

# Management's Report



The accompanying Consolidated Financial Statements of BlackPearl Resources Inc. and related financial information presented in this annual report are the responsibility of Management and have been approved by the Board of Directors. The Consolidated Financial Statements have been prepared in accordance with Canadian generally accepted accounting principles. The Consolidated Financial Statements and related financial information reflect amounts which must, of necessity, be based upon informed estimates and judgments of Management with appropriate consideration to materiality. All financial information contained in the annual report is consistent, where appropriate, with that contained in the Consolidated Financial Statements.

The Company has developed and maintains systems of internal controls, policies and procedures in order to provide reasonable assurance as to the reliability of the financial records and the safeguard of assets.

PricewaterhouseCoopers, LLP, independent external auditors appointed by the shareholders of the Company, review BlackPearl Resources Inc.'s systems of internal controls and conduct their work to the extent they deem appropriate. They have examined the Consolidated Financial Statements and they have expressed an opinion on the statements. Their report is included in the Consolidated Financial Statements.

The Board of Directors has established an Audit Committee. The Audit Committee reviews with Management and the external auditors any significant financial reporting issues, the financial statements, and any other matters of relevance to the parties. The Audit Committee meets quarterly to review and approve the interim financial statements prior to their release, as well as annually to review the Company's annual financial statements and Management's discussion and analysis, and to recommend their approval to the Board of Directors. The external auditors have unrestricted access to the Company, the Audit Committee and the Board of Directors.

A handwritten signature in black ink, appearing to read 'J. Festival', is written in a cursive style.

**John L. Festival**  
**President and Chief Executive Officer**

A handwritten signature in black ink, appearing to read 'D. Cook', is written in a cursive style.

**Donald W. Cook**  
**Chief Financial Officer**

**February 24, 2010**



# Auditors' Report

February 25, 2010

To the Shareholders of BlackPearl Resources Inc.

We have audited the consolidated balance sheets of BlackPearl Resources Inc. as at December 31, 2009 and 2008 and the consolidated statements of operations, comprehensive loss and deficit, and cash flows for the periods then ended. These consolidated 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 consolidated 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 periods then ended in accordance with Canadian generally accepted accounting principles.

*PricewaterhouseCoopers LLP*

Chartered Accountants  
Calgary, Alberta

# Consolidated Balance Sheets



As at December 31 (audited)

(Cdn\$ in thousands)

	2009	2008
<b>ASSETS</b>		
Current assets		
Cash	\$ 56,352	\$ 24,059
Accounts receivable	11,977	9,536
Income and other taxes receivable	4,817	5,607
Prepaid expenses and deposits	1,167	1,658
	<b>74,313</b>	40,860
Investments (note 6)	1,284	9,619
Petroleum and natural gas properties (note 7)	392,712	421,664
	<b>\$ 468,309</b>	<b>\$ 472,143</b>
<b>LIABILITIES</b>		
Current liabilities		
Accounts payable and accrued liabilities	\$ 16,318	\$ 34,408
Future income tax (note 12)	-	4,036
Asset retirement obligation (note 9)	25,435	20,064
	<b>41,753</b>	58,508
<b>SHAREHOLDERS' EQUITY</b>		
Share capital (note 11)	779,809	723,122
Contributed surplus (note 11)	15,444	11,895
Deficit	(368,697)	(321,382)
	<b>426,556</b>	413,635
	<b>\$ 468,309</b>	<b>\$ 472,143</b>

Commitments and contingencies (note 13)  
See accompanying notes to consolidated financial statements

Signed on behalf of the Board:

**Keith C. Hill**  
Chairman and Director

**Brian D. Edgar**  
Director

# Consolidated Statement of Operations, Comprehensive Loss and Deficit

(Audited)	Year ended December 31	
(Cdn\$ in thousands, except for per share amounts)	2009	2008
<b>REVENUE</b>		
Oil and gas sales	\$ 89,637	\$ 183,536
Royalties	(21,262)	(45,192)
	<b>68,375</b>	<b>138,344</b>
<b>EXPENSES</b>		
Production	29,461	49,907
Transportation	3,466	3,664
General and administrative	6,913	15,000
Depletion, depreciation and accretion	81,100	85,385
Write-down of petroleum and natural gas properties	–	57,427
Stock-based compensation (note 11)	1,461	3,116
Interest (income)	(44)	(683)
Foreign currency exchange loss (gain)	762	(466)
Dilution gain on investment	–	(2,268)
Write-down of investments	556	2,575
	<b>123,675</b>	<b>213,657</b>
Loss before income taxes	<b>(55,300)</b>	<b>(75,313)</b>
<b>INCOME TAXES (note 12)</b>		
Current income tax (recovery)	(2,351)	(517)
Future income tax (recovery)	(5,634)	4,066
	<b>(7,985)</b>	<b>3,549</b>
<b>COMPREHENSIVE LOSS FOR THE YEAR</b>	<b>(47,315)</b>	<b>(78,862)</b>
<b>DEFICIT, BEGINNING OF YEAR</b>	<b>(321,382)</b>	<b>(242,520)</b>
<b>DEFICIT, END OF YEAR</b>	<b>\$ (368,697)</b>	<b>\$ (321,382)</b>
Basic and diluted loss per share	\$ (0.19)	\$ (0.42)
Weighted average number of common shares used in computing loss per share:		
basic	243,185,591	189,241,716
diluted <sup>(1)</sup>	243,185,591	189,241,716

See accompanying notes to consolidated financial statements

<sup>(1)</sup> Any impact of unexercised stock options or warrants are not included in the calculation of net loss per share or weighted average number of shares outstanding as they would be anti-dilutive.

# Consolidated Statements of Cash Flow



(Audited)	Year ended December 31	
(Cdn\$ in thousands)	2009	2008
<b>OPERATING ACTIVITIES</b>		
Net loss for the year	\$ (47,315)	\$ (78,862)
Items not involving cash:		
Depletion, depreciation and accretion	81,100	85,385
Stock-based compensation	1,461	3,116
Future income tax (recovery)	(5,634)	4,066
Foreign exchange loss (gain)	762	(466)
Gain on investments	–	(2,268)
Provision for bad debts (reduction)	(1,322)	1,815
Write-down of investments	556	2,575
Write-down of petroleum and natural gas properties	–	57,427
Abandonment costs	(604)	(668)
	<b>29,004</b>	<b>72,120</b>
Changes in non-cash working capital balances related to operations	<b>(29,593)</b>	<b>(2,613)</b>
	<b>(589)</b>	<b>69,507</b>
<b>FINANCING ACTIVITIES</b>		
Proceeds on issue of common shares, net of costs	43,838	–
Advances of bank loan	–	25,000
Repayments of bank loan	–	(25,000)
	<b>43,838</b>	<b>–</b>
<b>INVESTING ACTIVITIES</b>		
Additions to petroleum and natural gas properties	(27,878)	(107,367)
Proceeds from sale of petroleum and natural gas properties	250	79,097
Proceeds from sale of investment	4	–
Cash received on acquisition of BlackCore Resources Inc.	5,589	–
Changes in non-cash working capital from investing	11,079	(21,977)
	<b>(10,956)</b>	<b>(50,247)</b>
<b>NET INCREASE IN CASH</b>	<b>32,293</b>	<b>19,260</b>
<b>CASH, BEGINNING OF YEAR</b>	<b>24,059</b>	<b>4,799</b>
<b>CASH, END OF YEAR</b>	<b>\$ 56,352</b>	<b>\$ 24,059</b>
Supplementary Information		
Cash interest paid	\$ 87	\$ 828
Cash taxes paid	\$ 1,004	\$ 1,010

See accompanying notes to consolidated financial statements

# Notes to the Consolidated Financial Statements

(audited) (tabular amounts in thousands of Cdn\$, except as noted)

## 1. NATURE OF OPERATIONS

On May 8, 2009, Pearl Exploration and Production Ltd. formally changed its name to BlackPearl Resources Inc. BlackPearl Resources Inc. (collectively with its subsidiaries, the "Company" or "BlackPearl") is listed and traded on the TSX Exchange under the trading symbol "PXX" and on the First North (OMX Nordic Exchange) under the symbol "PXXS". The Company is engaged in the business of oil and gas exploration, development and production in North America.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in Canada ("Canadian GAAP"). The significant accounting policies used in these consolidated financial statements are as follows:

### (a) Consolidation

These consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries.

### (b) Cash and Cash Equivalents

Cash and cash equivalents include short-term highly liquid interest-bearing investments with maturities of three months or less from the date of acquisition. Cash and cash equivalents are designated as held-for-trading and are carried at fair value.

### (c) Measurement Uncertainty

The preparation of consolidated financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, expenses and the disclosure of contingencies. These estimates are subject to measurement uncertainty. Actual results could differ from and affect the results reported in these consolidated financial statements.

Significant estimates used in the preparation of the consolidated financial statements include asset retirement obligations, future income taxes, stock-based compensation, the estimate of oil and gas reserves and the related depletion, depreciation and accretion, asset impairment, the estimate of capital and operating costs incurred, as well as revenue earned, but not invoiced as of December 31, 2009.

### (d) Foreign Currency Translation

The Company's reporting and functional currency is Canadian dollars.

The Company's U.S. operations are considered integrated. Accordingly, the Company uses the temporal method of accounting for the foreign currency transactions of its U.S. subsidiaries. Under the temporal method, monetary assets and liabilities are translated at the exchange rates in effect at the balance sheet date. Non-monetary assets and liabilities are translated at the historical exchange rates. Revenues and expenses are translated at the average rate for the period, except for charges related to non-monetary assets which are translated at the historical rate for the assets to which the charge relates, and material items where a specific date can be identified for the transaction which is translated at the rate on that specific date. Exchange gains or losses are included in the determination of net income.

**(e) Joint Interests**

A substantial portion of the Company's activities are conducted jointly with others through joint ventures. These consolidated financial statements reflect only the Company's proportionate interest in such activities.

**(f) Petroleum and Natural Gas Properties**

The Company follows the full cost method of accounting for its petroleum and natural gas properties whereby all costs relating to the exploration for and development of oil and gas reserves are capitalized in country-by-country cost centres and charged against income as set out below. Capitalized costs include lease acquisition costs, geological and geophysical expenditures, costs of drilling exploration and development wells, gathering and production facilities and other development expenditures. Gains and losses are not recognized upon disposition of petroleum and natural gas properties unless such a disposition would alter the rate of depletion by 20 percent or more.

**Depreciation, Depletion and Amortization**

Capitalized costs, along with estimated future costs to develop proved reserves, are depleted on a unit-of-production basis using estimated proved oil and gas reserves before royalties, as determined by independent engineers. Natural gas reserves and production are converted to equivalent barrels of oil based upon the relevant energy content (6:1). Costs of acquiring and evaluating unproved properties are excluded from costs subject to depletion until it is determined whether proved reserves are attributable to the properties or impairment occurs. Unproved properties are evaluated for impairment on at least an annual basis. If an unproved property is considered to be impaired, the amount of the impairment is added to costs subject to depletion.

Office furniture and equipment is depreciated on the declining balance basis at rates ranging from 10 to 30 percent per year.

**Ceiling Test**

The net amount at which petroleum and natural gas properties are carried is subject to a cost recovery test (the "ceiling test"). The ceiling test is an impairment test whereby the carrying amount of petroleum and natural gas properties, excluding the cost of unproved properties, is compared to the undiscounted cash flows from proved reserves using future forecast prices, adjusted for the Company's contract prices and quality differentials. If the carrying value exceeds the undiscounted cash flows, an impairment loss would be recorded against income. The impairment is measured as the amount by which the carrying amount of petroleum and natural gas properties exceeds the discounted cash flows from proved and probable reserves. The Company's risk-free interest rate is used to arrive at the net present value of future cash flows.

**(g) Revenue Recognition**

Revenue from the sale of petroleum and natural gas is recorded when title passes to an external party.

**(h) Investments**

Long-term investments include interest-bearing investments with maturities longer than one year. Long-term investments whereby the Company has significant influence are accounted for using the equity method. All other long-term investments are designated as held-for-trading and available-for-sale and are carried at fair value (see note 15(a) for classification).

**(i) Stock-Based Compensation**

Stock options granted are accounted for using the fair value method. Fair values are determined, at the grant date, using the Black-Scholes option-pricing model. The compensation expense associated with these options is charged to earnings over the vesting period with a corresponding increase in contributed surplus. When stock options are exercised, the consideration paid to the Company, along with amounts previously credited to contributed surplus, is credited to common shares. Forfeitures are accounted for as they occur and result in a reduction in compensation expense.

**(j) Asset Retirement Obligation**

The fair values of the estimated asset retirement obligation is recorded as a liability when incurred and the associated cost is capitalized as part of the cost of the related asset. Over time, the liability is accreted for the change in its present value and the initial capitalized costs are depleted on a unit-of-production basis over the life of the reserves. The associated accretion is charged to earnings in the period. Actual expenditures incurred are charged against the accumulated obligation. Revisions to the estimated timing of cash flows or the original estimated undiscounted cost would also result in an increase or decrease to the obligation and related asset.

**(k) Earnings per Share**

Basic earnings per share is calculated using the weighted average number of common shares outstanding during the year. Diluted earnings per share is calculated based upon the treasury stock method which assumes that any proceeds from the exercise of in-the-money stock options or warrants would be used to purchase the Company's common shares at the average market price during the year (or period if applicable). Diluted earnings per share do not include any anti-dilutive conversions, nor is diluted earnings per share presented where the total effect would be anti-dilutive.

**(l) Flow-Through Shares**

The resource expenditure deductions for income tax purposes related to exploratory activities funded by flow-through share arrangements are renounced to investors in accordance with tax legislation. A future tax liability is recognized upon the filing of the renunciation with the tax authorities and share capital is reduced by the estimated costs of the renounced tax deductions.

**(m) Income Taxes**

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



#### **(n) 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. Financial assets and financial liabilities are recognized on the consolidated balance sheet at the time the Company becomes a party to the contractual provisions. Upon initial recognition, financial instruments are measured at fair value. Measurement in subsequent periods is dependent on the classification of the financial instrument. These instruments will be classified into one of the following five categories: held-for-trading, held-to-maturity, loans and receivables, available-for-sale or other financial liabilities.

Held-for-trading instruments are financial assets and liabilities typically acquired with the intention of generating revenues in the short-term. However, an entity is allowed to designate any financial instrument as held-for-trading on initial recognition even if it would otherwise not satisfy the definition. As at December 31, 2009, the Company does not hold any financial instruments that do not satisfy the definition. Financial assets and financial liabilities required to be classified or designated held-for-trading are measured at fair value, with gains and losses recorded in net earnings for the period in which the change occurs.

Held-to-maturity investments are non-derivative financial assets, with fixed or determinable payments and fixed maturity that an entity has the intention and ability to hold to maturity. These financial assets are measured at amortized cost using the effective interest method. As at December 31, 2009, the Company does not have any financial assets classified as held-to-maturity.

Available-for-sale financial assets are non-derivative assets that are designated as available-for-sale or that are not classified as loans and receivables, held-to-maturity investments or held-for-trading. Available-for-sale financial assets are carried at fair value with unrealized gains and losses included in other comprehensive income (OCI) until such gains or losses are realized or an other than temporary impairment is determined to have occurred. Available-for-sale assets are measured at fair value, except for assets that do not have a readily determinable fair value which are recorded at cost.

Financial assets classified as loans and receivables are measured at amortized cost using the effective-interest method.

Other financial liabilities are measured at amortized cost using the effective interest method and include all liabilities other than derivatives or liabilities that have been identified as held-for-trading.

The Company will assess at each reporting period whether there is any objective evidence that a financial asset, other than those classified as held-for-trading, is impaired.

### 3. CHANGES IN ACCOUNTING POLICIES

During 2009 the Company adopted the following CICA Handbook Sections:

- Section 3064 “Goodwill and Intangible Assets”, which replaces Section 3062 “Goodwill and other Intangible Assets”. The new standard revises the requirement for recognition, measurement, presentation and disclosure of intangible assets. It was adopted on January 1, 2009 and has had no effect on the consolidated financial statements as of December 31, 2009.
- Section 1582 “Business Combinations”, which replaces Section 1581 “Business Combinations”. The new standard establishes principles and requirements of the acquisition method for business combinations and related disclosures. It was adopted on January 1, 2009 and has had no effect on the consolidated financial statements as of December 31, 2009.
- Section 1601 “Consolidated Financial Statements” and Section 1602 “Non-controlling Interests”, both of which replace Section 1600 “Consolidated Financial Statements”. Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 provides guidance on accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. Both sections were adopted on January 1, 2009 and have had no effect on the consolidated financial statements as of December 31, 2009.
- Section 3862 “Financial Instruments – Disclosures” was amended to include additional disclosure requirements about fair value measurement for financial instruments and liquidity risk disclosures. These amendments require a three-level hierarchy that reflects the significance of the inputs used in making the fair value measurement. Fair values of assets and liabilities in Level 1 are determined by reference to quoted prices in active markets for identical assets and liabilities. Assets and liabilities in Level 2 include valuations using inputs other than quoted prices for which all significant outputs are observable, either directly or indirectly. Level 3 valuations are based on inputs that are unobservable and significant to the overall fair value measurement. The amendments to this standard were adopted on December 31, 2009 and result in increased note disclosures for financial instruments.

### 4. RECENT ACCOUNTING PRONOUNCEMENTS

The CICA Accounting Standards Board (“AcSB”) has confirmed that the use of International Financial Reporting Standards (“IFRS”) will be required for interim and annual reporting purposes for fiscal years beginning on or after January 1, 2011 for publicly accountable profit-oriented enterprises. Companies will be required to provide comparative IFRS information for 2010. The Company is assessing the potential impacts of this changeover and has developed a plan for the conversion, but the Company has not at this time made any determination on the impact on its financial statements.

### 5. ACQUISITIONS

On January 8, 2009, the Company acquired all of the issued and outstanding shares of BlackCore Resources Inc., a private oil and gas company, in exchange for 17,600,000 common shares of the Company, as well as 5,000,160 Class A and 5,000,160 Class B share purchase warrants. Each Class A and B warrant allow the holder to acquire one BlackPearl share for a price of \$0.60 when the BlackPearl share price reaches a volume weighted average price for 30 consecutive days of \$1.50 and \$2.00, respectively. These price thresholds were met during 2009. The warrant price



was calculated by using the weighted average share price for the five days before and after the date the agreement was entered into.

The consideration, including transaction costs, for the BlackCore acquisition totaled \$12.9 million. The allocation of the purchase price is as follows:

<b>Net assets acquired</b>	
Petroleum and natural gas properties	\$ 12,691
Working capital	5,468
Asset retirement obligation	(3,023)
Future income tax	(2,274)
<b>Total net assets acquired</b>	<b>\$ 12,862</b>

  

<b>Consideration paid</b>	
Common shares	\$ 10,560
Warrants	2,200
Acquisition costs	102
<b>Total purchase price</b>	<b>\$ 12,862</b>

## 6. INVESTMENTS

	December 31, 2009	December 31, 2008
Investment in Serrano Energy Ltd. ("Serrano")	\$ -	\$ 7,768
MAV Notes (formerly Asset-backed commercial paper)	<b>1,284</b>	1,288
Investment in Tyner Resources Ltd. ("Tyner")	-	563
	<b>\$ 1,284</b>	<b>\$ 9,619</b>

- (a) On January 28, 2009, the Company closed an agreement with Serrano Energy Ltd. ("Serrano") to exchange the Company's equity interest in Serrano for an additional 15% working interest in the Blackrod area lands and a carried work commitment of \$5 million. The Company was also appointed the operator of the Blackrod project.
- (b) The Company acquired an interest in third party asset-backed commercial paper ("ABCP") with a face value of \$5 million on October 19, 2007 as part of a corporate acquisition. As a result of liquidity issues in the ABCP market, these investments did not settle on maturity. On January 21, 2009, a restructuring plan was implemented which resulted in the Company receiving longer-term replacement notes for its investment in short-term ABCP.

The Company received the following replacement notes:

Notes	Maturity Date <sup>(1)</sup>	Interest Rate <sup>(2)</sup>	Face Amount
MAV II Class A-1	July 15, 2056	BA - 0.5%	\$ 1,534
MAV II Class A-2	July 15, 2056	BA - 0.5%	2,804
MAV II Class B	July 15, 2056	BA - 0.5%	509
MAV II Class C	July 15, 2056	BA +20%	150
			<b>\$ 4,997</b>

<sup>1)</sup> Maturity date reflects legal maturity date. The latest maturity date of the underlying assets is December 31, 2016.

<sup>2)</sup> BA represents Bankers Acceptance interest rates with a maturity of 90 days.

The replacement notes have been classified as held-for-trading which will require them to be measured at fair value at each period end with changes in fair value included in the consolidated statement of operations in the period in which they arise. Although a small number of transactions have been made public, the Company does not consider them to be of sufficient volume or value to constitute an active market. Accordingly, the Company has not used these trades to determine the fair value of the notes. Until an active market is established, however, the fair value will be determined using a probability weighted discounted cash flow considering the best available public information regarding market conditions and other factors that a market participant would consider for such investments. As at December 31, 2009, the Company has estimated the fair value of the notes at \$1,284,000 (December 31, 2008 – \$1,288,000). This includes a principle prepayment of \$4,000 which was received in 2009. No gain or loss was recorded on the exchange of ABCP for the replacement notes.

- (c) On December 30, 2008, the Company sold all of its interests in certain lands, wells, pipelines and other associated equipment located in the Palo Duro Basin area of Texas. In exchange, BlackPearl received 18,756,414 common shares of Tyner Resources Ltd. at a price of \$0.03 per share. The Company has written down the value of its investment in Tyner to NIL in accordance with equity investment accounting, based on BlackPearl's ownership interest in Tyner, and the losses incurred since the acquisition was made on December 30, 2008.

## 7. PETROLEUM AND NATURAL GAS PROPERTIES

December 31, 2009			
	Cost	Accumulated depreciation and depletion	Net book value
Petroleum and natural gas properties	\$ 650,744	\$ 259,903	\$ 390,841
Office equipment	2,916	1,045	1,871
	<b>\$ 653,660</b>	<b>\$ 260,948</b>	<b>\$ 392,712</b>

  

December 31, 2008			
	Cost	Accumulated depreciation and depletion	Net book value
Petroleum and natural gas properties	\$ 600,297	\$ 180,581	\$ 419,716
Office equipment	2,739	791	1,948
	<b>\$ 603,036</b>	<b>\$ 181,372</b>	<b>\$ 421,664</b>

The depletion and ceiling test calculations have excluded the cost of unproved properties of \$33.6 million (December 31, 2008 – \$31.1 million) and included future development costs of \$63.6 million (December 31, 2008 – \$34.7 million).

The Company performed the ceiling test calculations at December 31, 2009 to assess whether the carrying value of the petroleum and natural gas properties were recoverable. A write-down in the amount of \$2.9 million (December 31, 2008 – \$57.4 million) of the US assets has been included in depletion, depreciation and accretion in the Company's December 31, 2009 financial statements. The following represent the prices that were used in the December 31, 2009 ceiling test:



Average Price Forecast <sup>(1)</sup>				
Year	WTI Cushing 40° API (US\$/bbl)	Hardisty Lloydblend 20.5° API (CDN\$/bbl)	Alberta AECO-C Spot (CDN\$/MMBtu)	Exchange rate (US\$/Cdn\$)
2010	79.17	74.14	5.36	0.92
2011	84.46	78.29	6.21	0.92
2012	86.89	76.86	6.44	0.92
2013	90.20	78.87	7.23	0.92
2014	92.01	79.49	7.98	0.92
2015	93.85	81.09	8.16	0.92
2016	95.72	82.73	8.34	0.92
2017	97.64	84.40	8.52	0.92
2018	99.59	86.10	8.71	0.92
2019	101.58	87.84	8.90	0.92
2020	103.61	89.61	9.10	0.92
Escalation rate of 2.0% thereafter <sup>(2)</sup>				

<sup>(1)</sup> The benchmark prices listed above are adjusted for quality differentials, heat content, distance to market and other factors in performing the ceiling test.

<sup>(2)</sup> Percentage change represents the change in each year after 2020 to the end of the reserve life.

## 8. CREDIT FACILITY

The Company has a credit facility with a Canadian financial institution which is comprised of a \$25 million revolving 364-day extendible term facility. The Company may borrow, repay and re-borrow advances with the aggregated outstanding not to exceed the total credit facility. The facility bears interest at the institution's prime rate or at banker's acceptance or LIBOR loan rates, plus applicable margins, which varies depending on the Company's working capital ratio. At December 31, 2009, a prime rate based drawdown would be at the institution's prime rate plus 0.75%. The Company also incurs a standby fee for undrawn amounts. The facility is secured by a fixed and floating charge on the assets of the Company and is secured by a general securities agreement. At December 31, 2009, there were no advances outstanding under this facility.

The facility is subject to annual reviews. The next scheduled review is to be completed by May 31, 2010.

## 9. ASSET RETIREMENT OBLIGATION

The Company's asset retirement obligation results from ownership interest in oil and gas assets, including well sites, gathering systems, batteries and processing facilities. The total undiscounted amount of the estimated cash flows required to settle the asset retirement obligation is approximately \$38.3 million which will be incurred over the next 28 years with the majority of costs incurred between 2010 and 2024.

The fair value of the asset retirement obligation was calculated using a credit adjusted risk-free rate of 6.5 percent and an inflation factor of 2 percent. Settlement of the obligation is expected to be funded from general corporate funds at the time of retirement. As at December 31, 2009, no funds have been set aside to settle this obligation.

Changes to the asset retirement obligation were as follows:

	2009	2008
Asset retirement obligation at beginning of year	\$ 20,064	\$ 16,586
Liabilities acquired through acquisitions, net of dispositions	2,939	(6,464)
Liabilities incurred during the year	1,516	896
Adjustment for change in reserve life, abandonment costs, inflation and discount rates	–	8,545
Actual remediation costs	(604)	(668)
Accretion	1,520	1,169
Asset retirement obligation at end of year	\$ 25,435	\$ 20,064

## 10. RELATED PARTY TRANSACTIONS

During the year ended December 31, 2009, the Company entered into the following transactions with related parties in the normal course of business, which are recorded at the exchange amount established and agreed to by the related parties:

The Company paid \$45,000 (2008 – \$180,000) to Namdo Management Services Ltd. (“Namdo”) for executive and support services pursuant to a services agreement. Namdo is a private corporation owned by Lukas H. Lundin, a former director of the Company.

## 11. SHARE CAPITAL

### (a) Authorized:

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

### (b) Common Shares Issued:

	Number of Shares	Attributed Value
Balance as at December 31, 2008 and December 31, 2007	189,241,716	\$ 723,122
Shares issued for BlackCore acquisition (note 5)	17,600,000	10,560
Shares issued for property acquisitions	2,500,000	1,500
Shares issued for cash <sup>(i)</sup>	52,334,000	46,046
Shares issued upon exercise of stock options	285,001	326
Share issuance costs, net of tax		(1,745)
Balance as at December 31, 2009	261,960,717	\$ 779,809

<sup>(i)</sup> On April 20, 2009, the Company issued 52,334,000 special warrants of BlackPearl at a price of \$0.88 per special warrant for aggregate gross proceeds of \$46 million. On May 6, 2009 each special warrant was converted into one common share of the Company.



**(c) Warrants Outstanding:**

The following summarizes warrants outstanding as at December 31, 2009 and December 31, 2008:

	Number of warrants	Weighted average exercise price per share
Outstanding at December 31, 2007	4,091,800	\$ 0.98
Expired	(4,091,800)	0.98
Outstanding at December 31, 2008	–	0.00
<b>Class A warrants issued on BlackCore Acquisition (note 5) <sup>(i)</sup></b>	<b>5,000,160</b>	<b>0.60</b>
<b>Class B warrants issued on BlackCore Acquisition (note 5) <sup>(i)</sup></b>	<b>5,000,160</b>	<b>0.60</b>
<b>Outstanding at December 31, 2009</b>	<b>10,000,320</b>	<b>\$ 0.60</b>

<sup>(i)</sup> Each outstanding warrant allows the holder to acquire, on or before January 13, 2013, one BlackPearl share for a price of \$0.60 when the Company's share price reaches a volume weighted average price for 30 consecutive days of \$1.50 (Class A warrants) and \$2.00 (Class B warrants). As of December, 2009, the Class A and B warrants have vested and can be used to purchase common shares at the option of the holder.

**(d) Stock Options Outstanding**

The Company has a stock option plan (the "Plan") available to directors, officers, employees and certain consultants of the Company and its subsidiaries. Under the Plan, the number of common shares to be reserved and authorized for issuance pursuant to options granted under the Plan cannot exceed ten percent of the total number of issued and outstanding shares in the Company. The term and the vesting period of any options granted are determined at the discretion of the board of directors. The maximum term for options granted is ten years. The exercise price of the option cannot be less than the five-day volume weighted average trading price of the common shares immediately preceding the day the option is granted.

The following summarizes stock options outstanding as at December 31, 2009 and December 31, 2008:

	Number of options	Weighted average exercise price (\$)
Outstanding at December 31, 2007	7,726,357	3.98
Granted	6,484,500	0.95
Forfeited	(1,620,751)	4.12
Expired	(1,451,670)	4.21
Outstanding at December 31, 2008	11,138,436	2.16
<b>Granted</b>	<b>6,325,500</b>	<b>1.59</b>
<b>Exercised</b>	<b>(285,001)</b>	<b>0.75</b>
<b>Forfeited</b>	<b>(3,724,602)</b>	<b>3.32</b>
<b>Outstanding at December 31, 2009</b>	<b>13,454,333</b>	<b>1.60</b>

Options outstanding and exercisable as at December 31, 2009 are summarized below:

Range of Exercise Price (\$)	Options Outstanding			Options Exercisable		
	Number of Options	Weighted-Average Exercise Price (\$)	Weighted-Average Life (Years)	Number of Options	Weighted-Average Exercise Price (\$)	Weighted-Average Life (Years)
0.40 – 1.50	7,388,833	0.72	4.05	2,602,841	0.72	4.04
1.51 – 3.00	5,029,500	2.23	4.42	743,000	2.37	3.09
3.01 – 4.50	144,000	3.38	2.84	96,000	3.38	2.84
4.51 – 5.15	892,000	5.10	2.02	859,000	5.12	2.01
	13,454,333	1.60	4.04	4,300,841	1.94	3.44

**(e) Stock-Based Compensation**

Stock-based compensation of \$1,461,000, net of recoveries of \$1,290,000, has been recorded in the Consolidated Statements of Operations and Deficit for the year ended December 31, 2009 (2008 – expense of \$3,116,000). The fair value of common share options granted is estimated on the date of grant using the Black-Scholes option pricing model. The weighted average fair value of options granted during 2009 and the assumptions used in their determination are noted below:

	December 31, 2009	December 31, 2008
Weighted average fair value of stock options granted (per option)	\$ 0.85	\$ 0.73
Expected life of stock options (years)	2.58	5.00
Volatility (weighted average)	88%	117%
Risk-free rate of return (weighted average)	1.43%	1.69%
Expected dividend yield	0%	0%

**(f) Contributed Surplus Continuity**

The following table summarizes changes in contributed surplus during the year:

	December 31, 2009	December 31, 2008
Balance, beginning of the year	\$ 11,895	\$ 8,778
Stock-based compensation	2,751	3,749
Recovery of expense on forfeited stock options	(1,290)	(632)
Warrants issued on BlackCore acquisition	2,200	–
Transferred to share capital on exercise of stock options	(112)	–
Balance, end of year	\$ 15,444	\$ 11,895



## 12. INCOME TAXES

### (a) Future Income Tax Expense:

The provision for income taxes reflects an effective income tax rate which differs from Federal and Provincial statutory tax rates. The main differences are as follows:

	December 31, 2009	December 31, 2008
Income (loss) before income taxes	(55,300)	(75,315)
Corporate income tax rate	30.46%	30.88%
Computed income tax recovery	(16,843)	(23,257)
Increase (decrease) resulting from:		
Change in valuation allowance	9,002	27,992
Non-deductible stock-based compensation expense	445	962
Foreign exchange	(785)	(144)
Change in enacted tax rates	1,768	(2,136)
Capital tax and Saskatchewan Resource Surcharge	(2,352)	1,642
Other	780	(1,510)
Income tax expense (recovery)	\$ (7,985)	\$ 3,549

### (b) The components of the future income tax liability are as follows:

	December 31, 2009	December 31, 2008
<b>Future Income Tax Assets:</b>		
Non-capital losses	32,759	11,370
Share issue costs	2,785	2,729
Asset retirement obligation	6,829	5,863
Other	1,152	398
Valuation allowance	(38,034)	(29,032)
	5,491	(8,672)
<b>Future Income Tax Liabilities:</b>		
Property, plant and equipment	(5,491)	4,636
Net future tax asset (liability)	\$ 0	\$ (4,036)

The Company has \$116.1 million of non-capital losses with various expiry dates between 2009 to 2029.

## 13. COMMITMENTS AND CONTINGENCIES

(a) The Company has a seven-year operating lease for office space as at December 31, 2009, the payments (net of sublease proceeds) due under this lease agreement (including an estimate for operating costs) are as follows:

	2010	2011	2012	2013	2014	Subsequent to 2014
Office rent	\$ 1,098	\$ 1,166	\$ 1,234	\$ 1,234	\$ 1,626	\$ 2,946

The Company's office lease was executed jointly with another party. Under the terms of the lease, BlackPearl and the other party are joint and severally liable for the obligations pursuant to the lease. Accordingly, if the other party or any of the subtenants of a portion of the space are unable to fulfill their lease obligation, BlackPearl would be required to pay an additional \$19.3 million (including an estimate for operating costs) over the next seven years.

- (b) The Company has contracted drilling rig services over the next four years. In the event that the Company does not utilize the minimum contracted days, the Company would be obligated to pay the rig operator a variable rate based on days not utilized under the contracts. As at December 31, 2009, the payments that would be due under the agreement (assuming no drilling days used) are as follows:

	2010	2011	2012	2013	2014	Subsequent to 2014
Drilling Contract	\$ 616	\$ 935	\$ 1,211	\$ 319	–	Nil

- (c) In connection with a November 2007 property acquisition, the Company may be required to pay a performance payment of US \$9.8 million in cash prior to November 6, 2010, if either: (i) production from the assets reaches 5,000 barrels of oil per day; or (ii) proven reserves from the assets is greater than 50 million barrels of oil. As at December 31, 2009, there was no production from and no reserves attributable to these assets.

#### 14. SEVERANCE BENEFITS

During the first quarter of 2009, the Company incurred a number of staff terminations. As a result, the Company has included severance benefits in the aggregate amount of \$431,000 in general and administrative costs in the Company's financial statements. All severance benefits were paid in the first quarter 2009.

#### 15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

The Company is exposed to financial and market risk in a range of financial instruments including cash, accounts receivable, certain investments and accounts payable. The Company manages its risk through its policies and processes, but the Company generally has not used derivative financial instruments to manage these risks.

##### (a) Fair Value of Financial Instruments

The following tables set out the Company's classification, carrying amount and fair values of its financial assets and liabilities as at December 31, 2009 and December 31, 2008:

			December 31, 2009		December 31, 2008	
Classification			Carrying Amount	Fair Value	Carrying Amount	Fair Value
Cash and cash equivalents	Held-for-trading	(i)	\$ 56,352	\$ 56,352	\$ 24,059	\$ 24,059
Accounts receivable	Loans and receivables	(i)	11,977	11,977	9,536	9,536
Investment in MAV Notes	Held-for-trading	(ii)	1,284	1,284	1,288	1,288
Other investments	Available-for-sale	(iii)	–	–	7,768	7,768
Accounts payable and accrued liabilities	Other financial liabilities	(iv)	(16,318)	(16,318)	(34,408)	(34,408)



The fair values of financial assets and financial liabilities are calculated on the basis of information available at the balance sheet date using the following methods:

- (i) The fair value of cash and cash equivalents and accounts receivable approximates their carrying amounts due to the short-term nature of the instruments.
- (ii) Effective December 31, 2009, the Company adopted the amendments to Section 3862 “Financial Instruments – Disclosures”. These amendments require the Company to present information about financial instruments measured at fair value in accordance with a three level hierarchy. The hierarchy groups financial assets and liabilities into three levels based on the significance of inputs used in measuring the fair value of the financial assets and liabilities. The fair value hierarchy has the following levels:
  - a. Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities;
  - b. Level 2: inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (ie. as prices) or indirectly (ie. derived from prices); and
  - c. Level 3: inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The level within which the financial asset or liability is classified is determined based on the lowest level of significant input to the fair value measurement. At December 31, 2009, the only instrument held by the Company that is subject to valuation through the hierarchy is the Company's investment in MAV notes. The fair value of the investment is determined by a cash flow model considering the best available public information regarding market conditions and other factors that a market participant would consider for such investments. The change in value from December 31, 2008 is the result of a principle prepayment on the investment and not a change in fair value.

- (iii) Investment in shares of a private company are valued at fair market value based on some comparable transactions involving the issuance of additional shares of the private company.
- (iv) The fair value of accounts payable and accrued liabilities approximates their carrying amounts due to the short-term nature of the instruments.

**(b) Commodity Price Risk**

Commodity price risk is the risk that future cash flows will fluctuate as a result of changes in the price of oil and natural gas. Commodity prices are impacted by world economic events that affect supply and demand, which are generally beyond the Company's control. Changes in crude oil and natural gas prices may significantly affect the Company's results of operations, costs generated from operating activities, capital spending and the Company's ability to meet its obligations. The majority of the Company's production is sold under short-term contracts, consequently BlackPearl is at risk to near term price movements. A \$1.00 change in oil prices at the wellhead would have the effect of changing net earnings for 2009 by approximately \$1.2 million. The Company manages this risk by constantly monitoring commodity prices and factoring them into operational decisions, such as contracting or expanding its capital expenditures program. As at December 31, 2009 and throughout 2009, the Company did not use derivative financial instruments to manage its exposure to this risk.

### **(c) Foreign Currency Exchange Risk**

The Company is exposed to risks arising from fluctuations in foreign currency exchange rates and the volatility of those rates. This exposure primarily relates to: (i) prices received for its crude oil and natural gas are primarily determined in reference to US dollars; (ii) certain expenditure commitments, deposits, accounts receivable, and accounts payable which are denominated in US dollars; and (iii) its operations in the United States. The Company manages this risk by monitoring foreign exchange rates and evaluating their effects on using Canadian or US vendors as well as timing of transactions. As at December 31, 2009, the Company has not entered into any fixed rate contracts. As at December 31, 2009, the Company held US\$2,302,000 in cash and short-term deposits and other net working capital items of US\$2,159,000.

As at December 31, 2009, if US\$ exchange rates had been \$0.10 lower with all other variables held constant, after tax earnings for the period would have been approximately \$543,000 higher, due to a decreased foreign exchange loss. An equal opposite impact would have occurred to net earnings had exchange rates been \$0.10 higher. The Company does not hedge its foreign currency risk.

### **(d) Credit Risk**

Credit risk is the risk that a third party fails to meet its contractual obligations that could result in the Company incurring a loss.

The Company's accounts receivable are primarily with oil and gas marketers and joint venture partners. Receivables from oil and gas marketers are generally collected on the 25th day of the month following production. The Company attempts to mitigate this risk by assessing the financial strength of its counterpart and entering into relationships with larger purchasers with established credit history. During 2009, the Company has not experienced any collection issues with its marketers. At December 31, 2009, over 81% of total accounts receivables are for revenue accruals. Receivables from joint venture partners arise when the Company conducts joint operations on behalf of its partners and invoices them for their share of costs. To mitigate the risk of non-payment from joint venture partners the Company can require partners to pay certain costs in advance as well as the Company has the ability to withhold production from partners in the event of non-payment. As at December 31, 2009, accounts receivable includes an allowance for doubtful accounts of \$826,000 from joint interest partners. These amounts primarily relate to joint venture receivables inherited from other companies that were acquired by BlackPearl over the last three years.

The Company typically does not obtain collateral or security from its joint venture partners or oil and gas marketers. The carrying amounts of accounts receivable represent the maximum credit exposure.

The Company is not the operator of certain oil and gas properties in which it has an ownership interest. The Company is dependent on such operators for the timing of activities related to such properties and will largely be unable to direct or control the activities of the operators. In addition, the Corporation's activities may be impacted by the ability, expertise, judgment and financial capability of the operators. As at December 31, 2009, one of the operators of a US property in which the Company has an interest in has filed for creditor protection in US bankruptcy court and has failed to pay certain suppliers, resulting in various liens on the property. Subsequent to December 31, 2009, the operator sold its interest in the property and the liens are in the process of being removed.



As at December 31, 2009, the Company held \$56.4 million in cash at various major banks throughout Canada and the USA, as well as \$1.3 million in investments. At December 31, 2009, two Canadian financial institutions held approximately 99% of our cash and short-term deposits. Cash balances in excess of the Company's day to day requirements are invested in short-term deposits of less than 30 days.

**(e) Interest Rate Risk**

Interest rate risk refers to the risk that a financial instrument or cash flows associated with the instrument will fluctuate due to changes in market interest rates. The Company is exposed to interest rate risk in relation to interest expense on its revolving credit facility due to the floating interest rate charged on advances. At this time, the Company is not drawn on this facility and, as a result, the Company considers this risk to be limited. In addition, the Company is exposed to interest rate risk on its excess cash balances and certain investments.

**(f) Liquidity Risk**

Liquidity risk is the risk the Company is unable to meet its financial obligations as they come due. The Company uses operating cash flows, credit facilities and equity offerings to fund its capital requirements.

The Company manages this risk by maintaining a conservative balance sheet with minimal use of long-term debt. As at December 31, 2009, the Company had an undrawn \$25 million credit facility, and a positive working capital position of \$58.0 million. The Company believes it has sufficient funding from these sources to meet its foreseeable obligations. The maturity dates for the Company's financial liabilities are as follows:

	<6 Months	6 months – 1 Year	1-2 Years
Accounts payable and accrued liabilities	\$ 16,318	–	–

**(g) Capital Management**

The Company defines capital as working capital, total debt and equity. The current capital management strategy is designed to minimize the use of long-term debt and maintain positive working capital. This strategy should provide the financial flexibility to fund the Company's capital program and profitable growth opportunities. The unutilized \$25 million credit facility capacity provides additional liquidity to the Company. This structure can be adjusted as a result of changes in economic conditions or risks associated with its oil and gas assets. During 2008, the Company elected to eliminate its existing bank debt from the sale of certain non-strategic assets. In order to maintain or adjust its capital structure, the Company may from time to time issue additional common shares. As a result of the economic global downturn access to capital markets may be limited. In addition, the Company's credit facilities are based on its petroleum and natural gas reserves whose values are impacted by, among other things, global commodity prices. The Company will adjust its capital spending if access to external capital sources is unavailable. In order to manage the balance in the Company's capital structure, some of the financial tests that BlackPearl considers are debt-to-equity ratios, debt-to-cash flow from operating activities and interest coverage tests. To facilitate the management and control of these ratios, the Company prepares annual operating and capital budgets. These budgets are generally updated quarterly, or more frequently if circumstances change. In order to improve its financial flexibility, the Company raised approximately \$43 million of additional equity during the second quarter of 2009. These funds will be used to expand exploration and development programs over the next 12 – 18 months.

Financial covenants associated with the Company's credit facility are reviewed regularly and controls are in place to maintain compliance with these covenants. The only financial covenant in the Company's credit facility is to maintain a working capital ratio of 1:1 at the end of each fiscal quarter. Working capital ratio is defined as current assets plus unutilized credit under the bank credit facility compared to current liabilities. The Company had a working capital ratio of 6.1:1 at December 31, 2009 and was in compliance with these covenants throughout 2009.

## 16. SEGMENTED INFORMATION

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

	Year Ended December 31, 2009		
	Canada	USA	Consolidated
<b>Total revenues, net of royalties</b>	\$ 67,922	\$ 453	\$ 68,375
Expenses	118,744	3,613	122,357
Foreign currency loss (gain)	(281)	1,043	762
Write-down of investments	–	556	556
Net loss before income taxes	(50,541)	(4,759)	(55,300)
Income tax recovery	(7,665)	(320)	(7,985)
<b>Net loss</b>	\$ (42,876)	\$ (4,439)	\$ (47,315)
<b>Segment assets</b>	461,529	6,780	468,309
<b>Segment petroleum and natural gas properties</b>	390,713	1,999	392,712
<b>Capital additions</b>	\$ 25,837	\$ 2,041	\$ 27,878

	Year Ended December 31, 2008		
	Canada	USA	Consolidated
Total revenues, net of royalties	\$ 136,440	\$ 1,904	\$ 138,344
Expenses	150,611	5,778	156,389
Foreign currency loss (gain)	8	(474)	(466)
Write-downs	2,575	57,427	60,002
Dilution gain on investment	(2,268)	–	(2,268)
Net loss before income taxes	(14,486)	(60,827)	(75,313)
Income taxes (recovery)	6,435	(2,886)	3,549
Net loss	\$ (20,921)	\$ (57,941)	\$ (78,862)
Segment assets	459,659	12,484	472,143
Segment petroleum and natural gas properties	418,444	3,220	421,664
Capital additions	\$ 86,765	\$ 20,602	\$ 107,367

## 17. COMPARATIVE FIGURES

Certain comparative figures have been reclassified to conform to the presentation adopted in 2009.