

## **BLACKPEARL RESOURCES INC.**

### **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. for the second quarter 2010. These results are being compared with the three and six month periods ended June 30, 2009. The MD&A should be read in conjunction with the Company's unaudited consolidated financial statements for the three and six months ended June 30, 2010, together with the accompanying notes.

References to "we", "our", "us", "the Company", "the Corporation" or "BlackPearl" means BlackPearl Resources Inc. and its subsidiaries.

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 for 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 does not represent a value equivalence at the wellhead.

This report includes terms commonly used in the oil and gas industry, such as cash flow and funds from operations which represent cash flow from operating activities expressed before changes in non-cash working capital, and cash flow per share. 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. These terms do not have standardized meanings prescribed by GAAP and therefore may not be comparable with the calculations of similar measures for 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](http://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 August 10, 2010.

## **OVERVIEW**

BlackPearl is a Canadian-based oil and gas company whose common shares are traded on the TSX Exchange 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. The Company also holds interests in a number of natural gas properties.

BlackPearl’s current core properties include:

- Onion Lake, Saskatchewan – heavy oil;
- Mooney, Alberta – heavy oil; and
- Blackrod, Alberta – heavy oil.

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.

As part of BlackPearl’s overall business plan, management intends to sell the majority of the Company’s non-core assets. In the first half of 2010, the Company sold assets producing approximately 700 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 the first half of 2010 the Company sold various non-core assets for \$19.2 million. The assets sold included natural gas properties in southern Alberta and conventional heavy oil properties in Saskatchewan.
- On March 29, 2010 the Company acquired the remaining 20% working interest in the Blackrod area, located in the Athabasca oil sands, from Serrano Energy Ltd. for \$21 million. The acquisition results in BlackPearl having sole interest in the Blackrod area lands. The Company plans to construct a SAGD pilot on the property in 2010. The pilot will include drilling 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 million.

## SELECTED QUARTERLY INFORMATION

	30-Jun	31-Mar	31-Dec	30-Sep	30-Jun	31-Mar	31-Dec	30-Sep
\$000s, except where noted	2010	2010	2009	2009	2009	2009	2008	2008
Production (boe/d)	7,163	6,685	5,306	5,091	5,170	5,510	6,198	5,776
Revenue (\$/boe)	52.58	60.55	56.69	51.94	47.07	31.77	36.28	85.02
Oil & gas revenue	34,274	36,429	27,674	24,065	22,143	15,755	20,687	45,180
Production costs	9,306	10,552	7,251	6,172	5,873	10,165	10,299	9,272
Net earnings (loss)	(10,276)	(8,053)	(3,897)	(12,013)	(10,889)	(20,516)	(83,686)	1,926
Per share, basic and diluted (\$)	(0.04)	(0.03)	(0.01)	(0.05)	(0.05)	(0.10)	(0.44)	0.01
Cash flow from operations	13,926	15,029	14,677	8,221	7,910	(1,804)	3,623	21,021
Per share, basic and diluted (\$)	0.05	0.06	0.06	0.03	0.03	(0.01)	0.02	0.11
Total assets	470,843	463,655	468,309	465,942	477,876	450,836	472,143	554,956
Weighted average shares outstanding (000s)	268,047	262,057	261,731	261,684	240,973	207,555	189,242	189,242

## RESULTS OF OPERATIONS

\$000s, except where noted

	2010		2009	Six months ended June 30	
	Q2	Q1	Q2	2010	2009
Net loss	(10,276)	(8,053)	(10,889)	(18,329)	(31,405)
Per share, basic and diluted (\$)	(0.04)	(0.03)	(0.05)	(0.07)	(0.14)

For the three months ended June 30, 2010, the Company incurred a net loss of \$10.3 million or \$0.04 per share compared to a net loss of \$10.9 million or \$0.05 per share for the same period 2009. The six month period ended June 30, 2010 yielded losses of \$18.3 million compared to \$31.4 million in 2009. The net loss each year is due principally to high depletion charges.

## Commodity Prices

	2010		2009		
	Q2	Q1	Q4	Q3	Q2
Crude Oil Prices					
West Texas Intermediate (WTI) (US\$/bbl)	\$78.03	\$78.71	\$76.19	\$68.30	\$59.62
Western Canadian Select (WCS) (Cdn\$/bbl)	65.78	72.51	71.53	63.77	60.66
Differential – WCS/WTI (Cdn\$/bbl)	14.43	9.43	8.93	11.16	8.92
Differential – WCS/WTI (%)	18.0%	11.5%	11.1%	14.9%	12.8%
Natural Gas Prices					
AECO gas (Cdn\$/GJ)	3.66	5.06	4.26	2.78	3.66
Foreign Exchange (Cdn\$/US\$)	1.028	1.041	1.056	1.097	1.167

Crude oil prices weakened slightly during the second quarter 2010, with the West Texas Intermediate (WTI) reference price averaging US\$78.03 per barrel compared with US\$78.71 per barrel in the first quarter 2010. Demand for crude oil is tied to global economic growth. In 2010, North America and China

have seen reasonable economic growth; however, there has been concern with slower growth, credit risks and government deficit spending in some European countries. The WTI forward strip price for the remainder of 2010 is approximately US\$81.

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 a heavy barrel. 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 light/heavy differential averaged 18% for the second quarter 2010, compared with 11.5% in Q1 2010 and 12.8% in Q2 2009. The recent light/heavy differential is considerably narrower than the five-year average of approximately 23%, a trend that has been attributed to increased heavy oil refining capacity in the U.S., increased demand for Canadian heavy oil due to reduced supply of heavy oil from Mexico and Venezuela, as well as improved pipeline access for Canadian heavy crude to the Gulf Coast, a heavy oil refining hub.

Oil prices in Canada are also impacted by the Canada/U.S. dollar exchange rate since the WTI reference price of oil is in U.S. dollars. During Q2 2010, the Canadian dollar strengthened against the U.S. dollar, averaging 1.028 compared with 1.041 for the Q1 2010. The strengthening of the Canadian dollar partially compounds the decreased WTI benchmark pricing experienced during the second quarter 2010.

In the second quarter of 2010, natural gas prices decreased 28% compared to Q1 2010, reflecting lower demand, but remained consistent with Q2 2009. The AECO-C gas price averaged \$3.66 per GJ in the second quarter 2010 compared to \$5.06 per GJ in Q1 2010.

#### ***Oil and Gas Production, Pricing and Revenue***

	2010		2009	Six months ended June 30	
	Q2	Q1	Q2	2010	2009
Daily production / sales volumes <sup>(1)</sup>					
Oil (bbls/d)	<b>6,515</b>	5,941	4,167	<b>6,230</b>	4,294
Natural gas (mcf/d)	<b>3,890</b>	<u>4,462</u>	<u>6,017</u>	<b>4,174</b>	<u>6,271</u>
Combined (boe/d)	<b>7,163</b>	6,685	5,170	<b>6,925</b>	5,339
Product pricing					
Oil (\$/bbl)	<b>55.03</b>	63.77	53.33	<b>59.18</b>	42.40
Natural gas (\$/mcf)	<b>3.97</b>	<u>5.01</u>	<u>3.51</u>	<b>4.53</b>	<u>4.32</u>
Combined (\$/boe)	<b>52.58</b>	60.55	47.07	<b>56.40</b>	39.22
Revenue (\$000s)					
Oil and gas revenue – gross	<b>34,274</b>	36,429	22,143	<b>70,703</b>	37,898
Royalties	<b>(8,868)</b>	<u>(9,350)</u>	<u>(5,053)</u>	<b>(18,218)</b>	<u>(7,927)</u>
Oil and gas revenue – net	<b>25,406</b>	27,079	17,090	<b>52,485</b>	29,971

(1) Gas production converted at 6:1

Oil and gas revenues increased 55% in the second quarter 2010 to \$34.3 million compared with \$22.1 million in Q2 2009. The increase is attributable to:

- a 56% increase in oil production;
- a 3% increase in the average oil price; and partially offset by
- a 35% decrease in natural gas production

Overall, average production increased to 7,163 boe/d for the quarter ended June 30, 2010 compared with 6,685 boe/d in Q1 2010 and 5,170 boe/d in the same period 2009. For the six months ended June 30, 2010, production increased 30% to 6,925 boe/d from 5,339 boe/d in 2009. The increase in 2010 production is attributable to drilling 28 wells at Onion Lake last fall and an additional 8 wells in the first quarter of this year.

boe/d	2010		2009	Six months ended	
	Q2	Q1	Q2	2010	June 30
Onion Lake	<b>5,098</b>	4,301	2,063	<b>4,702</b>	2,115
Mooney	<b>980</b>	1,136	1,424	<b>1,062</b>	1,320
Ear Lake	<b>316</b>	361	461	<b>340</b>	447
Salt Lake	<b>253</b>	288	416	<b>270</b>	396
Long Coulee/Little Bow	<b>368</b>	403	426	<b>385</b>	446
Other	<b>148</b>	196	380	<b>166</b>	615
	<b>7,163</b>	6,685	5,170	<b>6,925</b>	5,339

On a boe basis, 91% of the Company's oil and gas production in the second quarter 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 71% of total production in Q2 2010 and will contribute a higher proportion for the remainder of the year as it will account for most of BlackPearl's near-term drilling activity.

Production levels in the third quarter of 2010 will be lower than in the second quarter due to the sale of producing properties in the first half of the year. However, reduced production as a result of these asset dispositions should be more than offset in the fourth quarter as a result of new drilling activity.

The Company did not enter into any hedging arrangements in Q2 2010, and, at the present time, does not anticipate hedging any of its production for the remainder of the year.

### **Royalties**

\$000s, except where noted	2010		2009	Six months ended	
	Q2	Q1	Q2	2010	June 30
Royalties	<b>8,868</b>	9,350	5,053	<b>18,218</b>	7,927
As a percentage of revenue	<b>26%</b>	26%	23%	<b>26%</b>	21%

Royalties increased 75% from \$5.1 million in Q2 2009 to \$8.9 million in the same period during 2010. The increases reflect higher revenues and production during the first six months of 2010. Conversely, the slight decrease in royalties from Q1 to Q2 2010 is a result of a decrease in commodity prices during Q2. Generally, royalty rates in western Canada are sensitive to prevailing commodity prices. As a result, royalties, as a percentage of revenues, were higher in the three and six-month periods ended 2010 compared to 2009, primarily due to higher crude oil prices.

In the first quarter of 2010, the Alberta government undertook a review of the energy sector to determine if, among other things, the royalty structure in Alberta is competitive with other jurisdictions. On May 27, 2010, the Alberta government announced changes to the structure, which include a reduction in the maximum royalty rate from 50% to 40% for conventional oil and from 50% to 36% for natural gas. These

changes will take effect January 1, 2011. In addition, production from new oil wells will have a maximum royalty rate of 5% for the first year of production or the first 50,000 barrels of production, which ever occurs first. Approximately 20% of BlackPearl's total production is from Alberta based properties which will be impacted by the new royalty structure.

### *Production Costs*

\$000s, except where noted	2010		2009	Six months ended June 30	
	Q2	Q1	Q2	2010	2009
Production costs	<b>9,306</b>	10,552	5,873	<b>19,857</b>	16,038
Per boe (\$)	<b>14.31</b>	17.54	12.48	<b>15.86</b>	16.60

Production expenses, on an absolute basis, have increased for the three and six months ended June 30, 2010 compared to the prior year period primarily due to increased production volumes. However, on a boe basis costs have decreased from Q1. 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 significantly increased 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.

### *Transportation Costs*

\$000s, except where noted	2010		2009	Six months ended June 30	
	Q2	Q1	Q2	2010	2009
Transportation costs	<b>654</b>	522	687	<b>1,177</b>	1,991
Per boe (\$)	<b>1.00</b>	0.87	1.46	<b>0.94</b>	2.06

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

	2010		2009	Six months ended	
	Q2	Q1	Q2	June 30	2009
Revenues	\$52.58	\$60.55	\$47.07	\$56.40	\$39.22
Royalties	(13.60)	(15.54)	(10.74)	(14.53)	(8.20)
Transportation costs	(1.00)	(0.87)	(1.46)	(0.94)	(2.06)
Production costs	(14.31)	(17.54)	(12.48)	(15.86)	(16.60)
Netback per boe	\$23.67	\$26.60	\$22.39	\$25.07	\$12.36

The Q2 2010 netback of \$23.67 per boe is a slight increase from the \$22.39 reported in Q2 2009, but is a reduction from the Q1 2010 netback of \$26.60. The decrease from Q1 is a result of a drop in oil prices in Q2. However, the six month 2010 netback of \$25.07 is considerably higher than the 2009 netback of \$12.36. This is primarily attributable to the overall recovery in crude oil prices in 2010.

## General and Administrative Expenses (G&A)

	2010		2009	Six months ended	
	Q2	Q1	Q2	June 30	2009
\$000s, except where noted					
Gross G&A expense	1,846	2,162	2,421	4,007	5,728
Operator recoveries	(345)	(404)	(264)	(749)	(686)
	1,501	1,758	2,157	3,258	5,042
Per boe (\$)	2.30	2.92	4.59	2.60	5.22

The Company continued with its cost reduction initiatives which resulted in general and administrative costs decreasing to \$1.5 million in the second quarter compared with \$1.8 million in Q1 and \$2.2 million in the second quarter of 2009. Cost savings are primarily in areas such as outside consulting fees, travel costs and office expenses, as well as reduced staff levels from prior years. Net general and administrative costs are expected to be in the area of \$7 million for 2010. As production volumes are expected to increase in 2010, general and administrative costs on a boe basis should decline.

## Stock-Based Compensation

	2010		2009	Six months ended	
	Q2	Q1	Q2	June 30	2009
\$000s, except where noted					
Stock-based compensation	864	937	541	1,801	528
Per boe (\$)	1.33	1.56	1.15	1.44	0.55

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. In the second quarter 2010, the Company issued 150,000 options at an average exercise price of \$2.79 per share. In addition, 314,001 options were exercised and 232,999 were forfeited.

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

\$000s, except where noted	2010		2009	Six months ended June 30	
	Q2	Q1	Q2	2010	2009
Depletion, depreciation and accretion	<b>23,635</b>	22,349	19,628	<b>45,984</b>	41,732
Per boe (\$)	<b>36.26</b>	37.15	41.72	<b>36.68</b>	43.18

DD&A expense increased 20% to \$23.6 million or \$36.26 per boe for the second quarter 2010 compared to \$19.6 million or \$41.72 per boe for the same quarter in 2009. The lower depletion rate per boe in 2010 is a result of an increase in proved reserves as detailed in the Company's 2009 reserve report. A write-down in the amount of \$0.2 million of the US assets has been included in the Q2 2010 depletion, depreciation and accretion in the Company's June 30, 2010 financial statements.

### *Interest Expense*

\$000s, except where noted	2010		2009	Six months ended June 30	
	Q2	Q1	Q2	2010	2009
Interest income	<b>(121)</b>	(64)	(111)	<b>(184)</b>	(176)
Interest expense	<b>10</b>	11	143	<b>21</b>	163
Net interest expense (income)	<b>(111)</b>	(53)	32	<b>(163)</b>	(13)
Per boe (\$)	<b>(0.17)</b>	(0.09)	0.07	<b>(0.13)</b>	(0.01)

Interest expense consists mainly of standby fees on the Company's undrawn credit facility. Any interest earned on excess cash held by the Company is netted against interest expense. Net interest income for the three and six months ended June 30, 2010 has increased as a result of a higher cash balance held by the Company in 2010.

### *Other Income*

\$000s, except where noted	2010		2009	Six months ended June 30	
	Q2	Q1	Q2	2010	2009
Other income	-	1,152	-	<b>1,152</b>	-

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 a third party that did not have sufficient production to utilize the credits. The Company has entered into agreements to acquire additional third party drilling credits. BlackPearl will generate an additional \$1.5 million in revenues if the Company is able to fully utilize these credits by March 31, 2011.

## *Income Taxes*

	2010		2009		Six months ended June 30	
\$000s, except where noted	Q2	Q1	Q2	2010	2009	
Current income and other taxes	53	62	328	115	530	
Future income tax (recovery)	-	-	(2,507)	-	(5,258)	
	53	62	(2,179)	115	(4,728)	

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 2010 as the Company has sufficient resource pools to shelter expected income.

## **LIQUIDITY AND CAPITAL RESOURCES**

At June 30, 2010, BlackPearl had a working capital surplus of \$97.4 million compared to a surplus of \$58.0 million at December 31, 2009. The increase is a result of common share issuances totaling \$29.1 million, the disposition of non-core properties for net proceeds of \$19.2 million and operating cash flows of \$29 million, which was partially offset by \$37.9 million in capital expenditures.

In addition to its working capital position, BlackPearl also has an undrawn \$25 million credit facility. The amount available under the credit facility is based on the value of oil and gas reserves. The credit facility was recently renewed on substantially the same terms as 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 10.7:1 at June 30, 2010 and was in compliance with these covenants throughout the first six months of 2010.

The Company expects its 2010 capital spending to be approximately \$125 million. This will be financed from working capital and anticipated funds from operations. The Company does not expect to utilize its credit facility to fund this program. The Company can adjust its capital program if required to maintain its financial stability.

## CAPITAL EXPENDITURES

BlackPearl's capital program is focused on heavy oil opportunities. During the six months ended June 30, 2010, capital spending was significantly higher than 2009. The increase was primarily a result of acquiring the remaining 20% of the Blackrod SAGD project for \$21 million and drilling 8 heavy oil wells at Onion Lake during the first quarter. During Q2 2010, the Company's capital program totalled \$5.7 million, an increase from the \$0.9 million spent in the second quarter 2009. During the second quarter of 2010 the Company completed the sale of certain oil and gas properties for proceeds of \$13.8 million. Total dispositions of non-core assets totaled \$19.2 million during the first half of 2010. The assets sold were mainly natural gas properties in southern Alberta and heavy oil properties in Saskatchewan.

\$000s	2010		2009	Six months ended June 30	
	Q2	Q1	Q2	2010	2009
Land	320	277	264	597	573
Seismic	80	50	-	130	-
Drilling and completion	2,634	6,623	44	9,257	1,517
Equipment	2,474	4,187	624	6,661	1,976
Other	179	46	-	225	-
Total	5,687	11,183	932	16,870	4,066
Property acquisitions	-	21,000	-	21,000	13
Total capital expenditures	5,687	32,183	932	37,870	4,079
Property dispositions	(13,849)	(5,389)	-	(19,238)	-
Net capital expenditures	(8,162)	26,794	932	18,632	4,079

## 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 June 30, 2010:

\$000s	2010	2011	2012	2013	2014	Thereafter
Long-term debt	-	-	-	-	-	-
Operating leases <sup>(1)</sup>	549	1,166	1,234	1,234	1,626	2,946
Drilling rig commitment <sup>(2)</sup>	412	935	1,211	319	-	-
	961	2,101	2,445	1,553	1,626	2,946

(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 \$18 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.

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 OTHER INSTRUMENTS

The following table outlines the classification, carrying value and fair value of the Company's financial instruments. All of these instruments are used in the normal course of business. The Company has not entered into any derivative financial instruments or any other hedging activities.

	Classification	June 30, 2010		December 31, 2009	
		Carrying Amount	Fair Value	Carrying Amount	Fair Value
Cash and cash equivalents	Held-for-trading (i)	\$93,895	\$93,895	\$56,352	\$56,352
Accounts receivable	Loans and receivables (i)	11,893	11,893	11,977	11,977
Investment in MAV Notes	Held-for-trading (ii)	1,284	1,284	1,284	1,284
Accounts payable and accrued liabilities	Other financial liabilities (iii)	(12,580)	(12,580)	(16,318)	(16,318)

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

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

The level within which the financial asset or liability is classified is determined based on the lowest level of significant input to the fair value measurement. At June 30, 2010, the only instrument held by the Company that is subject to valuation through the hierarchy is the Company's investment in MAV notes, which have been assessed as being level 3. 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.

- (iii) The fair value of accounts payable and accrued liabilities approximates their carrying amounts due to the short-term nature of the instruments.

The risks associated with these financial instruments include commodity price risk, foreign currency exchange risk, credit risk, interest rate risk and liquidity risk which are more fully discussed in note 9 of the Interim Financial Statements.

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

The Company has no off-balance sheet arrangements.

#### **RELATED PARTY TRANSACTIONS**

There were no related party transactions during the first six months of 2010.

#### **OUTSTANDING SHARE DATA**

As at August 10, 2010, the Company had 272,855,386 common shares outstanding, 10,000,320 vested warrants outstanding and 12,945,499 stock options outstanding under its stock-based compensation.

#### **PROPOSED TRANSACTIONS**

As of the date of this MD&A, the Company does not have any 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 Company's significant accounting policies and critical estimates is contained in the MD&A and audited consolidated financial statements for the year ended December 31, 2009. There have been no significant changes in critical accounting estimates since December 31, 2009.

#### **RISKS AND UNCERTAINTIES**

Please refer to the Company's 2009 MD&A and the 2009 Annual Information Form for a discussion of the risks and uncertainties associated with the Company's activities. There have been no significant changes in these risks and uncertainties during the first six months of 2010.

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

In January 2006, the CICA Accounting Standards Board (AcSB) adopted a strategic plan for the direction of accounting standards in Canada. As part of that plan, the Accounting Standards Board confirmed in February, 2008 that International Financial Reporting Standards (IFRS) will replace Canadian GAAP for interim and annual reporting purposes. The objective is to improve financial reporting by having one single set of accounting standards that are comparable with other entities on an international basis. The required changeover date is for fiscal years beginning on or after January 1, 2011.

The Company has commenced the process to transition from current Canadian GAAP to IFRS. There are three phases in the process: diagnostic, detailed assessment and design and implementation. The Company's internal staff has been appointed the task of performing the actual conversion, while the Company's external auditors have been engaged to act as advisors. The Company has completed a high

level review of the major differences between current Canadian GAAP and IFRS and has commenced the detailed assessment and design phase of the project. The following areas have been identified as to be significantly affected by the changeover to IFRS:

### Property, Plant & Equipment

Under Canadian GAAP, the Company adheres to the full cost method of accounting as dictated by Accounting Guideline 16. This method of accounting is not recognized under IFRS. The significant differences in accounting include:

- Pre-exploration costs (costs incurred prior to obtaining the legal right to explore) are to be expensed whereas, under full cost accounting, these costs are included in PP&E.
- Exploration and evaluation costs (“E&E”) will be initially capitalized as E&E assets under IFRS. 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 must be expensed in the period the determination is made. Under full cost accounting, E&E costs are recorded to PP&E, but are not included in the calculation of depletion. Costs are subsequently included in the depletable base when proved reserves are assigned or when it is determined that the costs are impaired.
- PP&E costs will be depreciated on a unit-of-production basis at the area asset level (unit of account). Under Canadian GAAP, depreciation is recorded at the country costcentre level. The Company has tentatively determined its asset areas for purposes of performing these depletion calculations. Under IFRS the Company has the option of using proved reserves (1P) or proved plus probable reserves (2P) to calculate depletion. Using Canadian GAAP the Company is required to only use 1P reserves 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. Under full cost accounting, impairment is tested at the country costcentre level. The Company anticipates it will have between four and eight cash generating units. Under IFRS impairment losses can be reversed if the recoverable amount increases in the future. Existing Canadian GAAP doesn’t permit reversal of impairments.
- Asset dispositions will generally result in a gain or loss recorded in the statement of operations. Under full cost accounting, proceeds received on asset sales are deducted from the full-cost pool without recognizing a gain or loss unless it results in a significant change in your depletion rate.

One of the major steps for many oil and gas companies moving to IFRS is transitioning away from the full cost accounting method for property, plant and equipment costs. The International Accounting Standards Board has approved a transition amendment to IFRS 1 – First Time Adoption of IFRS that will allow Canadian oil and gas companies that use 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, which is required under IFRS. BlackPearl will elect to utilize this exemption.

### Asset Retirement Obligations

Currently, under Canadian GAAP, once an obligation is recorded, the liability is not subsequently re-measured using updated assumptions. Under IFRS, however, these assumptions are constantly updated at each balance sheet date and the liability altered accordingly. 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. In subsequent periods, the impact of changes in assumptions on the ARO liability is adjusted to PP&E.

### Income Taxes

Both 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 impacted by the tax effects of any changes noted in the above areas.

Of the above differences, the Company anticipates that the changes in the depletion calculation will have the most significant impact resulting in lower depletion, depreciation and amortization charges in the Company's financial statements under IFRS. As at June 30, 2010, these differences have not been quantified.

The Company is currently in the process of establishing new IFRS accounting policies and is expecting to be completed in the third quarter of 2010. The Company also expects to have a tentative opening balance sheet (January 1, 2010) that is in accordance with IFRS by the end of the third quarter of 2010. It should be noted that control requirements are currently being developed for the opening balance sheet, dual reporting and the maintenance of IFRS after the required changeover date.

During the second quarter, the Company implemented system and software changes required to support reporting under IFRS. The system is currently being analyzed and tested to determine the appropriate process changes required, if any, as well as any additional internal control changes that may result. It should be noted that the upgrade functions as a separate component of the current system, allowing the original software and processes to function normally without being subject to disruption or potential error during testing.

During the implementation phase, the Company will execute the required changes to business processes, financial systems, accounting policies, disclosure controls and internal controls over financial reporting. At this time, the impact on financial statements cannot be reasonably determined.

## **CONTROL CERTIFICATION**

### *Disclosure Controls and Procedures and Internal Controls over Financial Reporting*

Management reported on its disclosure controls and procedures and the design of its internal controls over financial reporting in the year end 2009 MD&A. There has been no material change to the Company's disclosure controls or procedures or to the design of internal controls over financial reporting since that time.

## OUTLOOK

The Company previously provided guidance on its 2010 results in its Q1 report to shareholders. This current update to the Q1 guidance primarily reflects slightly higher average production levels for the year and changes in commodity prices.

Our planned capital expenditure program remains unchanged at approximately \$125 million. The major components of this program include drilling 60 – 70 wells at Onion Lake, construction of the SAGD pilot at Blackrod, acquiring the remaining 20% working interest on the Blackrod project and building the facilities for phase 1 of the commercial ASP flood at Mooney.

2010 Guidance	Original 2010 Guidance	Q1 2010 Update	Q2 2010 Update
Production (boe/d)			
Annual average*	6,400	6,500	6,800 – 7,300
Exit*	7,000 - 7,500	8,000 - 8,500	8,000 – 9,000
Cashflow from operations (\$mm)	40 - 50	50 - 55	53 – 57
Capital budget (\$mm)	86	125	120 – 130
Year-end debt	-	-	-
Year-end working capital (\$mm)	26	30 - 35	30 – 35
Pricing Assumptions (Averages for the year)			
Crude oil - WTI	US\$72	US\$79	US\$77
Light/heavy differential	US\$10	US\$10	US\$12
Cdn/US\$ exchange	0.95	0.99	0.99

\*net of dispositions

## 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;

- impact of the changes to the Alberta royalty framework;
- estimated tax pools;

In addition, statements relating to "reserves" 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 in fact 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 the remainder of 2010 are located in the "Outlook" section of this MD&A. 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 forward-looking statements will not be achieved. These factors include, but are not limited to, risks associated with oil and gas exploration, financial risks, substantial capital requirements, bank financing, government regulation, environmental matters, prices, markets and marketing, dependence on key personnel, availability of drilling equipment and access, uninsurable risks, management of growth, expiration of licenses and leases, reserves estimates, seasonality, competition, conflicts of interest, issuance of debt, title to properties, variations in exchange rates and hedging and uncertainty in global financial markets. Further information regarding these risk factors may be found under the heading "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 may 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.