8W5	February 9, 2010	On Stream on May 9, 2010
1-17-68-8W5	10-17-68-8W5	March 15, 2010	Starting completion
6-20-68-8W5	10-17-68-8W5	April 11, 2010	Drilled and awaiting completion
10-32-68-8W5	15-29-68-8W5	April 5, 2010	Drilled and awaiting completion
8-30-68-8W5	10-29-68-8W5	March 10, 2010	Starting completion
5-28-68-8W5	10-29-68-8W5	April 18, 2010	Drilled and awaiting completion
9-30-68-8W5	15-29-68-8W5	April 26, 2010	Drilled and awaiting completion
13-17-68-8W5	02-17-68-8W5	May 17, 2010	Drilling
14-17-68-8W5	12-20-68-8W5	Late May 2010	To spud late May 2010

Nine of the ten wells are in the Unit where Arcan already has existing operated pipelines, roads, water injection and facilities in place to accommodate 4,000 barrels per day with room for expansion to 8,000 barrels per day. The horizontal drilling and multi-stage fracture completion capital along with associated equipment and tie-in costs are expected to be approximately \$4.7 million per well, before royalty incentives. 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 a number of horizontal multi-stage wells have recently been drilled by a competitors in adjoining sections. Arcan has received approval to inject over fracture pressure in several wells within the Unit allowing voidage replacement to be maintained.

*Swan Hills - The Consolidated Outlook*

The initial production of the first two horizontal wells and approximately 500 boe per day of productive capacity on the 102 (81 net) sections of land in the Swan Hills area obtained in the Acquisition increases the productive capacity on Arcan's lands in the Swan Hills play from approximately 650 net barrels per day at December 31, 2009. Current production from the Swan Hills is approximately 1,500 net boe per day. This base production includes lost production related to numerous vertical wells that were producing and were shut-in to accommodate horizontal drilling. Arcan anticipates that most of the current vertical wells will serve as water source wells or water injection wells in the future.

**Hamburg, Alberta**

In February 2006, Arcan discovered the Hamburg GG oil, is the operator and owns a 50.25% working interest in the pool. These wells are prolific, producing 41° API sweet oil. Arcan enhanced its water injection in the pool in March of 2010 by converting a third well to an injector and adding a free water knock-out. Arcan currently has two to four infill development opportunities to drill in the GG pool and will evaluate this program as economic conditions warrant with longer-term plans for additional exploration tests that have been selected based on 3D seismic.

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

Fiscal quarter ended	2010	2009				2008		
	March	Dec.	Sept.	June	March	Dec.	Sept.	June
<b>Operating</b>								
Oil and NGLs (barrels per day)	1,142	1,001	913	1,061	1,110	1,102	1,087	1,241
Price (\$/bbl)	77.35	73.80	70.18	63.98	49.36	63.55	118.63	118.48
Natural gas (mcf per day)	1,951	2,105	2,166	2,772	1,444	2,199	2,144	2,174
Price (\$/mcf)	5.91	5.20	3.27	4.09	6.17	8.19	9.26	12.17
Barrels of oil equivalent (boe per day)	1,468	1,352	1,274	1,523	1,350	1,468	1,444	1,604
<b>Financial (\$000's, except per share amounts)</b>								
<b>Revenues</b>								
Petroleum and natural gas	8,992	7,804	6,546	7,209	5,731	8,099	13,690	15,793
Royalties	(2,352)	(2,554)	(2,010)	(1,275)	(1,277)	(1,881)	(3,681)	(2,876)
Interest and other income	3	1	-	2	1	(220)	207	14
Realized loss on commodity contracts	-	(737)	(481)	(222)	-	-	-	-
Unrealized gain (loss) on commodity contracts	-	531	1,228	(1,115)	(644)	-	-	-
Net revenues	6,643	5,045	5,283	4,599	3,810	5,998	10,216	12,931
<b>Expenses</b>								
Operating	2,388	2,672	2,465	1,593	1,352	2,416	2,482	1,832
General and administrative	1,034	788	1,063	959	863	1,086	672	1,089
Stock-based compensation	438	391	166	193	193	337	159	187
Interest	382	380	494	398	272	291	311	337
Accretion	108	103	104	105	101	99	88	85
Depletion and depreciation	3,219	2,795	2,680	3,098	2,720	3,036	3,553	3,960
Total expenses	7,569	7,130	6,972	6,346	5,501	7,265	7,265	7,490
Income (loss) before income taxes	(926)	(2,085)	(1,689)	(1,747)	(1,690)	(1,269)	2,951	5,441
Future income tax expense (reduction)	(122)	(354)	(281)	(433)	(400)	(495)	806	1,458
Net income (loss)	(804)	(1,730)	(1,408)	(1,314)	(1,290)	(772)	2,145	3,983
Net income (loss) per share- basic	(0.02)	(0.04)	(0.04)	(0.03)	(0.03)	(0.02)	0.06	0.11
Net income (loss) per share- diluted	(0.02)	(0.04)	(0.04)	(0.03)	(0.03)	(0.02)	0.05	0.10
Funds from operations	2,826	667	32	2,680	1,966	1,987	6,747	9,617
Per share – basic	0.06	0.02	0.00	0.07	0.05	0.05	0.18	0.25
Cash flow from (used in) operating activities (per GAAP)	2,548	(371)	1,235	2,102	1,361	4,590	7,150	9,665
<b>Operating Netbacks (\$/boe)</b>								
Petroleum and natural gas revenues	68.07	62.74	55.85	52.01	47.16	59.95	103.03	108.21
Royalties	17.81	20.53	17.15	9.20	10.51	13.93	27.71	19.71
Operating and transportation expenses	18.08	21.48	21.03	11.50	11.12	17.88	18.68	12.55
Operating Netbacks	32.18	20.73	17.67	31.31	25.53	28.15	56.64	75.95
<b>Total assets (\$000's)</b>	<b>227,067</b>	151,251	146,130	145,729	150,398	149,724	143,006	132,263
<b>Capital expended (\$000's)</b>	<b>70,835</b>	4,979	3,111	229	3,177	9,980	11,323	4,062
<b>Debt and working capital (\$000's)</b>	<b>(40,908)</b>	(34,779)	(42,622)	(40,414)	(42,073)	(40,406)	(32,412)	(27,835)
<b>Shares (000's)</b>	<b>74,928</b>	47,940	37,869	37,869	37,869	37,869	37,869	37,869

## Results of Operations

Arcan invested \$70.8 million of capital in the first quarter of 2010, of which \$52.8 million was expended on the Acquisition. For the first quarter of 2010, operations were mainly focused on the Swan Hill horizontal drilling program and the completion of the waterflood facilities related to the Hamburg GG pool.

### Drilling

	Drilling		Success rate (%) (gross)	Working interest (%)
	Gross	Net		
Q1 / 2010	4	2.8	75	70

In the first quarter of 2010, Arcan drilled four gross (2.8 net) wells. One exploration well, on which Arcan paid 20% of the drilling costs, remains standing, one (0.5 net) oil producing well was drilled in the Hamburg GG pool and is on production and two (1.8 net) horizontal wells were drilled in the Swan Hills reef play. In the first quarter of 2010 Arcan also expended \$4.3 million on Crown land sales primarily in the Swan Hills area.

### Production

	Quarter ended		
	March 31, 2010	March 31, 2009	December 31, 2009
Crude Oil and NGLs (barrels per day)	1,142	1,110	1,001
Natural gas (mcf per day)	1,951	1,444	2,105
Total oil equivalent (boe per day)	1,468	1,350	1,352
Oil as a % of total volumes	78	82	74

Arcan's average production rate for the first quarter of 2010 was 1,468 boe per day, a 9% increase over the first quarter of 2009 average of 1,350 boe per day and the 1,352 boe per day average in the fourth quarter of 2009. Production was higher due to the new horizontal wells more than offsetting vertical well shut-ins in the Swan Hills area. The 500 boe per day of volumes acquired in the Acquisition were not included in the operating results of the first quarter of 2010.

Arcan's capital expenditures continue to be focused towards its oil properties as oil prices have remained stable and elevated as compared to natural gas prices. Arcan expects the balance of its efforts for the remainder of 2010 will be directed to expanding the Swan Hills light oil production base and water injection. Arcan's oil and natural gas liquids ("NGL") weighting was 78% for the first quarter of 2010, although it is estimated to be 80-90% light oil in the second quarter of 2010 as the new oil wells and the Acquisition expands Arcan's oil production rates.

### Netbacks

The Corporation considers corporate netbacks to be an indication of ability to produce oil and natural gas profitably to earn a return on capital invested and is one of Arcan's three sources of funding (the others being raising debt and equity). Commodity price increases of 44% and volume increases of 9% were the main factors causing the gains in corporate netbacks for the first quarter of 2010 over the first quarter of 2009. Netbacks were also up over the fourth quarter of 2009 due to higher prices and lower operating costs and royalties in the first quarter of 2010. While Arcan expects commodity price fluctuations over the upcoming year, overall oil price levels are expected to remain relatively stable at \$75-\$90 per barrel, royalty rates are expected to decrease (due to announced drilling incentives that help offset the Alberta royalty structure) and operating costs are expected to be reduced to the \$8-12 per boe range. These factors, as well as Arcan's growing oil production, are expected to increase the netbacks received by Arcan for the balance of 2010.

<b>Netbacks</b> \$ thousands	<b>Quarter ended</b>		
	<b>March 31, 2010</b>	<b>March 31, 2009</b>	<b>December 31, 2009</b>
Revenue	<b>8,992</b>	5,731	7,804
Royalties	<b>2,352</b>	1,277	2,554
Operating expenses	<b>2,388</b>	1,352	2,672
Operating netbacks	<b>4,252</b>	3,102	2,578
Realized economic hedging loss	-	-	737
G&A	<b>1,034</b>	863	788
Interest expense	<b>379</b>	273	379
Corporate netbacks	<b>2,839</b>	1,966	674
<b>Netbacks - \$ per boe</b>			
Revenue	<b>68.07</b>	47.16	62.74
Royalties	<b>17.81</b>	10.51	20.53
Operating expenses	<b>18.08</b>	11.12	21.48
Operating netbacks	<b>32.18</b>	25.53	20.73
Realized economic hedging loss	-	-	5.92
G&A	<b>7.83</b>	7.11	6.34
Interest expense	<b>2.87</b>	2.23	3.05
Corporate netbacks	<b>21.48</b>	16.19	5.42

Arcan's operating netback, defined as sales revenue, less royalties and operating expenses, was \$4.3 million in the first quarter of 2010, a 37% increase from \$3.1 million recorded in the first quarter of 2009. Arcan's operating netback on a per boe basis was \$32.18 in the first quarter of 2010, a 26% increase from \$25.53 per boe recorded in the first quarter of 2009. The increase in operating netback was largely due to a 44% increase in the prices it received which offset increases in royalties and operating costs on a per boe basis in the first quarter of 2010 as compared to the same period in 2009; however, the impact of this price increase has been curtailed as a result of the rising value of the Canadian dollar versus the U.S. dollar. The significant increase in the operating netback over the fourth quarter of 2009, both on a dollar basis as well as a boe basis, is due to increases in volumes and prices coupled with decreased royalties and operating costs. The move to oil weighting has increased Arcan's exposure to price upside in oil versus natural gas in both 2010 and 2009.

Operating netbacks from oil were \$33.26 per boe and natural gas were \$22.69 per boe in the first quarter of 2010 versus \$26.10 per boe for oil and \$23.66 per boe for natural gas in the first quarter of 2009. Operating netbacks from oil were \$20.92 per boe and natural gas were \$15.25 per boe during the fourth quarter of 2009. Arcan's oil netbacks were stronger than natural gas netbacks for all periods as a result of commodity pricing.

Arcan's corporate netback, defined as operating netback, less G&A and interest (income less expense), was \$2.8 million in the first quarter of 2010 as compared to \$2.0 million in the first quarter of 2009. The increase from 2009 related mainly to volumes and commodity prices. On a per boe basis, the corporate netback was \$21.48 in the first quarter of 2010 as compared to \$16.19 per boe in the first quarter of 2009 and \$5.42 per boe in the fourth quarter of 2009. Changes in netbacks and the components thereof are detailed by category in the above table.

Operation details by area for the three months ended March 31, 2010 and 2009 are as follows:

**Operating Netbacks by Area**

(Per boe) Area	<b>Three months ended March 31, 2010</b>			<b>Three months ended March 31, 2009</b>		
	<b>Hamburg</b>	<b>Deer Mountain</b>	<b>McLeod</b>	<b>Hamburg</b>	<b>Deer Mountain</b>	<b>McLeod</b>
Daily production	<b>652</b>	<b>696</b>	<b>117</b>	593	643	112
Revenue	<b>62.29</b>	<b>77.93</b>	<b>42.37</b>	47.78	48.41	37.06
Royalties	<b>15.88</b>	<b>22.38</b>	<b>1.66</b>	9.92	12.39	3.99
Operating costs	<b>14.67</b>	<b>20.85</b>	<b>18.02</b>	7.92	13.47	17.40
Operating netbacks	<b>31.74</b>	<b>34.70</b>	<b>22.69</b>	29.94	22.55	23.66

## Revenues

Arcan posted increased production revenues for the quarter ended March 31, 2010. The 9% increase in production and 44% increase in price resulted in an increase in revenue of 57% to \$9.0 million in the first quarter of 2010 from the \$5.7 million recorded in the first quarter of 2009 and was up from the \$7.8 million in the fourth quarter of 2009.

### Revenue and Realized Prices

(\$000's)	Quarter ended		
	March 31, 2010	March 31, 2009	December 31, 2009
Oil and NGL	<b>7,953</b>	4,929	6,797
Natural gas	<b>1,039</b>	802	1,007
Total petroleum and natural gas revenue	<b>8,992</b>	5,731	7,804
<b>\$ per boe</b>			
Oil and NGL (per boe)	<b>77.35</b>	49.36	73.80
Natural gas (per mcf)	<b>5.91</b>	6.17	5.20
Total petroleum and natural gas revenue (per boe)	<b>68.07</b>	47.16	62.74
<b>Benchmarks</b>			
WTI (U.S.\$ per barrel)	<b>78.88</b>	43.18	76.03
Edmonton Light Sweet (Cdn\$ per barrel)	<b>80.53</b>	50.27	76.73
Alberta Plant Gate (per mcf)	<b>4.92</b>	4.79	4.50
Cdn\$ per U.S.\$	<b>0.961</b>	0.804	0.950

## Commodity Prices

In the first quarter of 2010, Arcan realized average revenue per boe of \$68.07 as compared to \$47.16 per boe recorded in the first quarter of 2009 and \$62.74 in the fourth quarter of 2009. Arcan realized an average of \$77.35 per barrel of oil and NGL in the first quarter of 2010, an increase of 57% from the \$49.36 per barrel realized in the first quarter of 2009 and up from the \$73.80 per barrel received in the fourth quarter of 2009. This compares to an average Edmonton Light Sweet price of \$80.53 per barrel in the first quarter of 2010. Oil and NGL prices received by the Corporation moved consistently with benchmark prices for the relative periods. The Corporation realized an average natural gas price of \$5.91 per thousand cubic feet ("mcf") in the first quarter of 2010, a 4% decrease from the \$6.17 per mcf averaged in the first quarter of 2009 and a 14% increase from the \$5.20 per mcf received in the fourth quarter of 2009. This is consistent with the price changes at the Alberta Plant Gate for the same periods. Arcan continues to receive a premium for its heat content on natural gas. Arcan anticipates oil prices will remain above U.S.\$60 WTI and that gas prices may remain soft into the fall of 2010. The strength in oil prices has been mitigated somewhat by the strength in the Canadian dollar. Based on anticipated production volumes Arcan anticipates that it will post higher revenues for the balance of 2010. Pricing is expected to average approximately the same in the second quarter of 2010 as the first quarter, based on current market conditions.

All of Arcan's production for 2010 has been sold on the spot market. Arcan had no hedged volumes during the quarter ended March 31, 2010. For the period from April 1, 2009 to December 31, 2009 Arcan had an economic hedge of 500 barrels per day of oil at \$64.40 per barrel.

## Royalties

Royalty expense in the first quarter of 2010 was \$2.4 million or 26% of revenue, compared to \$1.3 million or 22% of revenue in the first quarter of 2009 and was \$2.6 million or 33% of revenue in the fourth quarter of 2009. Royalties have increased on a percentage of revenue, gross dollar and on a per boe basis from the first quarter of 2009 as a result of higher commodity prices. Royalties have decreased on a percentage of revenue, gross dollar and on a per boe basis from the fourth quarter of 2009 as a result of royalty incentives. 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 modified and reduced the royalties a number of times, with the latest announcement of changes being made in March 2010. Recent announcements regarding royalty reductions in Alberta suggest that royalties, as a percentage of revenue, may decline and royalty maximums may be reduced from 50% of revenue to 40% of revenue on January 1, 2011.

Only the impact of royalties enacted by December 31, 2009 has been factored into Arcan's reserves estimates and credit facilities. Arcan continues to monitor and plan for the impact of the NRF and any subsequent modifications. Based on fluctuating commodity prices, production rates, drilling profiles 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% to 40% depending on production volumes, prices and possible future royalty changes.

Drilling creates royalty credits that are recorded as a reduction to capital costs and are capped at 50% of royalties paid. Depending on production volumes and commodity prices, Arcan anticipates that it will be in a position to drill 12-18 horizontal wells so as to maximize its drilling credits by the end of the first quarter of 2011.

#### Royalties

	Quarter ended		
	March 31, 2010	March 31, 2009	December 31, 2009
Total (\$000s)	2,352	1,277	2,554
% of revenue	26	22	33
Per boe (\$)	17.81	10.51	20.53

#### Operating Expense (Including Transportation)

Higher costs in the first quarter of 2010 due to operating workovers resulted in an increase in per boe operating costs of 63% to \$18.08 per boe of production from the \$11.12 per boe recorded in the first quarter of 2009. Operating costs in the first quarter of 2010 were down 16% from \$21.48 per boe in the fourth quarter of 2009. Total operating expenses in the first quarter of 2010 were \$2.4 million, up 77% from \$1.4 million in the first quarter of 2009 and down from the \$2.7 million in the fourth quarter of 2009. Elevated costs in the last three quarters of Arcan resulted from the preparation of the Swan Hills property for the multi-stage horizontal drilling activity and related water injection, as well as water handling costs at Hamburg.

Arcan's operating expenses have increased since 2006 due to the Corporation's move toward oil-weighted production. Arcan's continued transition towards oil-weighted production from horizontal wells, including costs to operate the enhanced recovery, is anticipated to result in \$8-\$12 per boe average operating costs per unit of production. Arcan expects that per boe operating expenses will decrease in 2010 as production volumes increase. Cost reductions are anticipated as a result of the new free water knock out in Hamburg, the change in pump systems to jet pumps in Swan Hills and the prolific nature of the horizontal wells.

#### Operating Expenses (Including Transportation)

	Quarter ended		
	March 31, 2010	March 31, 2009	December 31, 2009
Total (\$000s)	2,388	1,352	2,672
Per boe (\$)	18.08	11.12	21.48

#### Unrealized and Realized Loss on Commodity Contracts

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, 2010 to December 31, 2010 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"). There are no amounts in prior periods as this was Arcan's first commodity

contract. Arcan has no production hedged in 2010. The unrealized loss on commodity contracts was \$0.6 million at March 31, 2009. In 2009 Arcan had marked-to-market the fixed price swap and recorded gains and losses to the statement of operations for each reporting period.

Arcan had a realized loss during the fourth quarter of 2009 of \$0.7 million and a total realized loss of \$1.4 million in 2009 related to this hedge. No amounts were realized in 2010.

### Cash General and Administrative ("Cash G&A")

Cash G&A expenses for the first quarter of 2010 increased on a per boe basis to \$7.83 per boe from \$7.11 per boe in the first quarter of 2009 and increased from \$6.34 per boe in the fourth quarter of 2009. The increase for the first quarter of 2010 was largely the result of a \$0.3 million charge from a third party firm Arcan had hired to determine potential avenues of debt financing for the Acquisition should the equity issuance prove unsuccessful. Excluding that charge Arcan's costs would have been \$5.92 per boe. Total Cash G&A expenses for the first quarter of 2010, net of recoveries of \$0.2 million, were \$1.0 million, compared to \$0.9 million in the first quarter of 2009 after recoveries of \$0.1 million. In the fourth quarter of 2009, Cash G&A was \$0.8 million net of recoveries of \$0.1 million.

Total Cash G&A for three months ended March 31, 2010 of which \$1.0 million was primarily comprised of a finance charge of \$0.3 million, wages of \$0.4 million, and rent of \$0.1 million.

Arcan does not capitalize any Cash G&A expenses. 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. Arcan expects Cash G&A costs to grow marginally as Arcan continues to increase activity levels; however, per boe numbers should decline as production volumes increase.

### Cash G&A Expenses

(\$000s except per boe)

	Quarter ended		
	March 31, 2010	March 31, 2009	December 31, 2009
Total	1,034	863	788
Per boe (\$)	7.83	7.11	6.34

### Interest Expense

Interest expense in the first quarter of 2010 was \$0.4 million or \$2.87 per boe as compared to \$0.3 million or \$2.23 per boe in the first quarter of 2009 and \$0.4 million or \$3.05 per boe in the fourth quarter of 2009. Arcan's interest expense is related to higher interest rates even though its debt levels were reduced from \$41.2 million at March 31, 2009 to \$26.8 million at March 31, 2010 and \$28.6 million at December 31, 2009. Arcan's management does increase debt levels based on operational success. Arcan forecasts that the debt to annualized first quarter 2010 cash flow ratio is at 3.6 to 1. Arcan estimates that interest expense will increase as higher debt levels are maintained and interest rates increase. Arcan had an effective interest rate of 4.75% on its debt facility at March 31, 2010 compared to 5.0% at March 31, 2009.

Subsequent to the end of the first quarter of 2010, Arcan has continued to increase its draws on its New Credit Facility and expects to carry bank debt as required as part of routine operations on an ongoing basis. Based on Arcan's assets, the New Credit Facility was increased from \$50 million at the start of 2009 to \$70 million in May 2010.

### Interest Expense, Net

	Quarter ended		
	March 31, 2010	March 31, 2009	December 31, 2009
Total (\$000s)	379	272	380
Per boe (\$)	2.87	2.23	3.05

### Funds from Operations

Funds from operations increased by 44% in the first quarter of 2010 to \$2.8 million from \$2.0 million in the first quarter of 2009, and were up significantly from \$0.7 million in the last quarter of 2009. On a diluted per share basis, funds from operations remained relatively flat at \$0.06 in the first quarter of 2010 from \$0.05 in the same period of 2009. Arcan anticipates increased funds from operations in the second quarter of 2010 based on current commodity prices and anticipated increases in production volumes.

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

	Quarter ended		
	March 31, 2010	March 31, 2009	December 31, 2009
(\$000's except per share and per boe)			
Cash flow from (used in) operating activities (per GAAP)	2,548	1,361	(371)
Change in non-cash working capital	278	605	1,038
Funds from operations	2,826	1,966	667
Per share – basic and diluted	0.06	0.05	0.02
Per boe (Corporate Netbacks)	21.48	16.19	5.42

Funds from operations per share is calculated using the weighted average basic and diluted shares used in calculating earnings per share.

### Stock-Based Compensation

Arcan recorded stock-based compensation expense of \$0.4 million in the first quarter of 2010, calculated using the Black-Scholes option-pricing model. This increase in expense over the first quarter of 2009 is due to options issued in the fourth quarter of 2009 that had a one year vesting term. During the first quarter of 2010 Arcan did not grant any options; however, Arcan did grant 2.9 million options on April 1, 2010. These newly granted options have vesting terms with one-third of the options vesting on each of the first three anniversary dates and expire after five years. Changes to the various periods are as a result of inputs for calculations, varied amounts of option grants as well as relative numbers of options vesting during the periods.

Stock-based compensation expense 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 expense to increase as new options are issued, but decrease on a per unit basis as volumes increase. No stock-based compensation is capitalized.

### Stock-Based Compensation Expense

	Quarter ended		
	March 31, 2010	March 31, 2009	December 31, 2009
(\$000's except per boe)			
Total	438	193	391
Per boe	3.32	1.59	3.14

## Depletion, Depreciation and Accretion ("DD&A")

Depletion and depreciation are calculated based upon capital expenditures, production rates and reserves. Arcan recorded \$3.3 million or \$25.18 per boe in depletion and depreciation expense in the first quarter of 2010 based on production volumes of 132,087 boe. The 8% increase in depletion expense per boe as compared to the first quarter of 2009, where Arcan recorded \$23.21 per boe and the fourth quarter of 2009 of \$23.31 per boe is primarily the result of the Acquisition which was acquired at a slightly higher cost per proved reserves than historic carrying values. The Corporation plans to decrease the depletion per boe amount in future years by adding reserves through an effective exploration and development program.

The Corporation excluded from its depletion and depreciation calculation costs associated with undeveloped land and seismic of \$23.5 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 decreased each reporting period due to the passage of time and the amount of accretion is charged to earnings in the period. Arcan recorded \$0.81 per boe of accretion expense in the first quarter of 2010, an increase from \$0.83 per boe in the first quarter of 2009 as a result of decreased volumes and higher accumulating obligations in 2010 compared to 2009. The estimated clean-up costs related to the properties in the Acquisition accounted for the majority of the change to the asset retirement obligation of \$9.7 million at March 31, 2010 from \$5.4 million at December 31, 2009.

### DD&A Expense

(\$000's except per boe)	Quarter ended		
	March 31, 2010	March 31, 2009	December 31, 2009
Total	3,327	2,821	2,899
Per boe	25.18	23.21	23.31

### Income and Other Taxes

A future tax reduction of approximately \$0.1 million has been recognized in the financial statements for the first quarter of 2010, which relates to the Corporation experiencing a pre-tax loss of \$0.9 million for the quarter. This compares to the first quarter of 2009 when the pre-tax loss was \$1.7 million and a future tax reduction of \$0.4 million was recorded. The Corporation also recorded a future tax asset of \$1.1 million on the tax effect of the share issue costs and a future tax liability of \$0.4 million on the tax effect of the flow-through shares issued in 2009. The provision for income taxes differs from the amount obtained by applying the combined federal and provincial income tax rate for 2010, which was 28.0% to pre-tax income due to non-deductible stock-based compensation and future tax rate differences.

As at March 31, 2010 the Corporation has approximately \$0.8 million in flow-through obligations outstanding.

Arcan has not paid any cash taxes since inception and estimates it has approximately \$184 million in tax pools. With capital spending in 2010 and reduced commodity prices, Arcan does not expect to be in a taxable position until 2012 at the earliest. However, Arcan is not able to forecast future possible changes in federal and provincial tax regimes.

### Future Tax Reduction

(\$000's except per boe)	Quarter ended		
	March 31, 2010	March 31, 2009	December 31, 2009
Total	122	400	354
Per boe	0.92	3.29	2.85

## Net Loss

The net loss for the first quarter of 2010 was \$0.8 million or \$0.02 per basic and diluted share, down from the \$1.3 million of net loss created in the first quarter of 2009 and the \$1.7 million of net loss in the fourth quarter of 2009. The change in operating netbacks was the primary contributor to this change.

### Net Loss

(\$000's except per share and per boe)	Quarter ended		
	March 31, 2010	March 31, 2009	December 31, 2009
Total	(804)	(1,290)	(1,730)
Per share and diluted	(0.02)	(0.03)	(0.04)
Per boe	(6.09)	(10.62)	(13.91)

## Capital Expenditures

The first quarter of 2010 was focused mainly in the Swan Hills area. Capital expenditures for the first quarter of 2010 were \$70.8 million, which included the \$52.8 million spent in respect of the acquisition. This was up from the \$3.2 million spent in the first quarter of 2009. The capital program additionally consisted of drilling four (2.8 net) wells, building access roads, installing a free water knock out and converting one well to a water injector.

### Capital Expenditure Summary

(\$ millions)	Q1 2010
Land and seismic	4.3
Drilling and intangibles	9.0
Facilities and equipment	4.7
Acquisitions	52.8
<b>Total Capital – Cash expended</b>	<b>70.8</b>

Property, plant and equipment on the balance sheet in the financial statements increased to \$212.1 million at March 31, 2010 from \$140.3 million at the end of 2009. This change reflects the increased capital expended of \$70.8 million reduced by DD&A expense of \$3.2 million.

## Liquidity and Capital Resources

Arcan incurred \$70.8 million on the Acquisition and capital expenditures during the first quarter ended March 31, 2010, up significantly from \$3.2 million for the quarter ended March 31, 2009. Arcan generated \$2.8 million in funds from operations in first quarter of 2010, and at March 31, 2010 had borrowed \$26.8 million from its credit facility and had a working capital deficit including bank debt of \$40.9 million as at March 31, 2010. With its current 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 increased bank debt and working capital deficit levels from the \$34.8 million in fourth quarter of 2009 through increased capital expenditures and the Acquisition was partially offset by the issuance of equity. Arcan's first quarter 2010 annualized funds from operations to net debt was 3.6 to one. The ratio is expected to decrease to under three to one by the end of 2010.

Effective May 13, 2010, Arcan entered into an agreement for a \$70 million credit facility (the "**New Credit Facility**"). The New Credit Facility consists of a \$60 million syndicated revolving credit facility and a \$10 million revolving operating facility. The New Credit Facility replaced Arcan's \$50 million credit facilities with ATB, of which approximately \$38 million is currently drawn. The New Credit Facility has 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. This New Credit Facility has been reflected in the balance sheet in the unaudited interim financial statements for the first quarter of 2010, now classifying the bank loan as long term, out of current liabilities. The New Credit Facility is secured by a charge on all of Arcan's assets. The New Credit Facility includes customary positive and negative covenants by Arcan in favour of the lenders.

On March 24, 2010 Arcan issued 26 million 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 \$52.8 million). Arcan intends to apply the balance of the \$12.2 million to its 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 May 20, 2010, due to capital expenditures in the Swan Hills, its debt and working capital deficiency is approximately \$56 million, which is below its current debt facility. Arcan estimates that it will have capital expended in excess of cash flow 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 estimates that after completing eight wells by the end of the third quarter of 2010, Arcan will be able to drill approximately one additional horizontal well per month inside of its existing cash flow base and will evaluate expanding its drilling activities based on expanding its credit facilities and reserves going into the fourth quarter.

Arcan expects its capital expenditure program to be significantly higher in 2010 than in 2009 and anticipates the expenditures to be financed through its New Credit Facility and available funds from operations. Additional equity may be available later in 2010 if the condition of the 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 consist of:

(\$ 000's)	<b>Quarter Ended March 2010</b>	Quarter Ended March 2009	Quarter Ended December 2009
Current assets	<b>14,927</b>	10,017	10,947
Less:			
Accounts payable and accrued liabilities	<b>29,075</b>	10,252	17,140
Bank loan	<b>26,760</b>	41,194	28,586
Fair value of commodity contracts	-	644	-
Working capital (deficiency)	<b>(40,908)</b>	(42,073)	(34,779)

The change in current assets and accounts payable reflects the higher activity levels incurred since the end of 2009. The change to the classification of the bank loan to long term in the first quarter of 2010 from current liabilities on the balance sheet set forth in the 2009 annual financial statements reflects the change in nature of the New Credit Facility from the previous revolving loan. The increase in working capital deficiency from year end reflects the increased capital expenditures and the Acquisition partially offset by the issuance of equity.

### **Related Party Transactions**

In conjunction with the equity issuance by way of short form prospectus during the three months ended March 31, 2010, certain officers and directors acquired 68,000 common shares at \$2.50 per share.

In conjunction with the equity issuance by way of short form prospectus during the year ended December 31, 2009, certain officers and directors acquired 340,000 common shares at \$1.25 per share.

A share purchase loan of \$100,000 (2009 - \$100,000) is due from an officer of Arcan 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 common shares.

### Contractual Obligations

The Corporation has previously entered into, or is involved in, farm-in and/or farm-out agreements in the normal course of its business in 2010. As of the date of this MD&A, Arcan has no farm-in and/or farm-out commitments.

Arcan has the following commitments:

- (a) Future minimum lease payments relating to operating lease commitments as follows:

	<u>\$</u>
2010	178,875
2011	244,125
2012	249,750
2013	249,750
2014	249,750
2014 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 as follows:

	<u>\$</u>
March 2010 to February 2011	60,000

### Off-Balance Sheet Obligations

There were no off-balance sheet obligations at March 31, 2010.

### Outstanding Share Data

Arcan's issued and outstanding share capital consists of the following:

	<u>May 20, 2010</u>	<u>Quarter Ended March 31, 2010</u>	<u>Year Ended December 31, 2009</u>
Common shares	75,082,071	74,928,060	47,940,060
Warrants	293,500	458,631	586,631
Performance options	-	-	750,000
Stock options	7,359,000	4,497,000	4,671,166

Significant variations in share data and shareholders' equity from the year end of 2009 include the 26 million common shares issued as part of the Acquisition, the exercise of 750,000 performance options and the 2.9 million options granted on April 1, 2010.

Other than the 750,000 performance options exercised by three officers and the subsequent sale of 250,000 shares by one of those officers, none of the officers or directors of Arcan at March 31, 2010 exercised any stock options or sold any shares of Arcan during the quarter ended March 31, 2010, the year ended December 31, 2009 or during the period ended the date hereof.

## 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 increased production and recoveries creating enhanced reserves and NAV. Arcan is currently looking to 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 drilling for the first quarter of 2010 was focused on its Unit lands. Arcan's future plans for 2010 include:

- expansion of drilling horizontal multi-stage fracture wells in the Swan Hills reef light oil play on its 140 net sections of land; increase capacity at the Swan Hills battery and increase and expand its existing water injection scheme;
- continued development and water injection in the Hamburg GG pool; and
- ongoing review of opportunities 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 growth in the Swan Hills area. Arcan hopes to continue developing strategies to best exploit its land base over the long term. In the short term, Arcan intends to complete and commence production on the additional seven drilled or drilling horizontal wells in the Swan Hills area, as well as drill up to six additional horizontal wells inside of its existing debt and cash flow capabilities by the end of 2010. Arcan plans to review its reserves and banking facilities in the second half of 2010 and implement drilling expansions based on these results. 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.

## 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 there from, 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. 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**

For a full understanding of the Corporation's critical accounting estimates 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 and the MD&A for the years ended December 31, 2009 and 2008.

### **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 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.

In the first quarter of 2010, no changes were made to the Corporation's IFRS transition plan. No significant milestones were scheduled for this quarter due to the time constraints associated with year-end and first quarter reporting deadlines. Implementation steps will commence again in the second quarter of 2010.

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 GAAP. Arcan currently intends to elect to record P&NG assets at historic cost as calculated under GAAP on January 1, 2010.

Under 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 GAAP full cost ceiling test in several significant ways. Assets (including goodwill) will be allocated to Cash Generating Units ("**CGUs**") and a separate impairment test will be completed for each CGU identified. Under current 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 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 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 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 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 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 Advisories**

*Boes may be misleading, particularly if used in isolation. 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 method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.*

*Additional information about the Corporation, including the Corporation's annual information form for the year ended December 31, 2009, is available on SEDAR at [www.sedar.com](http://www.sedar.com).*

### **Forward-Looking Information and Statements**

*This MD&A contains certain forward-looking information and statements within the meaning of applicable securities laws (collectively, "**forward-looking information**"). 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. In particular, but without limiting the foregoing, this MD&A contains forward-looking information pertaining to the following: Arcan's income taxes, tax liabilities and tax pools; production volumes and product mix of Arcan's oil and gas production; oil and natural gas prices and Arcan's risk management programs; resource 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 flows; operating costs; financing of*

*expenditures; royalty rates and their impact on Arcan's operations and results; expectations regarding costs of drilling new wells and expanding facilities, potential effects of changes in drilling methods on future drilling results, potential effects of new drilling methods on future shareholder value, anticipated capital expenditures; and future growth, including development, exploration, and acquisition and development activities and related expenditures.*

*The forward-looking information contained in this MD&A reflects 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 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 included in this MD&A is not a guarantee of future performance and should not be unduly relied upon. Such forward-looking information involves 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 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 for the year ended December 31, 2009, copies of which are available on Arcan's SEDAR profile at [www.sedar.com](http://www.sedar.com).*

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

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