Management’s Discussion and Analysis

The following is Management’s Discussion and Analysis (MD&A) of the operating and financial results of BlackPearl Resources Inc. (“BlackPearl” or “the Company”) for the year ended December 31, 2010. These results are being compared with the year ended December 31, 2009. The MD&A should be read in conjunction with the Company’s audited consolidated financial statements for the 12 months ended December 31, 2010, together with the accompanying notes.

All dollar amounts are referenced in thousands of Canadian dollars, except where otherwise noted. The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP).

Throughout this MD&A the calculation of barrels of oil equivalent (boe) is based on a conversion rate of six thousand cubic feet (mcf) of natural gas to one barrel of oil. Boe may be misleading, particularly if used in isolation. A boe conversion ratio of 6 mcf:1 bbl is based on an energy equivalence conversion method primarily applicable at the burner tip and is not intended to represent a value equivalence at the wellhead.

This report includes terms commonly used in the oil and natural gas industry, such as cash flow and cash flow from operations which represent cash flow from operating activities expressed before changes in non-cash working capital, as well as cash flow per share and operating netback. These terms are used by the Company to analyze operating performance, leverage and liquidity and to provide shareholders and investors with additional information to measure the Company’s performance and efficiency and its ability to fund a portion of its future activities and to service any long-term debt if incurred in the future. These terms do not have standardized meanings prescribed by GAAP and therefore may not be comparable with the calculation of similar measures by other entities. Consequently, these are referred to as non-GAAP measures.

Additional information relating to the Company, including its Annual Information Form, is available on SEDAR at www.sedar.com.

This MD&A contains forward-looking information and statements. At the end of this MD&A is an advisory on forward-looking information and statements.

The effective date of this MD&A is February 25, 2011.

Overview

BlackPearl is a Canadian-based oil and natural gas company whose common shares are traded on the Toronto Stock Exchange (TSX) under the symbol “PXX”. The Corporation’s Swedish Depository Receipts trade on the NASDAQ OMX First North market under the symbol “PXXS”. BlackPearl’s main focus is heavy oil projects in Western Canada.

BlackPearl’s current core properties are:

- Onion Lake, Saskatchewan – heavy oil using primary drilling and thermal SAGD recovery;
- Mooney, Alberta – heavy oil using primary drilling and polymer flooding; and
- Blackrod, Alberta – heavy oil/bitumen from SAGD recovery process.

Through continuous investment by the Company in drilling wells, delineating resources and constructing surface facilities, these core properties provide the Company with a combination of short-term cash flow generation, medium-term reserves and production growth, enhanced oil recovery (EOR) development and longer-term reserves and production growth using thermal processes.

Under BlackPearl's business plan, management intends to sell the majority of the Company's non-core assets. In 2010, the Company sold properties producing approximately 1000 boe/day. Additional non-core asset sales are planned over the next two or three years.

2010 Significant Events

- On January 1, 2010, the Company amalgamated its wholly-owned subsidiary Pearl E&P Canada Ltd., with BlackPearl Resources Inc.
- In 2010 BlackPearl completed non-core asset sales for proceeds of $42.0 million. The assets sold included natural gas properties in southern Alberta and Texas, conventional heavy oil properties in Saskatchewan and undeveloped land in Montana.
- On March 29, 2010, the Company acquired the remaining 20 percent working interest in the Blackrod area, located in the Athabasca oil sands of northeast Alberta, from Serrano Energy Ltd. for $21.0 million. The acquisition results in BlackPearl having 100 percent working interest in the Blackrod area lands. The Company has begun constructing a steam-assisted gravity drainage (SAGD) pilot-scale project on the property and construction is expected to be completed in the first quarter of 2011. The pilot includes a single horizontal well pair, water source and monitoring wells, and construction of steam generation and water handling facilities.
- On May 11, 2010, the Company issued 10,350,000 common shares at a price of $2.90 per share, for aggregate gross proceeds of $30.0 million.
- On October 18, 2010, the Company announced it had received approval from the Energy Resources Conservation Board (ERCB) to proceed with development of the first phase of its polymer flood at Mooney. The ERCB also approved BlackPearl's application for the construction and operation of its SAGD pilot at Blackrod.
- On November 10, 2010, the Company released a summary of the contingent reserve study prepared by Sproule Unconventional Limited on its three core properties, which indicated a best estimate (P50) of 749 million barrels of potentially recoverable heavy oil/bitumen.
- On December 7, 2010, the Company issued 10,000,000 common shares at a price of $5.00 per share, for aggregate gross proceeds of $50.0 million.
- The Company has received, from the Alberta Department of Energy, EOR status for a portion of the Mooney field, which will initially reduce the royalty burden on Mooney production volumes generated from the planned polymer flood.
- Capital expenditures during 2010 were $95.8 million, with approximately $44 million spent at Blackrod, $26 million at Onion Lake and $22 million at Mooney.
- Cash flow from operations, before working capital adjustments increased by 116 percent in 2010 to $62.6 million.

Annual Financial Information

($000s, except where noted)	2010	2009	2008
Total revenues	**142,867**	89,637	183,536
Loss from continuing operations and net loss	**(31,272)**	(47,315)	(78,862)
Per share – basic and diluted ($)	**(0.12)**	(0.19)	(0.42)
Cash flow from operations [1]	**62,584**	29,004	72,120
Per share – basic and diluted ($)	**0.23**	0.12	0.38
Capital expenditures	**95,829**	27,878	107,367
Total assets (end of period)	**543,826**	468,309	472,143
Common shares outstanding (000s) (end of period)	**283,215**	261,961	189,242

[1] Cash flow from operations before working capital changes and cash flow per share do not have standardized meanings prescribed by Canadian GAAP and therefore may not be comparable to similar measures used by other companies. Cash flow from operations before working capital changes includes all cash flow from operating activities and is calculated before changes in non-cash working capital. Cash flow from operations before working capital changes is reconciled with net loss in the Consolidated Statements of Cash Flows. Management uses these non-GAAP measurements for its own performance measures and to provide its shareholders and investors with a measurement of the Company's efficiency and its ability to fund a portion of its growth expenditures.

Selected Quarterly Information

	2010				2009			
($000s, except where noted)	**Dec. 31**	**Sept. 30**	**June 30**	**March 31**	Dec. 31	Sept. 30	June 30	March 31
Production (boe/d)	**7,307**	**6,646**	**7,163**	**6,685**	5,306	5,091	5,170	5,510
Revenue ($/boe)	**57.63**	**54.66**	**52.58**	**60.55**	56.69	51.94	47.07	31.77
Oil and natural gas revenue	**38,743**	**33,421**	**34,274**	**36,429**	27,674	24,065	22,143	15,755
Production costs	**8,670**	**8,297**	**9,306**	**10,552**	7,251	6,172	5,873	10,165
Net loss	**(3,901)**	**(9,042)**	**(10,276)**	**(8,053)**	(3,897)	(12,013)	(10,889)	(20,516)
Per share, basic and diluted ($)	**(0.01)**	**(0.03)**	**(0.04)**	**(0.03)**	(0.01)	(0.05)	(0.05)	(0.10)
Additions to oil and natural gas properties	**38,033**	**19,926**	**5,687**	**32,183**	17,559	57,796	37,870	3,147
Cash flow from operations	**19,413**	**14,218**	**13,926**	**15,029**	14,677	8,221	7,910	(1,804)
Per share, basic and diluted ($)	**0.07**	**0.05**	**0.05**	**0.06**	0.06	0.03	0.03	(0.01)
Total assets (end of period)	**543,826**	**474,297**	**470,843**	**463,655**	468,309	465,942	477,876	450,836
Weighted average shares outstanding (000s)	**273,025**	**272,859**	**268,047**	**262,057**	261,731	261,684	240,973	207,555

Fluctuations in quarterly revenues and net earnings over the last eight quarters are due primarily to the volatility in oil and natural gas prices and changes in sales volumes due to production growth through successful drilling activity, principally in the Onion Lake area. Reduced sales volumes in the middle two quarters of 2009 reflect limited new drilling activity due to lower oil prices, which resulted in declining production from existing wells. Prices improved later in the year and the Company's capital expenditure program was expanded as cash flows improved. The continued improvement in heavy oil prices lead to a significant increase in BlackPearl's capital program throughout 2010.

Business Environment

Commodity Prices

	2010	2009
Average Crude Oil Prices		
West Texas Intermediate (WTI) (US$/bbl)	$ 79.48	$ 61.80
Western Canadian Select (WCS) (Cdn$/bbl)	67.27	58.69
Differential – WCS/WTI (Cdn$/bbl)	14.59	11.89
Differential – WCS/WTI (%)	18%	17%
Average Natural Gas Prices		
AECO gas (Cdn$/GJ)	4.08	3.75
Foreign Exchange (Cdn$/US$)	1.030	1.142

Crude oil prices strengthened during 2010, with the West Texas Intermediate (WTI) reference price averaging US$79.48 per barrel compared with US$61.80 per barrel in 2009. Demand for crude oil is generally tied to global economic growth, but is also influenced by factors such as political instability, market uncertainty, weather conditions and government regulations. The WTI forward strip price for the remainder of 2011 is currently approximately US$100.

The majority of BlackPearl's production revenues are derived from the sale of heavy oil, which receives a lower price than light oil due to increased processing requirements for heavy oil. The difference between the reference price of light oil and the reference price of heavy oil is commonly referred to as the light/heavy differential. The differential can be volatile due to supply and demand, refinery margins, seasonal fluctuations and transportation issues. The differential averaged 18 percent in 2010, which was generally consistent with 2009 although it fluctuated during the year, particularly in the fall due to several heavy oil pipeline disruptions.

Oil prices in Canada are also affected by the Canada/U.S. dollar exchange rate since the WTI reference price of oil is in U.S. dollars. During 2010, the Canadian dollar strengthened against the U.S. dollar, averaging Cdn$1.030 to US$1 compared with Cdn$1.142 to US$1 in 2009. The strengthening of the Canadian dollar partially offsets the increased WTI benchmark pricing experienced during 2010.

In 2010, natural gas prices increased by 9 percent from 2009. The AECO-C gas price averaged $4.08 per gigajoule (GJ) in 2010 compared to $3.75 per GJ 2009. As a result of asset dispositions during 2010, BlackPearl's natural gas production currently represents less than 10 percent of total production and therefore changes in natural gas prices have less impact on the Company's current operations.

Oil and Natural Gas Production, Pricing and Revenue

	2010	2009
Daily production / sales volumes [1]		
Oil (bbls/d)	**6,375**	4,324
Natural gas (mcf/d)	**3,455**	5,582
Combined (boe/d)	**6,951**	5,254
Product pricing		
Oil ($/bbl)	**58.86**	51.44
Natural gas ($/mcf)	**4.14**	4.10
Combined ($/boe)	**56.31**	46.74
Revenue ($000s)		
Oil and natural gas revenue – gross	**142,867**	89,637
Royalties	**(36,798)**	(21,262)
Oil and natural gas revenue – net	**106,069**	68,375

[1] Natural gas production converted at 6:1 (for boe figures)

Oil and natural gas revenues increased by 59 percent in 2010 to $142.9 million from $89.6 million in 2009. The increase is attributable to:

- A 32 percent increase in production (on a boe basis); and
- A 20 percent increase in product prices

Overall, average production increased to 6,951 boe per day for the year ended December 31, 2010 from 5,254 boe per day in 2009. The increase in 2010 production is primarily attributable to drilling 30 wells at Onion Lake during the year.

Production by Area (boe/d)	2010	2009
Onion Lake	**5,039**	2,297
Mooney	**1,008**	1,423
Ear Lake	**155**	448
Salt Lake	**274**	353
Long Coulee/Little Bow	**295**	410
Other	**180**	323
	6,951	5,254

On a boe basis, 92 percent of the Company's oil and natural gas production in 2010 was heavy oil. The percentage of revenues derived from heavy oil will likely increase in the future as all of the Company's ongoing development activities will be in heavy oil areas. The Onion Lake area accounted for 72 percent of total production in 2010 and is anticipated to contribute a higher proportion for 2011 as it will account for most of BlackPearl's near-term drilling activity.

The Company did not enter into any hedging arrangements in 2010 and, at the present time, does not anticipate hedging any of its production in 2011.

Royalties

	2010	2009
Royalties ($000s)	**36,798**	21,262
As a percentage of revenue	**26%**	24%

Royalties increased by 73 percent from $21.3 million in 2009 to $36.8 million in 2010. The increase reflects higher revenues and production during the year. Generally, royalty rates in western Canada are sensitive to prevailing commodity prices and individual well production rates. Royalties, as a percentage of revenues, were higher in 2010 than in 2009, primarily due to higher crude oil prices. Royalty rates at Onion Lake were 28 percent in 2010 and are unlikely to change significantly in 2011. Royalty rates at Mooney were 18 percent in 2010. As a result of receiving EOR status for the polymer flood at Mooney, the royalty rate should initially drop to approximately 10 percent when polymer injection commences later in the first half of 2011.

Production Costs

	2010	2009
Production costs ($000s)	**36,824**	29,461
Per boe ($)	**14.51**	15.36

Production expenses increased on an absolute basis in 2010 over the prior year primarily due to increased production volumes. On a per-unit-of-production basis, however, costs have decreased slightly from 2009. The Company expects production costs will continue in the range of $13 – $17 per boe. New heavy oil wells tend to have higher initial expenses due to high sand production, increased fuel costs until wells are tied into the fuel gas system, and increased emulsion trucking and treating costs. These initial costs will be reduced after several months of production from the new wells. In addition, when the polymer flood at Mooney is initiated operating costs will be higher due to the additional cost of chemicals for injection.

Transportation Costs

	2010	2009
Transportation costs ($000s)	**2,734**	3,466
Per boe ($)	**1.08**	1.81

Transportation costs are incurred to move marketable crude oil and natural gas to their selling points. Changes in transportation costs, on a boe basis, are generally related to moving crude oil to different sales points to capture better marketing opportunities, or as a result of production being shipped as emulsion rather than clean marketable oil. Costs related to trucking emulsion are classified as production expenses rather than transportation costs.

Operating Netback

($/boe)	2010	2009
Revenues	**$ 56.31**	$ 46.74
Royalties	**14.50**	11.09
Transportation costs	**1.08**	1.81
Production costs	**14.51**	15.36
Netback per boe	**$ 26.22**	$ 18.48

The 2010 netback of $26.22 per boe is a 42 percent increase from the $18.48 per boe reported in 2009. The increase in the netback is primarily attributable to the overall recovery in crude oil prices in 2010, as lower transportation and production costs per boe were offset by higher royalties.

General and Administrative Expenses (G&A)

($000s, except per boe)	2010	2009
Gross G&A expense	**8,528**	8,359
Operator recoveries	**(1,740)**	(1,446)
	6,788	6,913
Per boe ($)	**2.68**	3.60

G&A in absolute terms was flat from year to year while declining by more than 25 percent per unit of production, signaling greater cost-efficiency as BlackPearl grows. Costs are expected to increase in 2011 as a result of increased activity; however, as production volumes are expected also to increase in 2011, G&A per boe should continue to decline.

Stock-Based Compensation

	2010	2009
Stock-based compensation ($000s)	**3,995**	1,461
Per boe ($)	**1.57**	0.76

Stock-based compensation costs are non-cash charges which reflect the estimated value of stock options granted. The Company uses the fair value method of accounting for stock options granted to directors, officers, employees and consultants whereby the fair value of all stock options granted is recorded as a charge to operations over the period from the grant date to the vesting date of the option. The fair value of common share options granted is estimated on the date of grant using the Black-Scholes options pricing model. The increase in stock-based compensation expense in 2010 reflects additional options granted as well as a higher option value assigned to each grant of options. In 2010, the Company issued 2,786,500 options at an average exercise price of $4.74 per share. In addition, 904,670 options were exercised and 366,165 were forfeited.

Depletion, Depreciation and Accretion (DD&A)

	2010	2009
Depletion, depreciation and accretion ($000s)	**91,026**	81,100
Per boe ($)	**35.88**	42.29

DD&A expense increased by 12 percent to $91.0 million or $35.88 per boe for the year ended 2010 from $81.1 million or $42.29 per boe for 2009. The increase in depletion is a result of increased production in 2010; however, the lower depletion rate per boe is a result of an increase in proved reserves in 2010.

Interest Income

	2010	2009
Interest income ($000s)	**895**	321
Per boe ($)	**0.35**	0.17

Interest income consists of interest earned on excess cash held by the Company. Interest income has increased as a result of a higher cash balance held by the Company in 2010.

Other Income

($000s, except where noted)	2010	2009
Other income	**3,132**	–

Other income consists mainly of net cash received as part of a drilling incentive program offered by the Alberta government to encourage drilling activity within the province. These drilling credits received were acquired from third parties that did not have sufficient production to utilize the credits. The drilling credit program expires on March 31, 2011 and the Company does not plan to purchase any additional drilling credits.

Income Taxes

($000s)	2010	2009
Current income and other taxes	**187**	(2,351)
Future income tax (recovery)	**–**	(5,634)
	187	(7,985)

BlackPearl pays Saskatchewan resource surcharge based on a portion of its production revenues in the province, which is included in current income tax expense. BlackPearl does not have current income tax payable and does not expect to pay current income taxes in 2011 as the Company has sufficient resource pools to shelter expected income. The Company has the following estimated tax pools as at December 31, 2010:

($000s, except left-hand column)	Rate %	2010	2009
Canadian exploration expenses	100	**$ 14,459**	$ 9,581
Canadian development expenses	30	**130,634**	119,686
Canadian oil and gas property expenses	10	**18,964**	15,128
Undepreciated capital costs	10-30	**124,237**	173,977
Non-capital losses (various expiry dates)	100	**164,625**	92,173
Share issuance costs	5 years	**6,015**	10,419
		$ 458,934	$ 420,964

Results Of Operations

($000s, except where noted)	2010	2009
Net loss ($000s)	**(31,272)**	(47,315)
Per share, basic and diluted ($)	**(0.12)**	(0.19)

For the year ended December 31, 2010, the Company incurred a net loss of $31.3 million or $0.12 per share compared to a net loss of $47.3 million or $0.19 per share in 2009. The net loss in 2010 is principally a result of high depletion costs. The higher loss in 2009 is a result of not only higher depletion costs, but lower commodity prices during the first half of 2009.

Liquidity and Capital Resources

At December 31, 2010, BlackPearl had working capital of $144.0 million compared to $58.0 million at December 31, 2009. The increase is a result of common share issuances totaling $77.7 million, the disposition of non-core properties for net proceeds of $42.0 million and operating cash flows of $62.6 million, partially offset by $95.8 million in capital expenditures.

During 2010, the Company completed two equity offerings. The first occurred in May, when the Company issued 10,350,000 common shares at $2.90 per share, and the second offering occurred in December when the Company issued 10,000,000 million common shares at $5.00 per share. The additional capital was raised to ensure the Company had the funds available to expand the Company's capital spending program on its three core properties.

In addition to its working capital, BlackPearl also has an undrawn $25 million credit facility. The amount available under the credit facility is based on the value of oil and natural gas reserves. In May 2010, the credit facility was renewed on substantially the same terms as in the previous year. The next review of the Company's credit facility is scheduled to be completed by May 31, 2011. The only financial covenant in the 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 credit facility compared to current liabilities. The Company had a working capital ratio of 4.5:1 at December 31, 2010 and was in compliance with these covenants throughout 2010.

The Company expects capital spending during 2011 to be approximately $145 million. This will be financed from working capital and operating cash flows. The Company does not expect to utilize its credit facility to fund this program other than to issue letters of credit periodically to secure delivery of goods and services. The Company can adjust its capital program if required to maintain its financial flexibility.

On a longer-term basis, the December 31, 2010 oil and natural gas reserves evaluation and contingent resource study, prepared by Sproule Unconventional Limited, indicates that the Company will require significant capital investment to fully develop the Company's existing properties. The Company will likely require additional external financing to fund this capital investment; however, the Company has not determined the amount or structure of this financing. This requirement for additional funding will likely occur when the Company initiates commercial development of one of its thermal projects at Blackrod or Onion Lake.

Capital Expenditures

BlackPearl's capital program is focused on heavy oil opportunities. During 2010, capital spending was significantly higher than in 2009, totalling $95.8 million, an increase from the $27.9 million spent in 2009. The increase was primarily a result of acquiring the remaining 20 percent of the Blackrod SAGD project for $21.0 million and drilling 30 heavy oil wells at Onion Lake during the year. During 2010 the Company completed the sale of certain oil and natural gas properties for proceeds of $42.0 million. The assets sold were mainly natural gas properties in southern Alberta and heavy oil properties in Saskatchewan.

($000s)	**2010**	2009
Land	**5,168**	3,692
Seismic	**2,906**	168
Drilling and completion	**39,712**	18,849
Equipment	**26,791**	5,169
Other	**252**	–
Total	**74,829**	27,878
Property acquisitions	**21,000**	–
Total capital expenditures	**95,829**	27,878
Property dispositions	**(41,969)**	(250)
Net capital expenditures	**53,860**	27,628

Contractual Obligations and Contingencies

The Company has a number of financial obligations in the ordinary course of business. The following table summarizes the outstanding contractual obligations and commitments of the Company as at December 31, 2010:

($000s)	2011	2012	2013	2014	2015	Thereafter
Long-term debt	–	–	–	–	–	–
Operating leases [1]	1,166	1,234	1,234	1,626	1,626	1,320
Drilling rig commitment [2]	–	876	319	–	–	–
Electrical service agreement [3]	3,012	2,969	–	–	–	–
	4,178	5,079	1,553	1,626	1,626	1,320

[1] Relates to a lease for office premises, including estimated operating costs (net of sublease recoveries). 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 a maximum additional $21.3 million (including an estimate for operating costs) over the next seven years.

[2] Relates to a commitment to utilize a drilling rig from a specific company for a minimum number of days per year.

[3] Relates to a commitment for the installation of electrical services at the Mooney ASP facility.

These obligations are expected to be funded from operating cash flow.

The Company also has ongoing obligations related to the abandonment and reclamation of well sites and facilities which have reached the end of their economic lives. Remediation programs are undertaken regularly in accordance with applicable legislative requirements.

Financial Instruments and Risk Management

The financial instruments on the Company's balance sheet include cash, accounts receivable, investments in MAV notes and accounts payable. The Company manages its risk through its policies and processes, but generally has not used derivative financial instruments to manage these risks.

The carrying value of cash, accounts receivable and accounts payable approximates their fair value due to the short-term nature of these instruments. The fair value of the investment in MAV notes has been 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.

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 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 exposed to risk of near-term price movements. The Company manages this risk by constantly monitoring commodity prices and factoring them into operational decisions, such as contracting or expanding its capital expenditure program.

Foreign Currency Exchange Risk

Foreign currency risk is the risk that a variation in exchange rates between the Canadian dollar and the U.S. dollar will affect the Company's operating and financial results. As at December 31, 2010, the Company held US$3,997,000 in cash and short-term deposits and other net working capital items of US$1,460,000.

As at December 31, 2010, if the Cdn$-US$ exchange rates had been $0.10 lower with all other variables held constant, after tax earnings for the period would have been approximately $546,000 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.

Credit Risk

Credit risk is the risk that a third party fails to meet its contractual obligations in a way that could result in the Company incurring a loss. The Company's credit risk is primarily related to its holdings of cash, accounts receivable and investment in MAV notes.

As at December 31, 2010, the Company held $169.6 million in cash at various major financial institutions throughout Canada and the United States. At December 31, 2010, three Canadian financial institutions held approximately 99 percent of BlackPearl's 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.

The Company's accounts receivable are primarily with oil and natural gas marketers and joint venture partners. Receivables from oil and natural 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 counterparty and entering into relationships with larger purchasers with established credit history.

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

The Company is not the operator of certain oil and natural 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.

Interest Rate Risk

Interest rate risk is the risk that future cash flows of a financial instrument will fluctuate due to changes in interest rates. The Company is exposed to interest rate risk primarily related to its cash and the revolving credit facility, which remained undrawn throughout 2010 and is undrawn at this time.

Cash is held in highly liquid, short-term investments and therefore the risk to changes in interest rates is low. At December 31, 2010, if interest rates had been 1 percentage point (100 basis points) higher, with all other variables held constant, after tax earnings for the period would have been approximately $881,000 higher.

At December 31, 2010, the Company had not drawn on its credit facility and therefore the interest rate risk at that time was NIL.

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. Liquidity risk is currently low due to BlackPearl's large cash position. As at December 31, 2010, the Company had working capital of $144.0 million and an undrawn $25.0 million credit facility. The Company believes it has sufficient funding from these sources to meet its foreseeable obligations.

For more detailed information, see note 11 to the consolidated financial statements.

Off-Balance-Sheet Arrangements

The Company has no off-balance-sheet arrangements.

Related-Party Transactions

There were no related-party transactions during 2010.

Outstanding Share Data

As at February 25, 2011, the Company had 283,262,387 common shares outstanding, 10,000,320 vested warrants outstanding and 14,922,998 stock options outstanding under its stock-based compensation.

Proposed Transactions

As of February 25, 2011, the Company does not have any significant pending transactions.

Critical Accounting Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect reported assets and liabilities, disclosure of contingencies and revenues and expenses. Management is also required to adopt accounting policies that require the use of significant estimates. Actual results could differ materially from those estimates. A comprehensive discussion of the significant accounting policies adopted by BlackPearl can be found in notes 2 and 3 to the Consolidated Financial Statements.

Management believes the most critical accounting policies, including judgments in their application, which may have an impact on the Company's financial results, relate to the accounting for property, plant and equipment, and asset retirement obligations (ARO). The rate at which the Company's assets are depreciated or otherwise written off and the asset retirement liability provided for, with the associated accretion expensed to the income statement, are subject to a number of judgments about future events, many of which are beyond management's control. In addition, recognition of reserves is central to much of the accounting for an oil and natural gas company, as described below.

The following areas contain significant estimates made by management:

(i) Oil and natural gas reserves – Estimating reserves is a subjective process. It requires significant judgments using geological, engineering and economic data. The important assumptions made in preparing an estimate of oil and gas reserves include expected reservoir performance, future rates of production, oil and natural gas price forecasts, future operating and development costs, timing of expenditures and future fiscal regimes. These estimates can change substantially as additional data from ongoing development activities and production performance becomes available and as economic conditions change. The Company's oil and natural gas reserves are evaluated by Sproule Unconventional Limited, an independent reserves evaluator.

Reserves estimates can have a significant impact on net earnings, as they are a key component in the calculation of depletion and the ceiling test calculation discussed below. The reserve estimates are also used in determining the Company's borrowing base for its credit facilities.

(ii) DD&A expense – BlackPearl uses the full cost method of accounting for exploration and development activities whereby all costs associated with these activities, whether successful or not, are capitalized. The aggregate of capitalized costs, net of certain costs related to unproved properties, and estimated future development costs is amortized using the unit-of-production method based on estimated proved reserves. Changes in estimated proved reserves or future development costs have a direct impact on depreciation and depletion expense.

Certain costs related to unproved properties and major development projects may be excluded from costs subject to depletion until proved reserves have been determined or their value is impaired. At December 31, 2010, $76.0 million was excluded from the calculation of DD&A expense for the year. These costs primarily relate to the Blackrod property, where no reserves have been recognized as at December 31, 2010. These properties are reviewed quarterly to determine if proved reserves should be assigned, at which point they would be included in the depletion calculation.

(iii) Ceiling test – The Company is required to review the carrying value of all property, plant, and equipment for potential impairment. Impairment is indicated if the carrying value of the long-lived asset or oil and natural gas cost centre is not recoverable by the future undiscounted cash flows. If impairment is indicated, the amount by which the carrying value exceeds the estimated fair value of the long-lived asset is charged to earnings.

The ceiling test is based on estimates of reserves prepared by qualified independent evaluators, production rate, crude oil and natural gas prices, future costs and other relevant assumptions. By their nature, reserve estimates are subject to measurement uncertainty and the impact of ceiling test calculations on the consolidated financial statements of changes to reserve estimates could be material.

At December 31, 2010, the carrying value of the Company's Canadian oil and gas properties (less the amount for unproved properties) exceeded the undiscounted cash flows from proved properties only; therefore, assessing impairment using discounted cash flows from both proved and probable reserves was required. In performing this test, proved plus probable reserves were discounted at a risk-free rate of 4 percent. This calculation resulted in the pre-tax discounted cash flows exceeding the carrying value of the oil and natural gas properties by approximately $355.7 million and, therefore, no impairment was recorded.

As at December 31, 2010 the Company recorded a $0.7 million writedown of its U.S. oil and natural gas assets, as this amount represents their estimated salvage value.

(iv) Asset Retirement Obligation – The Asset Retirement Obligation is estimated based on existing laws, contracts or other policies. The fair value of the obligation is based on estimated future costs for abandonment and reclamation, discounted at a credit-adjusted risk-free rate. The costs are included in property, plant and equipment and amortized over their useful life. The liability is adjusted each reporting period to reflect the passage of time, with the accretion charged to earnings and for revisions to the estimated future cash flows. The estimates or assumptions required to calculate asset retirement obligation includes, among other items, abandonment and reclamation amounts, inflation rates, credit-adjusted discount rates and timing of retirement of assets. By their nature, these estimates are subject to measurement uncertainty and the impact on the financial statements could be material.

The following significant assumptions were used for the purpose of estimating asset retirement obligation:

	2010	2009
Undiscounted abandonment costs ($000s)	$ **27,482**	$ 38,290
Credit-adjusted risk-free rate	**6.5%**	6.5%
Inflation rate	**2%**	2%
Average years to reclamation	**12**	13

(v) Income taxes – The Company follows the liability method of accounting for income taxes. Under this method the Company records future income tax assets and liabilities based on temporary differences between the carrying value and tax basis of the Company's assets and liabilities. Future income tax provisions require estimating the timing of these temporary differences and estimating whether tax assets will be realized before expiry.

The determination of the Company's income and other tax liabilities requires interpretation of complex laws and regulations often involving multiple jurisdictions. All tax filings are subject to audit and potential reassessment after the lapse of considerable time. Accordingly, the actual income tax liability may differ significantly from that estimated and recorded. In addition, the Company is required to estimate whether it will be able to utilize all of its existing tax pools before their expiry.

(vi) Stock-based compensation – The Company uses the fair value method to account for stock options. The determination of the amounts for stock-based compensation is based on estimates of stock volatility, risk-free interest rates and the expected lives of the option. By their nature, these estimates are subject to measurement uncertainty and a change in these estimates would impact the valuation of the option and could result in a different amount for stock-based compensation expense.

(vii) Other estimates – The Company is required to make certain estimates for revenues, royalties, operating costs and capital expenditures as at a specific reporting date if actual amounts for these items have not been received.

Risks and Uncertainties

The Company is exposed to a number of risks and uncertainties inherent in exploring for, developing and producing crude oil and natural gas. These risks and uncertainties include, but are not limited to, the following:

- Risk of fluctuating oil, natural gas prices and diluent;
- Operational risk of finding and producing reserves economically;
- Uncertainties associated with estimating the quantity of reserves and resources;
- Risk associated with securing the needed capital to carry out the Company's operations;
- Changes in global economic conditions, particularly in Canada and the U.S.;
- Risk from aboriginal claims;

- Risk of changes in government policies, especially related to royalty legislation, income tax laws, incentive programs, operating practices and environmental protection, social instability or other political, economic or diplomatic developments in its operations;
- Environmental and safety risks related to its oil and gas properties;
- Competition for, among other things, capital, undeveloped land, skilled labour and equipment;
- Reliance on third parties for pipeline and other infrastructure;
- Risk of fluctuating foreign currency exchange rates;
- Credit or counterparty risk with respect to non-performance by counterparties to financial instruments;
- Risk of changes to interest rates;
- Marketing reserves at acceptable prices;
- Uncertainty associated with obtaining drilling licenses and other regulatory consents and approvals; and
- Uncertainties of the SAGD bitumen and ASP flood recovery processes.

Further information regarding these risks may be found under “Risk Factors” in the Company’s Annual Information Form.

Many of the previously mentioned risks are beyond the Company’s control and it is impossible to ensure that any exploration drilling program or piloting program will ultimately result in commercial operations. The Company does not currently utilize derivative instruments to hedge its commodity price, foreign currency exchange or interest rate risks.

BlackPearl strives to minimize and manage these risks in a number of ways, including:

- Employing qualified professional and technical staff;
- Maintaining a healthy balance sheet that minimizes the use of debt;
- Carrying insurance to provide a reasonable amount of protection from risk of loss;
- Communicating openly with members of the public regarding its activities;
- Concentrating in areas with long-life reserves to reduce the risk associated with commodity price cycles;
- Monitoring price trends and establishing relationships with creditworthy counterparties;
- Utilizing the latest technology for finding and developing reserves;
- Constructing high-quality, environmentally sensitive and safe production facilities; and
- Maximizing operational control of drilling and producing operations.

Environmental Risks

All phases of the oil and natural gas business present environmental risks and hazards and are subject to environmental regulation pursuant to a variety of federal, provincial and local laws and regulations. Compliance with such legislation can require significant expenditures and a breach could result in the imposition of fines and penalties, some of which could be material. Senior management continually assesses new and existing regulatory requirements and environmental risks and determines the impact these risks might have on the Company, as well as the appropriate actions necessary to manage those risks. These assessments and the resulting policy decisions are discussed quarterly with the Board of Directors which evaluates the performance and effectiveness of the Company's environmental policies and programs.

The Company's environmental responsibilities includes removing property, plant and equipment as well as reclaiming land and property to its original state, subsequent to the completion of oil and natural gas extraction activities. This requirement results in an ARO that provides current recognition of estimated expenditures that will be incurred in the future. The Company's ARO is discussed in further detail under "Critical Accounting Estimates" above, as well as in the notes to the Company's audited Consolidated Financial Statements.

In 2010, the Company received all required environmental and regulatory approvals for the Blackrod SAGD pilot, the polymer flood at Mooney and the 2011 Onion Lake drilling program.

International Financial Reporting Standards

In 2011, International Financial Reporting Standards (IFRS) will replace Canadian GAAP for publicly accountable enterprises. BlackPearl is required to adopt IFRS for the interim and annual periods beginning on January 1, 2011, including comparative information pertaining to 2010.

The Company remains on-schedule in the transition from current Canadian GAAP to IFRS. The Company has completed a high-level review of the major differences between current Canadian GAAP and IFRS, has established accounting policies and has completed a preliminary opening balance sheet as at January 1, 2010 under IFRS. Below is a summary of the estimated impact of IFRS adjustments on the Company's 2010 opening consolidated balance sheet:

($millions)	Canadian GAAP	IFRS Adjustments	IFRS
Total assets	468	–	468
ARO	25	8	33
Deficit	(368)	(8)	(376)

BlackPearl has also drafted preliminary results under IFRS for the year ended 2010. Any differences from Canadian GAAP are related to the accounting recognition of expenditures. We do not expect any changes in cash flows as a result of adopting IFRS. Below is a summary of the estimated impact of the significant IFRS adjustments to 2010 net earnings:

($millions)	Canadian GAAP	IFRS Adjustments	IFRS
Depletion and depreciation	90	(30-35)	55-60
Accretion	1	–	1
Loss on asset dispositions	–	0-2	0-2

The draft comparative opening balance sheet at January 1, 2010, as well as the estimated figures stated above, are based on available information and our expectations as of the date of this MD&A. They are also subject to further review by management and the Board of Directors and are subject to change.

The estimated changes listed above are a result of the following significant accounting policy differences between Canadian GAAP and IFRS:

Property, Plant & Equipment (PP&E)

- Pre-exploration costs (costs incurred prior to obtaining the legal right to explore) are to be expensed in the period incurred.
- Exploration and evaluation costs (E&E) will initially be capitalized as E&E assets. Once the associated project becomes technically and commercially viable, these costs will be transferred to PP&E. On the other hand, should the project be determined unviable, the related costs will be expensed in the period the determination is made. At January 1, 2010, $30.3 million in E&E costs will be moved out of PP&E and shown separately on the Company's balance sheet.
- PP&E costs will be depreciated on a unit-of-production basis at the area asset level (unit of account). The Company has determined its asset areas for purposes of performing these depletion calculations and has decided to use proved plus probable (2P) reserves as the basis to calculate depletion.
- Impairment of PP&E is to be assessed at the cash generating unit level. This is the lowest level at which cash inflows can be identified. The Company has determined it will initially have five cash generating units. Impairment losses can be reversed if the recoverable amount increases in the future. The Company does not anticipate an impairment at January 1, 2010.
- Asset dispositions will be recorded at the unit of account level and will result in a gain or loss being recorded in the statement of operations. Any gains or losses on the partial disposition of any unit of account will be determined by applying the proceeds from the disposition against a portion of the unit's net book value, which will be calculated based on 2P reserves. The Company disposed of a number of non-core properties in 2010. Although no gain or loss was recorded under Canadian GAAP, it is anticipated that a loss of $0-2 million will be realized under IFRS for the year ended December 31, 2010.
- IFRS 1 – *First Time Adoption of IFRS* allows Canadian oil and natural gas companies that used the full cost method of accounting for exploration and development activities to use their independent reserve report to allocate their property, plant and equipment full cost pool to individual cash generating units. BlackPearl has decided to utilize this exemption and to allocate its full cost pool using the net present value of its 2P reserves.

ARO

BlackPearl will discount its ARO using the current risk-free rate, as opposed to the credit-adjusted risk-free rate, which was required under Canadian GAAP. Upon adoption of IFRS, the transition amendment IFRS 1 allows for any change in the ARO liability resulting from adoption to be recorded to retained earnings. At January 1, 2010, this change will result in an estimated increase in the asset retirement obligation of approximately $7.5 million with the offsetting reduction to retained earnings. In subsequent periods, the impact of changes in assumptions on the ARO liability will be adjusted to PP&E.

Income Taxes

Canadian GAAP and IFRS follow the liability method of accounting for income taxes, where tax assets and liabilities are recognized on temporary differences. However, there are certain exceptions to the treatment of temporary differences under IFRS that may result in an adjustment to the Company's future tax liability under IFRS. In addition, the Company's future tax liability will be affected by the tax effects of any changes noted in the above areas. The Company is still assessing the specific impacts of these differences on its financial statements.

Business Combinations

IFRS 1 provides an exemption with respect to business combinations. Any business combinations and joint ventures entered into prior to January 1, 2010 are not required to be restated using IFRS principles. The Company has elected to utilize this exemption.

During the fourth quarter, the Company continued to make modifications to its computer and accounting software in preparation for IFRS, as well as any internal control changes that may result.

Control Certification

Disclosure Controls and Procedures

Disclosure controls and procedures have been designed to ensure that information required to be disclosed by the Company is accumulated and communicated to management to allow for timely decisions regarding required disclosures. The Company carried out an evaluation of the effectiveness of the Company's disclosure controls and procedures as at December 31, 2010. The evaluation was carried out under the supervision and with the participation of the Chief Executive Officer and the Chief Financial Officer. The Company's Chief Executive Officer and Chief Financial Officer, together with other members of management, have concluded, based on their evaluation of the effectiveness of the Company's disclosure controls and procedures as at year-end, that the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company is (i) recorded, processed, summarized and reported within the time periods specified in Canadian securities law and (ii) accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

It should be noted that while the Company's Chief Executive Officer and Chief Financial Officer believe that the Company's disclosure controls and procedures provide a reasonable level of assurance that they are effective, they do not expect that the disclosure controls and procedures will necessarily prevent all errors and fraud. A control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met.

Internal Controls over Financial Reporting

The Company's Chief Executive Officer and Chief Financial Officer have designed, or caused to be designed under their supervision, a system of internal control over financial reporting to provide reasonable assurance regarding the reliability of the Company's financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP. Such officers have evaluated, or caused to be evaluated under their supervision, the effectiveness of the Company's internal control over financial reporting at the financial year-end of the Company and concluded that the Company's internal control over financial reporting is effective, at the financial year-end of the Company, for the foregoing purpose.

The Company is required to disclose herein any change in its internal control over financial reporting during the period that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting. No material change in the Company's internal control over financial reporting was identified during such period that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

It should be noted that a control system, including the Company's disclosure and internal controls and procedures, no matter how well conceived, can provide only reasonable, but not absolute, assurance that the objectives of the control system will be met and it should not be expected that the disclosure and internal controls and procedures will prevent all errors or fraud.

Fourth Quarter 2010 Activities

($000s, except where noted)	2010		2009
	Q4	Q3	Q4
Production (boe/d)	**7,307**	**6,646**	5,306
Average wellhead price	**57.63**	**54.66**	56.69
Revenues	**38,743**	**33,421**	27,673
Net loss	**(3,901)**	**(9,042)**	(3,897)
Cash flow from operations, before working capital adjustments	**19,413**	**14,218**	14,679
Additions to oil and natural gas properties (at year-end)	**38,033**	**19,926**	17,559

Production revenues were $38.7 million in the fourth quarter of 2010 compared to $27.7 million in the same quarter 2009, due to a significant increase in production and a small increase in wellhead prices. BlackPearl sold an average of 7,307 boe per day during the fourth quarter of 2010, an increase of 38 percent over the same quarter of 2009. The increased sales volumes are attributable to continued development at Onion Lake.

Crude oil prices increased by 12 percent in the fourth quarter of 2010 from the same quarter of 2009, with WTI oil averaging US$85.10 per barrel. The increase in commodity prices is generally attributable to an increase in world crude oil demand as markets started to recover from the recent worldwide economic downturn, which originally caused a lower demand for commodities. Heavy oil prices, however, remained generally consistent with the fourth quarter of 2009 due to wider heavy oil differentials. The Western Canada Select to WTI price differential averaged US$18.19 per bbl in the fourth quarter of 2010 compared to US$12.30 per bbl in the fourth quarter of 2009. The wider differential was mainly attributable to pipeline disruptions in the U.S. which temporarily affected shipments of heavy oil. The general increase in oil prices offset by a wider differential resulted in an increase in BlackPearl's average wellhead price from $56.69 in the fourth quarter of 2009 to $57.63 in the fourth quarter of 2010.

Royalty rates were comparable quarter over quarter at 25 percent and 24 percent respectively. Operating and transportation costs increased in the fourth quarter of 2010 due to increased sales volumes, while declining on a per-unit-of-production basis. G&A increased in the fourth quarter of 2010 due to higher staff levels and consulting fees related to the preparation of the contingent resource study in 2010. In addition, administrative costs in 2009 included a large ($1.3 million) recovery adjustment for provision for bad debts, which reduced fourth quarter 2009 costs. On a per-unit-of-production basis, G&A declined substantially quarter over quarter.

Cash flow from operations and net loss in the fourth quarter of 2010 were $19.4 million and $3.9 million, respectively, compared to $14.7 million and $3.9 million, respectively in the fourth quarter of 2009. The increased cash flow was due to the increase in production and heavy oil prices.

Capital expenditures in the fourth quarter of 2010 were $38.0 million, 117 percent higher than in the fourth quarter of 2009 and 91 percent higher than in the third quarter of 2010. The increase is a result of the drilling of 19 wells during the fourth quarter of 2010, as well as continued construction of the polymer flood facilities at Mooney and the steam generation and water handling facilities for the Blackrod SAGD pilot project.

Outlook

BlackPearl's Board of Directors approved the Company's corporate budget for 2011. Key budgetary items and operating goals include:

2011 Guidance	
Production (boe/d)	
Annual average	9,200 – 9,700
Exit	11,000 – 13,000
Cash flow from operations ($millions)	65 – 70
Capital expenditures ($millions)	130 – 150
Year-end debt	–
Year-end working capital ($millions)	60 – 70
Pricing Assumptions (annual average)	
Crude oil – WTI	US$80
Light/heavy differential	US$16
Cdn$/US$ exchange	1.00

BlackPearl expects to exit 2011 with production of 11,000 – 13,000 barrels of oil equivalent per day. The relatively wide range in the exit rate target is due to the variability in the timing of initial response from the polymer flood at Mooney, which is expected to take 6-12 months.

In 2011, BlackPearl is planning a $130-$150 million capital expenditure program. The major components of this program are:

- Onion Lake – $60 million to drill between 100-120 wells;
- Blackrod – $22 million to complete construction of and commission the SAGD pilot; and
- Mooney – $43 million to complete construction of and commission the polymer flood.

This activity will be completely funded from existing working capital ($144 million at December 31, 2010) and forecast cash flow of $65-$70 million. No additional financing will be required in 2011; however, in the event that commodity prices drop and cash flows do not reach anticipated levels, the Company will lower its capital spending by reducing the number of wells drilled at Onion Lake to ensure it can remain debt-free.

Sensitivities

The significant factors that would affect forecast cash flows include commodity prices, heavy oil differentials, exchange rates and production volumes.

The following table summarizes the approximate effect changes in these factors could have on the Company's 2011 performance:

	Cash Flow	Net Earnings
	($000s)	
Price change		
US$5 per barrel change in the price of WTI oil	10,894	10,894
US$2 per barrel change in the light/heavy differential	4,357	4,357
Exchange rate		
$0.05 change in US/CDN rate	6,972	6,972
Production rate		
500 barrel per day change	4,045	151

In summary, 2011 will be even more active than 2010. BlackPearl's strong working capital, in conjunction with favourable commodity prices, strongly position the Company for continued development of its core properties and further production growth in 2011.

Forward-Looking Statements

This report contains certain forward-looking statements and forward-looking information (collectively referred to as **"forward-looking statements"**) within the meaning of applicable Canadian securities laws. All statements other than statements of historical fact are forward-looking statements. Forward-looking information typically contains statements with words such as "anticipate", "believe", "plan", "continuous", "estimate", "expect", "may", "will", "project", "should", or similar words suggesting future outcomes. In particular, this report contains forward-looking statements pertaining to the following:

- Business plans and strategies;
- Capital expenditure and drilling programs;
- Methods and ability to finance capital expenditure programs;
- Anticipated oil and gas production levels;
- Future oil and gas prices and their impact on BlackPearl;
- Future costs including operating and administrative costs and royalty rates;
- Future cash flows and net earnings;
- Future asset dispositions;
- Estimated tax pools;
- Corporate guidance for 2011; and
- The estimated quantity of resources from the contingent resource study and the ultimate recoverability of resources.

In addition, statements relating to "reserves" or "resources" are deemed to be forward-looking statements as they involve the implied assessment, based on certain estimates and assumptions, that the reserves and resources described exist in the quantities predicted or estimated and can be profitably produced in the future.

Undue reliance should not be placed on forward-looking statements, which are inherently uncertain, are based on estimates and assumptions, and are subject to known and unknown risks and uncertainties (both general and specific) that contribute to the possibility that the future events or circumstances contemplated by the forward-looking statements will not occur. There can be no assurance that the plans, intentions or expectations upon which forward-looking statements are based will be realized. Actual results will differ, and the difference may be material and adverse to the Corporation and its shareholders.

With respect to forward-looking statements contained in this report, management has made assumptions regarding future production levels; future oil and gas prices; future operating costs; timing and amount of capital expenditures; the ability to obtain financing on acceptable terms; availability of skilled labour and drilling and related equipment; general economic and financial market conditions; continuation of existing tax and regulatory regimes; and the ability to market oil and natural gas successfully to current and new customers. A description of some of the assumptions used for 2011 are located in "Outlook" above. Although management considers these assumptions to be reasonable based on information currently available to it, they may prove to be incorrect.

By their very nature, forward-looking statements involve inherent risks and uncertainties (both general and specific) and risks that the goals or figures contained in forward-looking statements will not be achieved. These factors include, but are not limited to, risks associated with fluctuations in market prices for crude oil, natural gas and diluent, general economic, market and business conditions, substantial capital requirements, uncertainties inherent in estimating quantities of reserves and resources, extent of, and cost of compliance with, government laws and regulations and the effect of changes in such laws and regulations from time to time, the need to obtain regulatory approvals on projects before development commences, environmental risks and hazards and the cost of compliance with environmental regulations, aboriginal claims, inherent risks and hazards with operations such as fire, explosion, blowouts, mechanical or pipe failure, cratering, oil spills, vandalism and other dangerous conditions, potential cost overruns, variations in foreign exchange rates, diluent supply shortages, competition for capital, equipment, new leases, pipeline capacity and skilled personnel, uncertainties inherent in the SAGD bitumen and Alkali Surfactant Polymer recovery processes, credit risks associated with counterparties, the failure of the Company or the holder of licenses, leases and permits to meet requirements of such licenses, leases and permits, reliance on third parties for pipelines and other infrastructure, changes in royalty regimes, failure to accurately estimate abandonment and reclamation costs, inaccurate estimates and assumptions by management, effectiveness of internal controls, the potential lack of available drilling equipment and other restrictions, failure to obtain or keep key personnel, title deficiencies with the Company's assets, geo-political risks, risks that the Company does not have adequate insurance coverage, risk of litigation and risks arising from future acquisition activities. Further information regarding these risk factors may be found under "Risk Factors" in the Annual Information Form. Readers are cautioned that these factors and risks are difficult to predict and that the assumptions used in the preparation of such information, although considered reasonably accurate at the time of preparation, may prove to be incorrect. Accordingly, readers are cautioned that the actual results achieved will vary from the information provided herein and the variations could be material. Readers are also cautioned that the foregoing list of factors is not exhaustive. Consequently, there is no representation by the Corporation that actual results achieved will be the same in whole or in part as those set out in the forward-looking information. Furthermore, the forward-looking statements contained in this report are made as of the date hereof, and the Corporation does not undertake any obligation, except as required by applicable securities legislation, to update publicly or to revise any of the included forward-looking statements, whether as a result of new information, future events or otherwise. The forward-looking statements contained herein are expressly qualified by this cautionary statement.

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.

John L. Festival
President and Chief Executive Officer

Donald W. Cook
Chief Financial Officer

February 25, 2011

Auditors' Report

February 25, 2011

To the Shareholders of Blackpearl Resources Inc.

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

Management's responsibility for the consolidated financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

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

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

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

Opinion

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

PricewaterhouseCoopers LLP

Chartered Accountants

Calgary, Alberta

Consolidated Balance Sheets

As at December 31		2010		2009
(Cdn$ in thousands)				
ASSETS				
Current assets				
Cash	$	**169,596**	$	56,352
Accounts receivable		**19,551**		11,977
Income and other taxes receivable		**2,083**		4,817
Prepaid expenses and deposits		**883**		1,167
		192,113		74,313
Investments (note 4)		**1,839**		1,284
Petroleum and natural gas properties (note 5)		**349,874**		392,712
	$	**543,826**	$	468,309
LIABILITIES				
Current liabilities				
Accounts payable and accrued liabilities	$	**48,081**	$	16,318
Asset retirement obligation (note 7)		**18,860**		25,435
		66,941		41,753
SHAREHOLDERS' EQUITY				
Share capital (note 8)		**857,813**		779,809
Contributed surplus (note 8)		**19,041**		15,444
Deficit		**(399,969)**		(368,697)
		476,885		426,556
	$	**543,826**	$	468,309

Commitments and contingencies (note 10)
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

Year ended December 31	2010	2009
(Cdn$ in thousands, except for per share amounts)		
Revenue		
Oil and gas sales	**$ 142,867**	$ 89,637
Royalties	**(36,798)**	(21,262)
	106,069	68,375
Other income	**3,132**	–
Interest income	**895**	321
	110,096	68,696
Expenses		
Production	**36,824**	29,461
Transportation	**2,734**	3,466
General and administrative	**6,788**	6,913
Depletion, depreciation and accretion	**91,026**	81,100
Stock-based compensation (note 8)	**3,995**	1,461
Interest and bank charges	**74**	277
Foreign currency exchange loss	**295**	762
Revaluation of investments (note 4)	**(555)**	556
	141,181	123,996
Loss before income taxes	**(31,085)**	(55,300)
Income taxes (note 9)		
Current income tax (recovery)	**187**	(2,351)
Future income tax (recovery)	**–**	(5,634)
	187	(7,985)
Comprehensive loss for the year	**(31,272)**	(47,315)
Deficit, beginning of year	**(368,697)**	(321,382)
Deficit, end of year	**$ (399,969)**	$ (368,697)
Basic and diluted loss per share	**$ (0.12)**	$ (0.19)
Weighted average number of common shares used in computing loss per share: basic and diluted [1]	**269,029,016**	243,185,591

See accompanying notes to consolidated financial statements

[1] 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

Year ended December 31 (Cdn$ in thousands)	2010	2009
Operating activities		
Net loss	**$ (31,272)**	$ (47,315)
Items not involving cash:		
Depletion,depreciation and accretion	**91,026**	81,100
Stock-based compensation	**3,995**	1,461
Future income tax (recovery)	**–**	(5,634)
Foreign exchange loss	**295**	762
Provision for bad debts (reduction)	**–**	(1,322)
Revaluation of investments	**(555)**	556
Abandonment costs	**(905)**	(604)
	62,584	29,004
Changes in non-cash working capital balances related to operations	**(3,750)**	(29,593)
	58,834	(589)
Financing activities		
Proceeds on issue of common shares, net of costs	**77,604**	43,838
	77,604	43,838
Investing activities		
Additions to petroleum and natural gas properties	**(95,829)**	(27,878)
Proceeds from sale of petroleum and natural gas properties	**41,969**	250
Proceeds from sale of investment	**–**	4
Cash received on acquisition of BlackCore Resources Inc.	**–**	5,589
Changes in non-cash working capital from investing	**30,666**	11,079
	(23,194)	(10,956)
Net increase in cash	**113,244**	32,293
Cash, beginning of year	**56,352**	24,059
Cash, end of year	**$ 169,596**	$ 56,352
Supplementary Information		
Cash interest paid	**$ 32**	$ 87
Cash taxes paid	**$ 172**	$ 1,004

See accompanying notes to consolidated financial statements

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

1. Nature of Operations

BlackPearl Resources Inc. (collectively with its subsidiaries, the "Company" or "BlackPearl") is engaged in the business of oil and gas exploration, development and production in North America. BlackPearl is listed and traded on the TSX Exchange under the trading symbol "PXX". The Company's Swedish Depository Receipts trade on the NASDAQ OMX First North market under the symbol "PXXS".

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.

(c) Measurement Uncertainty

The preparation of consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, expenses and the disclosure of contingencies. Such estimates primarily relate to unsettled transactions and events as of the date of the consolidated financial statements. These estimates are subject to measurement uncertainty. Actual results could differ from and affect the results reported in these consolidated financial statements.

Purchase price allocations, depletion, depreciation and amortization, and amounts used in impairment calculations are based on estimates of crude oil and natural gas reserves. By nature, estimates of reserves and the related future cash flows are subject to measurement uncertainty, and the impact of differences between actual and estimated amounts on the consolidated financial statements of future periods could be material.

The calculation of asset retirement obligations includes estimates of the future costs to settle the asset retirement obligation, the timing of the cash flows to settle the obligation, and the future inflation rates. The impact of differences between actual and estimated costs, timing and inflation on the consolidated financial statements of future periods may be material.

The calculation of income taxes requires judgement in applying tax laws and regulations, estimating the timing of the reversals of temporary differences, and estimating the realizability of future tax assets. These estimates impact current and future income tax assets and liabilities, and current and future income tax expense (recovery).

The calculation of stock-based compensation requires estimates relating to volatility, forfeiture rates and market prices surrounding the issuance of stock options. These estimates impact stock-based compensation expense and contributed surplus.

(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 Operations

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 11(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 obligations are 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) 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.

(m) 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.

Financial assets and liabilities held-for-trading instruments are subsequently measured at fair value with changes in fair value recognized in net income. Financial assets available-for-sale are subsequently measured at fair value with changes in fair value recognized in other comprehensive income, net of tax. Financial assets held-to-maturity, loans and receivables, and other financial liabilties are subsequently measured at amortized cost using the effective interest rate method.

The Company has no financial instruments that give rise to other comprehensive income. Cash and cash equivalents are designated as held-for-trading. Accounts receivable are designated as loans and receivables. The Company's investment in MAV notes are designated as held-for-trading and accounts payable and accrued liabilities are designated as other financial liabilities.

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. Recent Accounting Pronouncements (IFRS)

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. Additional information regarding the Company's IFRS conversion can be found in the accompanying MD&A.

4. Investments

	December 31, 2010	December 31, 2009
MAV Notes at beginning of year	**$ 1,284**	$ 1,284
Fair value adjustment	**555**	–
MAV Notes at end of year	**$ 1,839**	$ 1,284

The Company acquired an interest in third party asset-backed commercial paper (ABCP) 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. The ABCP was restructured and the Company received Master Asset Vehicle Notes (MAV Notes) with a face value of $5 million. As at December 31, 2010, the Company estimated the fair value of the notes at $1,839,000 (December 31, 2009 – $1,284,000).

5. Petroleum and Natural Gas Properties

			December 31, 2010
	Cost	**Accumulated depreciation and depletion**	**Net book value**
Petroleum and natural gas properties	**$ 696,937**	**$ 348,868**	**$ 348,069**
Office equipment	**3,169**	**1,364**	**1,805**
	$ 700,106	**$ 350,232**	**$ 349,874**

			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
	$ 653,660	$ 260,948	$ 392,712

During 2010, the Company sold a number of non-core properties for net proceeds of $42.0 million. The proceeds were recorded as a reduction in petroleum and natural gas properties.

The depletion and ceiling test calculations have excluded the cost of unproved properties of $76.0 million (December 31, 2009 – $33.6 million) and included future development costs of $104.5 million (December 31, 2009 – $63.6 million). The majority of the Company's unproved properties relate to the Blackrod area and the construction of the SAGD pilot. This project is currently in the pre-production stage and is not generating any revenues. The Company does not capitalize any interest or general and administrative expenses.

The Company performed ceiling test calculations at December 31, 2010 to assess whether the carrying value of the petroleum and natural gas properties were recoverable. A write-down of $0.7 million (December 31, 2009 – $2.9 million) in the carrying value of the U.S. assets has been included in depletion, depreciation and accretion in the consolidated financial statements. The following represent the prices that were used in the December 31, 2010 ceiling test:

Average Price Forecast [1]

Year	WTI Cushing 40° API (US$/bbl)	Hardisty Lloydblend 20.5° API (CDN$/bbl)	Alberta AECO-C Spot (CDN$/MMBtu)	Exchange rate (US$/Cdn$)
2011	88.40	80.04	4.04	0.93
2012	89.14	80.71	4.66	0.93
2013	88.77	78.48	4.99	0.93
2014	88.88	76.70	6.58	0.93
2015	90.22	77.86	6.69	0.93
2016	91.57	79.03	6.80	0.93
2017	92.94	80.23	6.91	0.93
2018	94.34	81.44	7.02	0.93
2019	95.75	82.67	7.14	0.93
2020	97.19	83.92	7.26	0.93
Escalation rate of 1.5% thereafter [2]				

[1] The benchmark prices listed above are adjusted for quality differentials, heat content, distance to market and other factors in performing the ceiling test.

[2] Percentage change represents the change in each year after 2020 to the end of the reserve life.

6. 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 amount not to exceed the total credit facility. The facility bears interest, at the Company's option at either 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, 2010, 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, 2010, 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, 2011.

7. 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 Company's total estimated undiscounted costs required to settle the asset retirement obligation is approximately $27.5 million (December 31, 2009 – $38.3 million) which will be incurred over the next 27 years, with the majority of costs incurred between 2011 and 2024. Settlement of the obligation is expected to be funded from general corporate funds at the time of retirement. As at December 31, 2010, no funds have been set aside to settle these obligations.

The asset retirement obligation was discounted using a credit-adjusted risk-free rate of 6.5 percent and an inflation rate of 2 percent.

Changes to the asset retirement obligation were as follows:

	Year ended December 31 , 2010	Year ended December 31, 2009
Asset retirement obligation at beginning of year	**$ 25,435**	$ 20,064
Liabilities acquired through acquisitions, net of dispositions	**(8,206)**	2,939
Liabilities incurred during the year	**1,165**	1,516
Actual remediation costs	**(905)**	(604)
Accretion	**1,371**	1,520
Asset retirement obligation at end of year	**$ 18,860**	$ 25,435

8. 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	189,241,716	$ 723,122
Shares issued for BlackCore acquisition	17,600,000	10,560
Shares issued for property acquisitions	2,500,000	1,500
Shares issued from treasury	52,334,000	46,046
Shares issued upon exercise of stock options	285,001	214
Transferred from contributed surplus on exercise of stock options	–	112
Share issuance costs	–	(1,745)
Balance as at December 31, 2009	261,960,717	$ 779,809
Shares issued from treasury	**20,350,000**	**80,015**
Shares issued upon exercise of stock options	**904,670**	**800**
Transferred from contributed surplus on exercise of stock options	**–**	**400**
Share issuance costs	**–**	**(3,211)**
Balance as at December 31, 2010	**283,215,387**	**$ 857,813**

(c) Warrants Outstanding

The Company has 10,000,320 warrants outstanding as a result of the acquisition of BlackCore Resources Inc in 2009 (note 12). Each warrant allows the holder to acquire, on or before January 13, 2013, one common share of the Company at $0.60.

(d) Stock Options Outstanding

The Company has a stock option plan (the "Plan") whereby options to purchase common shares may be granted 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 on the TSX Exchange immediately preceding the day the option is granted.

The following summarizes stock options outstanding as at December 31, 2010 and December 31, 2009:

	Number of Options	Weighted Average Exercise Price ($)
Outstanding at December 31, 2008	11,138,436	2.16
Granted	6,325,500	1.59
Exercised	(285,001)	0.75
Forfeited	(3,724,602)	3.32
Outstanding at December 31, 2009	13,454,333	1.60
Granted	**2,786,500**	**4.74**
Exercised	**(904,670)**	**0.89**
Forfeited	**(366,165)**	**2.95**
Outstanding at December 31, 2010	**14,969,998**	**2.20**

Options outstanding and exercisable as at December 31, 2010 are summarized below:

	Options Outstanding			Options Exercisable		
Range of Exercise Prices ($)	Number of Options	Weighted Average Exercise Price ($)	Weighted Average Remaining Life (Years)	Number of Options	Weighted Average Exercise Price ($)	Weighted Average Remaining Life (Years)
0.40 – 1.50	6,541,166	0.73	3.04	4,215,343	0.73	3.03
1.51 – 3.00	5,071,332	2.26	3.50	2,208,011	2.28	3.03
3.01 – 4.50	219,000	3.27	2.81	144,000	3.38	1.84
4.51 – 5.15	3,138,500	5.09	3.95	757,000	5.10	1.03
	14,969,998	2.20	3.38	7,324,354	1.70	2.80

(e) Stock-Based Compensation

Stock-based compensation of $3,995,000 net of recoveries of $67,000, has been recorded in the Consolidated Statements of Operations and Deficit for the year ended December 31, 2010 (2009 – $1,461,000). 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 and the assumptions used in their determination are noted below:

	December 31, 2010	December 31, 2009
Weighted average fair value of stock options granted (per option)	**$ 2.60**	$ 0.85
Expected life of stock options (years)	**3.00**	2.58
Volatility (weighted average)	**85%**	88%
Risk-free rate of return (weighted average)	**1.82%**	1.43%
Expected dividend yield	**0%**	0%

(f) Contributed Surplus Continuity

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

	December 31, 2010	December 31, 2009
Balance, beginning of year	**$ 15,444**	$ 11,895
Stock-based compensation	**4,062**	2,751
Recovery of expense on forfeited stock options	**(67)**	(1,290)
Warrants issued on BlackCore acquisition	**–**	2,200
Transferred to share capital on exercise of stock options	**(398)**	(112)
Balance, end of year	**$ 19,041**	$ 15,444

9. 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, 2010	December 31, 2009
Loss before income taxes	**$ (31,085)**	$ (55,300)
Corporate income tax rate	**29.28%**	30.46%
Computed income tax recovery	**$ (9,102)**	$ (16,843)
Increase (decrease) resulting from:		
Change in valuation allowance	**2,099**	9,002
Non-deductible stock-based compensation expense	**1,170**	445
Foreign exchange	**3,518**	(785)
Change in enacted tax rates	**823**	1,768
Capital tax and Saskatchewan Resource Surcharge	**165**	(2,352)
Other	**1,514**	780
Income tax expense (recovery)	**$ 187**	$ (7,985)

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

	December 31, 2010	December 31, 2009
Future Income Tax Assets:		
Non-capital losses	**$ 54,624**	$ 32,759
Share issue costs	**1,597**	2,785
Asset retirement obligation	**5,026**	6,829
Other	**956**	1,152
Valuation allowance	**(40,985)**	(38,034)
	21,218	5,491
Future Income Tax Liabilities:		
Property, plant and equipment	**(21,218)**	(5,491)
Net future tax asset (liability)	**$ 0**	$ 0

The Company has $194.9 million of non-capital losses with various expiry dates between 2011 to 2030.

Where unfavourable evidence exists, which in BlackPearl's case is primarily historical net losses, additional considerations and evidence for recognition of future tax assets is required. Management has evaluated the applicable factors necessary in making this determination and has concluded that the positive evidence in consideration of the estimated future cash flows based on reserve reports from the Company's independent engineers, does not sufficiently outweigh negative factors, such as the net loss in current and prior years. As a result, BlackPearl has determined that the Company does not meet the "more likely than not" criteria required for recognition of future tax assets and has therefore recognized a cumulative valuation allowance of $41.0 million against the Company's future tax assets.

10. Commitments and Contingencies

The Company has a number of financial obligations in the ordinary course of business. The following table summarizes the outstanding contractual obligations and commitments of the Company as at December 31, 2010:

($000s)	2011	2012	2013	2014	2015	Thereafter
Long-term debt	–	–	–	–	–	–
Operating leases [(a)]	1,166	1,234	1,234	1,626	1,626	1,320
Drilling rig commitment [(b)]	–	876	319	–	–	–
Electrical service agreement [(c)]	3,012	2,969	–	–	–	–
	4,178	5,079	1,553	1,626	1,626	1,320

(a) The Company has six years remaining on an operating lease for office space as at December 31, 2010. 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 a maximum additional $21.3 million (including an estimate for operating costs) over the next six years.

(b) The Company has contracted drilling rig services over the next three 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. The payments included herein assumes no drilling days used.

(c) The Company has entered into an agreement whereby an electrical service connection will be physically installed at a facility over the next two years. In the event that the project is not completed at BlackPearl's request, the Company would be obligated to pay the service provider the full amount of the contract.

11. 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 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 carrying value of cash and cash equivalents, accounts receivable and accounts payable and accrued liabilities, approximates their fair value amounts due to the short-term nature of the instruments.

(ii) The fair value of the investment in MAV notes have been measured 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 MAV notes have been valued using Level 3 of the hierarchy. 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.

(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 prices may significantly affect the Company's results of operations, cash 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 the year ended 2010 by approximately $1,876,000. 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. Natural gas currently represents less than 10% of the Company's total production and, as a result, any fluctuation in natural gas prices would have a nominal effect on current activities. As at December 31, 2010, 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 U.S. dollars; (ii) certain expenditure commitments, deposits, accounts receivable, and accounts payable which are denominated in U.S. 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 U.S. vendors as well as timing of transactions. As at December 31, 2010, the Company has not entered into any fixed rate contracts. As at December 31, 2010, the Company held US$3,997,000 in cash and short-term deposits and other net working capital items of US$1,460,000.

As at December 31, 2010, 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 $546,000 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 delivery. 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 2010, the Company has not experienced any collection issues with its marketers. At December 31, 2010, over 96 percent 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, 2010, accounts receivable includes an allowance for doubtful accounts of $815,000 from joint interest partners.

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, 2010, the Company held $169.6 million in cash at various major financial institutions throughout Canada and the USA, as well as $1.8 million in investments. At December 31, 2010, three Canadian financial institutions held approximately 99 percent 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. As at December 31, 2010, if interest rates had been 1 percent higher with all other variables held constant, after tax earnings for the period would have been approximately $881,000 higher.

(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, 2010, the Company had an undrawn $25 million credit facility, and working capital of $144.0 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	$ 48,081	–	–

(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. In order to maintain or adjust its capital structure, the Company may from time to time issue additional common shares. 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 $80 million of additional equity during 2010 (See note 8(b)). These funds will be used to fund 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 credit facility compared to current liabilities. The Company had a working capital ratio of 4.5:1 at December 31, 2010 and is in compliance with these covenants.

12. 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 share purchase warrants to acquire one BlackPearl share for a price of $0.60.

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

Net assets acquired		
Petroleum and natural gas properties	$	12,691
Working capital		5,468
Asset retirement obligation		(3,023)
Future income tax		(2,274)
Total net assets acquired	$	12,862
Consideration paid		
Common shares	$	10,560
Warrants		2,200
Acquisition costs		102
Total purchase price	$	12,862

13. Comparative Figures

Certain comparative figures have been reclassified to conform to the presentation adopted in 2010.