PAINTED PONY PETROLEUM LTD.

A STRONG FUTURE

2010 ANNUAL REPORT TO SHAREHOLDERS

PAINTED PONY PETROLEUM LTD.

CORPORATE PROFILE

Painted Pony Petroleum Ltd. ("Painted Pony" or the "Company") is a public junior oil and gas exploration company based in Calgary, Alberta, Canada. The Company closed its initial public offering and commenced trading on the TSX Venture Exchange in May 2007. Painted Pony's corporate philosophy is to grow through exploration and development drilling complemented by strategic corporate and asset acquisitions. The Company's long term target is to maintain a balanced crude oil and natural gas portfolio in resource-type plays.

ANNUAL GENERAL AND SPECIAL MEETING

Painted Pony Petroleum Ltd. invites shareholders and interested parties to attend its Annual General and Special Meeting to be held in the Bennett Room at the Ranchmen's Club, 717 - 13 Avenue SW, Calgary, Alberta on Monday, June 6th, 2011 at 3:00 pm (Calgary time). Shareholders not attending the meeting are encouraged to complete the form of proxy and deliver it in accordance with the instructions therein at their earliest convenience.

GLOSSARY

ARC	asset retirement costs
ARO	asset retirement obligations
/d	per day
boe	barrels of oil equivalent (6 mcf of natural gas = 1 barrel of oil equivalent)
bbls	barrels
GOR	gross overriding royalties
mboe	thousand barrels of oil equivalent
mbbl	thousand barrels
mcf	thousand cubic feet
mmcf	million cubic feet
NGL	natural gas liquids
NI 51-101	National Instrument 51-101
WTI	West Texas Intermediate, a benchmark crude oil used for pricing comparison

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Cover painting "A Strong Future" by Paul Van Ginkel (www.paulvanginkel.com)

FINANCIAL AND OPERATING HIGHLIGHTS

		Year ended December 31, 2010		2009
FINANCIAL *($000s except per share and shares outstanding)*				
Petroleum and natural gas revenue (before royalties)		**58,283**		28,895
Funds flow from operations[1]		**36,279**		15,210
Per share - basic[2]		**0.76**		0.44
Per share - diluted[2]		**0.74**		0.44
Cash flow from operating activities		**35,360**		12,460
Net earnings (loss)		**1,894**		(3,656)
Per share - basic and diluted[2]		**0.04**		(0.10)
Capital expenditures[3]		**123,292**		56,003
Working capital (deficiency)		**(1,205)**		40,679
Total assets		**234,197**		164,907
Shares outstanding				
Class A		**51,016,700**		44,081,700
Class B		**1,173,600**		1,173,600
OPERATIONAL				
Daily sales volumes				
Oil *(bbls/d)*		**1,667**		893
Condensate *(bbls/d)*		**28**		24
NGL's *(bbls/d)*		**34**		17
Gas *(mcf/d)*		**6,718**		3,712
Total *(boe/d)*		**2,848**		1,552
Realized prices				
Oil *(/bbl)*	**$**	**77.84**	$	69.15
Gas *(/mcf)*	**$**	**3.94**	$	4.20
Field operating netbacks				
Oil *(/bbl)*	**$**	**55.42**	$	47.49
Gas and associated liquids *(/boe)*	**$**	**13.11**	$	8.41
Company combined *(/boe)*	**$**	**37.88**	$	30.89
Wells drilled[4]				
Gross		**45**		20
Net		**33.7**		17.0
Net success rate		**92%**		98%

1. This table contains the term "funds flow from operations", which should not be considered an alternative to, or more meaningful than "cash flow from operating activities" as determined in accordance with Canadian generally accepted accounting principles ("GAAP") as an indicator of the Company's performance. Funds flow from operations and funds flow from operations per share (basic and diluted) does not have any standardized meaning prescribed by GAAP and may not be comparable with the calculation of similar measures for other entities. Management uses funds flow from operations to analyze operating performance and leverage and considers funds flow from operations to be a key measure as it demonstrates the Company's ability to generate the cash necessary to fund future capital investment and to repay debt. The reconciliation between funds flow from operations and cash flow from operating activities can be found in the Company's "Management's Discussion and Analysis". Funds flow from operations per share is calculated using the basic and diluted weighted average number of shares for the period, and after the deemed conversion of the Class B shares to Class A shares, consistent with the calculations of earnings per share. This table also contains other industry benchmarks and terms, such as working capital (deficiency) (calculated as current assets less current liabilities) and operating netbacks (calculated on a per unit basis as oil, gas and natural gas liquids revenues less royalties, transportation, and operating costs), which are not recognized measures under GAAP. Management believes these measures are useful supplemental measures of, firstly, the total net position of current assets and current liabilities of the Company and, secondly, the Company's profitability relative to commodity prices.

2. Class B shares are converted into Class A shares at $10 divided by the greater of $1.00 and the Current Trading Price, defined as the weighted average trading price of the Class A shares for the last 30 consecutive trading days.

3. Including Asset Retirement Costs and capitalized Stock-Based Compensation.

4. Excluding in 2010 6(1.2 net) joint venture wells.

TO OUR SHAREHOLDERS

As the world economy continued a slow recovery in 2010, strong demand from emerging economies in Asia drove the demand for commodities. This led to recovering prices through much of 2010 for most commodities. Oil ranged between $70 and $80 per bbl for most of the year and natural gas prices climbed to $12 per mcf in most of the world. The exception was in North America, where new shale gas supplies in the US and modest growth in demand resulted in gas prices at about one-third of world prices. This was primarily due to an inability to export to overseas markets, resulting in North American companies focusing capital on oil and liquids-rich gas.

In 2010 the Company achieved several major milestones:

- *grew daily production to average 2,848 boe/d in 2010, up 84% over 2009. Fourth quarter production in 2010 averaged 3,443 boe/d (weighted 53% oil and liquids and 47% gas);*
- *enjoyed 2010 field netbacks of $55.42 per bbl for oil on sales prices averaging $77.84 per bbl;*
- *continued to grow its land to a total of 202,307 net acres of developed and undeveloped land in Saskatchewan and British Columbia, with undeveloped land valued at $168.1 million;*
- *drilled 51 (34.9 net) wells at a net success rate of 92%, including 6 (1.2 net) joint venture wells.*
- *increased proved plus probable reserves by 401% from 6,491.0 mboe to 32,538.7 mboe*
- *made discoveries in the Bakken formation at Flat Lake and Weyburn in Saskatchewan;*
- *raised $44 million in a bought-deal financing through the issuance of Class A shares at $6.48 per share in August 2010; and*
- *exited 2010 with an undrawn credit facility of $65 million;*

In 2011 to date, the Company has:

- *increased the undrawn credit facility to $75 million; and*
- *raised $80 million in bought-deal financing through the issuance of Class A shares at $10.50 per share in February 2011.*

Throughout 2010, Painted Pony continued to explore and develop its large land base in southeast Saskatchewan by focusing on light Bakken oil. In northeast British Columbia, the Company's joint venture on the Cameron/Kobes land block began to produce some exceptional results in the Montney Formation. Utilizing the positive results from initial wells drilled on the Cameron/Kobes lands, Painted Pony then commenced an operated drilling program on the Blair/Town land block also targeting Montney.

In the 2010 year, Painted Pony has taken significant steps in proving up the Montney asset base on its lands. The Montney Formation is 1,000 feet thick, gas charged, over-pressured, capable of high rates in all three layers and liquids-rich. What makes this asset more notable is the location; Painted Pony lands have year-round accessibility, there are existing pipelines and gas plants with excess capacity, and the location of the lands allow horizontal Montney wells to qualify for a $2.2 million royalty credit per well. All of these factors help ensure the economics of Painted Pony's Montney play are comparatively amongst the best of any gas play on the continent.

TO OUR SHAREHOLDERS

BUSINESS PLAN FOR 2011

Painted Pony is anticipating another active year. With the 2011 capital budget currently set at $160 million, allocating approximately 47% to British Columbia targeting liquids-rich Montney gas and 53% towards Saskatchewan targeting Bakken and Mississippian light oil plays, the Company expects to grow both core areas.

A total of 38.3 net wells are planned in Saskatchewan including follow-up drilling on the discovery wells in Weyburn and Flat Lake. In British Columbia, 8.3 net wells (including anticipated joint venture wells) are planned, focusing on developing the three layers of liquids rich Montney within the existing land base. Mid-year, the Company is planning to complete two (1.0 net) wells to establish the commerciality of gas from the Buckinghorse formation. To supplement the existing exploration and development program, the Company will continue to pursue acquisitions complementary to existing core areas.

PLANS FOR A STRONG FUTURE

Painted Pony's financial flexibility remains strong. As at December 31, 2010, the Company had no bank debt and a working capital deficiency of $1.2 million. On February 17, 2011, the Company completed a bought-deal financing of 7,620,000 Class A shares at a price of $10.50 per share for total gross proceeds of $80 million. In March 2011, Painted Pony's demand credit facility was increased to $75 million from $65 million, on which no balance is currently owed.

With an evolving world class, liquids-rich Montney gas project in British Columbia, a large land position and growing production base in the light oil Bakken play in Saskatchewan along with the Buckinghorse shale project, the Company has the potential to demonstrate strong growth. With a four-year track record of steady growth, multiple resource plays to focus continued delineation on supported by conservative financial management, we believe Painted Pony has a “Strong Future”.

The Company would like to thank our shareholders for their continued support.

On Behalf of the Board of Directors

Patrick R. Ward
President and Chief Executive Officer
March 29, 2011

*“If you can imagine it, you can achieve it.
If you can dream it, you can become it.”
William Arthur Ward*

REVIEW OF OPERATIONS

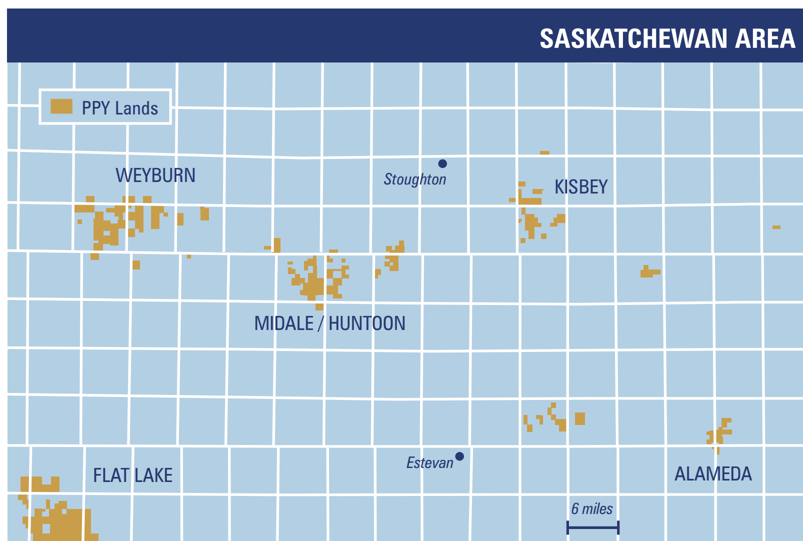
Painted Pony's operations are located in southeast Saskatchewan and in northeast British Columbia. In Saskatchewan, the Company targets light oil from the Bakken and Mississippian formations. In British Columbia the Company has targeted three geological formations; the conventional Bluesky/Gething and the unconventional Montney/Doig and Buckinghorse shale formations. Production volumes averaged 2,848 boe/d in 2010, up 84% over 2009. Fourth quarter production in 2010 averaged 3,443 boe/d (weighted 53% oil and liquids and 47% gas).

Painted Pony expended $107.1 million in 2010 compared to $40.5 million in 2009 on exploration and development capital expenditures. The Company carried out an active program with the participation in 45 (33.7 net) wells at an overall net success rate of 92% plus 6 (1.2 net) joint venture wells. In addition, two acquisitions of producing properties and one acquisition of undeveloped land were completed in 2010 in Saskatchewan for an estimated total cost of $12.8 million, including costs and adjustments. In 2009, the Company completed four separate acquisitions of primarily Bakken producing properties and undeveloped land, in Saskatchewan for a total cost of $13.6 million, including closing costs and adjustments.

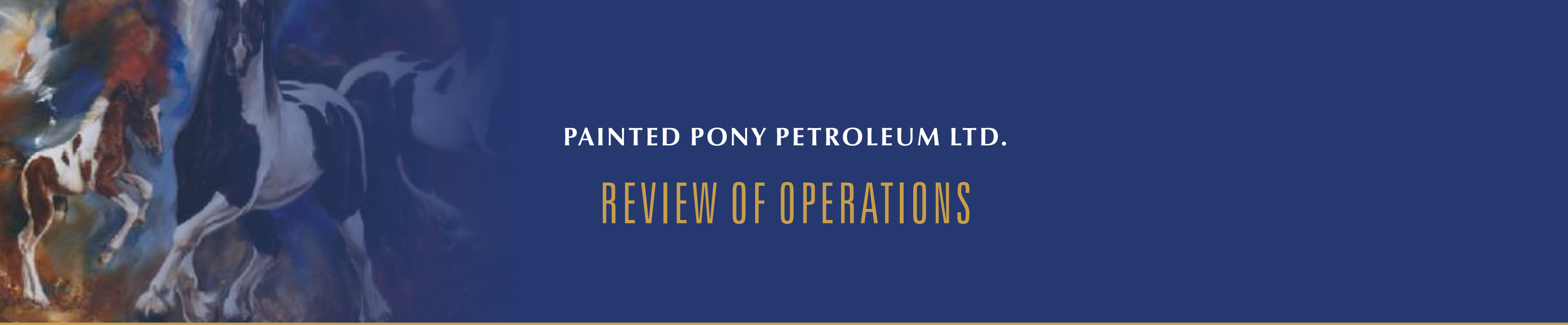
Painted Pony has set its capital budget at $160 million for 2011. The budget is allocated approximately 47% to British Columbia, targeting liquids-rich Montney gas, and 53% to Saskatchewan, targeting Bakken and Mississippian light oil plays. The Company plans to grow both core areas at a steady pace while maintaining financial flexibility and a conservative balance sheet.

SASKATCHEWAN

Painted Pony's operations in Saskatchewan are primarily located within relative proximity to Estevan in the general areas east and west of the town of Stoughton. The Company targets high netback, light sweet oil primarily from the Bakken formation, plus the Midale, Frobisher, Mississippian and Alida zones. The combination of technological advances, such as horizontal drilling and multi-stage fracture stimulation techniques, and provincial royalty incentive programs for horizontal drilling has encouraged the pursuit of this resource play. Operations are grouped into four main areas, based primarily on geographic proximity; Midale/Huntoon/Kisbey, Flat Lake, Weyburn and Other.

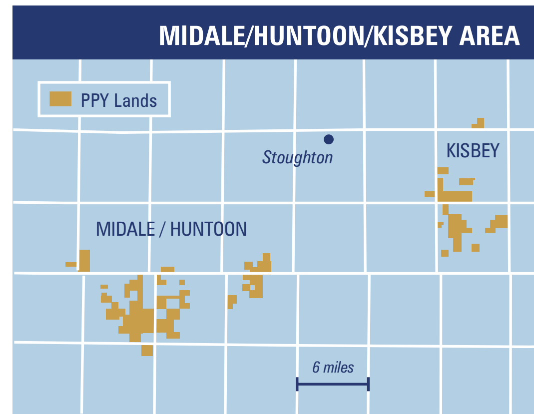


During 2010, Painted Pony carried out a very active drilling program in Saskatchewan expending $56.1 million of exploration and development expenditures and participating in 36 wells (28.6 net). In the Midale/Huntoon/Kisbey, Flat Lake, Weyburn and Other areas 33 (25.8 net) horizontal Bakken oil wells were drilled, 1 (1.0 net) horizontal Mississippian well was drilled in the Other area and 2 (1.8 net) exploration wells were drilled in the Other area. A total of 3 (2.8 net) unsuccessful wells were encountered in the Weyburn and Other areas. Painted Pony also closed three acquisitions at an estimated cost of $12.8 million including costs and adjustments.



Midale/Huntoon/Kisbey Area

The Midale/Huntoon/Kisbey area is located southwest of the town of Stoughton and produces 43 degree API light oil from the Bakken formation. Painted Pony operates in both the Midale and Huntoon areas, which are in close proximity to each other and together comprise the Corporation's main producing area in Saskatchewan. The Kisbey area, which is located approximately 15 miles to the east of Midale and Huntoon, is non-operated and has a lower working interest, averaging 25%. Painted Pony acquired its initial interests in the areas through farm-in agreements. The Company has continued to acquire undeveloped land and Bakken production in this area.



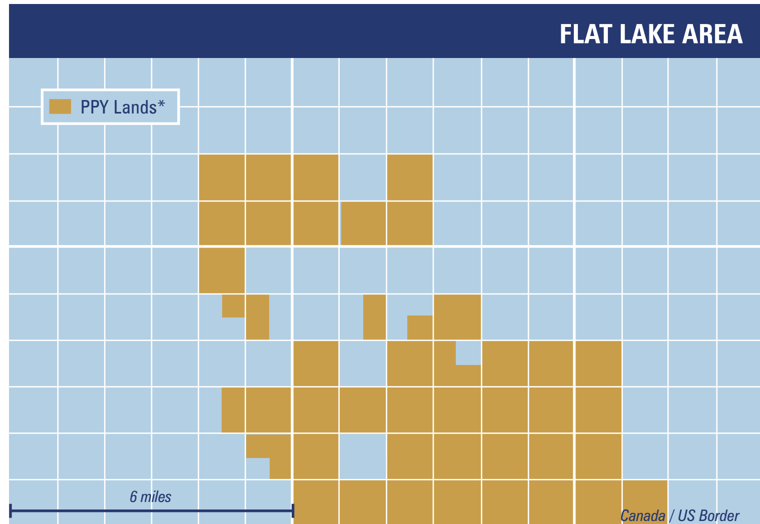
As at December 31, 2010, Painted Pony had 13,803 net acres (21.6 sections) of land in the Midale/Huntoon area, of which 85% is undeveloped. During 2010, Painted Pony participated in the drilling of 25 (22.2 net) wells in the Midale/Huntoon area. In 2011, the Company anticipates drilling 19 (17.0 net) wells on these lands. In 2009, oil sales averaged 644 bbls/d. In 2010, the combination of the successful drilling program since inception combined with the acquisitions, increased sales to an average 1,460 boe/d, with production during the fourth quarter averaging 1,533 boe/d.

With the Company's significant growth in Saskatchewan there was a need to construct facilities to handle the additional production growth. In the Midale and Huntoon areas, a multi-well oil battery and gathering system was constructed during the first half of 2010. In the Huntoon area, solution gas and liquids conservation commenced at the end of August with the facility being tied into an existing third-party gas plant. Wells in the area that were not tied in during the initial construction have subsequently been tied in. Economic benefits include reducing production disruptions caused by adverse weather, cost-effective water handling and disposal, reduced trucking costs and eliminating the capital investment of oil storage tanks at each well location.

The Kisbey area is located approximately 30 miles northeast of the town of Estevan. The Company is primarily focused on Bakken exploitation, though Bakken exploration is ongoing. In 2010, the Company participated in the drilling of 3 (0.65 net) wells in the area and 8 (1.9 net) wells are planned for 2011. At December 31, 2010, Painted Pony held 1,733 net acres in the Kisbey area, of which 88% is undeveloped. Sales in 2010 from the Kisbey area averaged 126 boe/d, weighted 93% oil and liquids.

REVIEW OF OPERATIONS

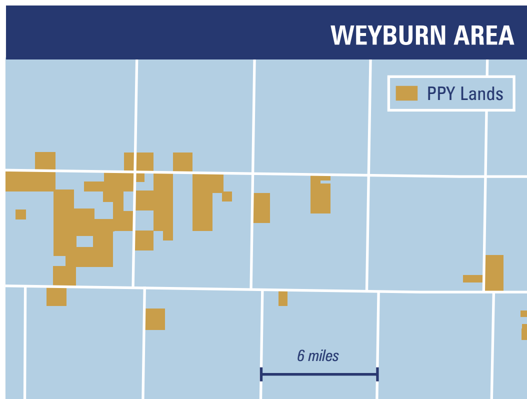
Flat Lake Area



* includes Q2 2011 acquisition

The Flat Lake area is located southwest of the Company's Weyburn area, close to the U.S. border. Painted Pony entered the Flat Lake area through a farm-in agreement mid-year 2010 where several prolific Bakken wells have been drilled in the area by competitors. During the third quarter of 2010, Painted Pony drilled 1 (0.35 net) well, which was completed at a 50% working interest (before penalty payout), that tested at 208 bbls/d of oil. During the fourth quarter of 2010, the well was on production intermittently, with net sales of 32 bbls/d.

As of December 31, 2010 the Company had a total of 5,149 net acres of land, of which 99% was undeveloped. In 2011, the Company acquired a 9.4 net section block (6,018 net acres) of land and 45 bbls/d of Bakken oil production for $7.7 million. The Company plans to drill 7 (3.1 net) wells in the Flat Lake area during 2011.



Weyburn Area

Painted Pony's team spearheaded the extension west of the Bakken-pool in 2008 into the Weyburn exploration area, located west of the Midale area. By the end of 2010, the Company had aggregated 21,624 net acres (34 sections) of developed and undeveloped land, through land sales, farm-in wells and freehold leasing. In 2010, Painted Pony drilled 4 (2.65 net) wells in the area. As part of the exploration component of the 2011 drilling program, the Company plans to drill 7 (5.8 net) wells on these lands. Sales in 2010 from the Weyburn area averaged 62 boe/d, weighted 98% oil and liquids.

Other Areas

Painted Pony's other areas include 34,806 net acres of land. In 2010, the Company drilled 3 (2.75 net) wells on these lands, targeting Bakken, Frobisher and Mississippian zones.

In the fourth quarter of 2010, Painted Pony closed a $10.6 million acquisition of light oil assets. The Company has identified numerous drilling locations within the lands acquired.

BRITISH COLUMBIA

The Company's operations in northeast British Columbia are located north of Fort St. John near the Alaska Highway. The area is prospective for gas from multiple zones, including the Montney, Halfway, Gething, Bluesky, Cadomin and Buckinghorse formations.

In British Columbia, in 2010 the Company invested $51.0 million of exploration and development expenditures to participate in the drilling of 9 (5.1 net) wells. Painted Pony drilled 2 (1.0 net) Buckinghorse shale gas wells, 2 (1.0 net) Bluesky/Cadomin wells, plus in the Blair/Town area, 2 (1.5 net) vertical wells and 3 (1.6 net) horizontal wells targeting the Montney. In addition, under the terms of the Cameron/Kobes joint venture, 6 (1.2 net) horizontal wells targeting the Montney formation were drilled. Painted Pony retains a 20% working interest in each joint venture well after electing to pay 20% of the equipping and tie-in costs.

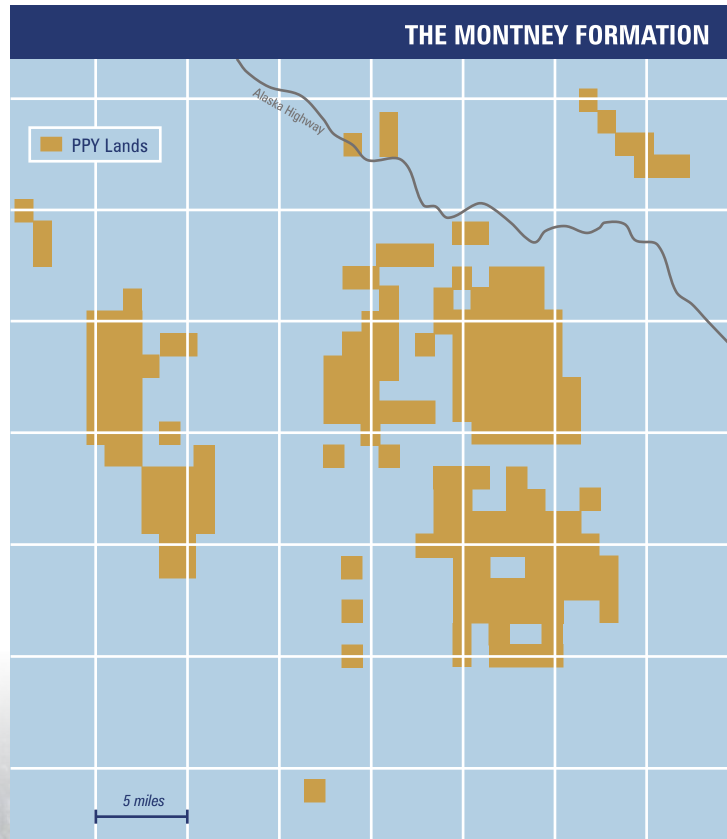
The Company holds a significant land base in the area, totaling 125,192 acres (196 net sections) as at December 31, 2010. The area assets have been sparsely drilled to-date, but since 2009 industry activity has accelerated, with successful results in both conventional and unconventional plays. Reservoirs in the area could be characterized as stacked, gas charged and over-pressured. Gas in the area is produced through gathering systems that are owned in part by the Company, and processed and transported through facilities owned by third-party midstream companies.

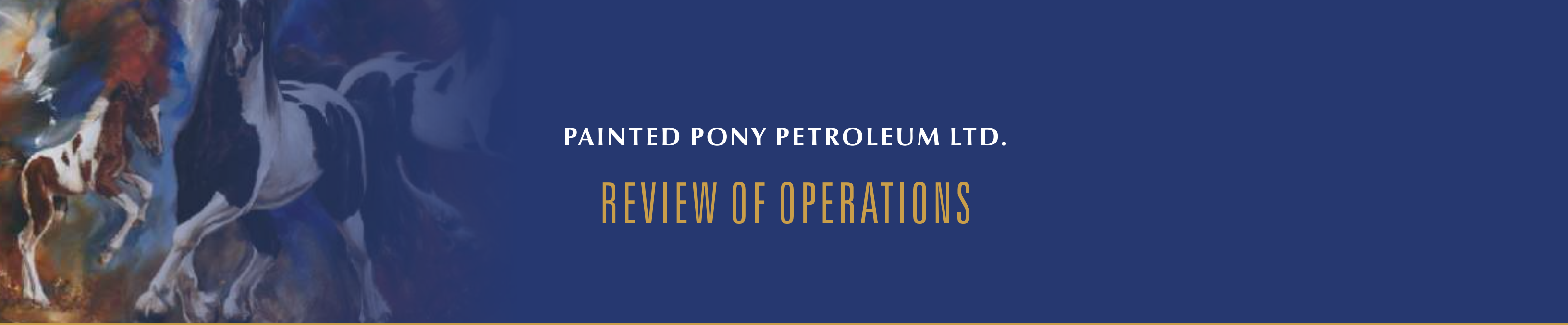
Play economics have been enhanced by improvements to the British Columbia provincial royalty incentive programs. Painted Pony is focused on evaluating and developing three plays; conventional gas, un-conventional Montney gas and Buckinghorse shale gas. Production from B.C. averaged 6,603 mcf/d plus 36 bbls/d of liquids in 2010. In the fourth quarter, B.C. production averaged 9,429 mcf/d plus 33 bbls/d of liquids.

THE MONTNEY FORMATION

The Montney formation is a thick, dolomitic siltstone in the area. Successful wells on the Company's land as well as industry activity nearby has shown this formation to hold significant reserves which can be recovered by applying advanced horizontal multi-stage fracture stimulations. The Company has accumulated a large land base in the area and has begun developing the resource on three blocks.

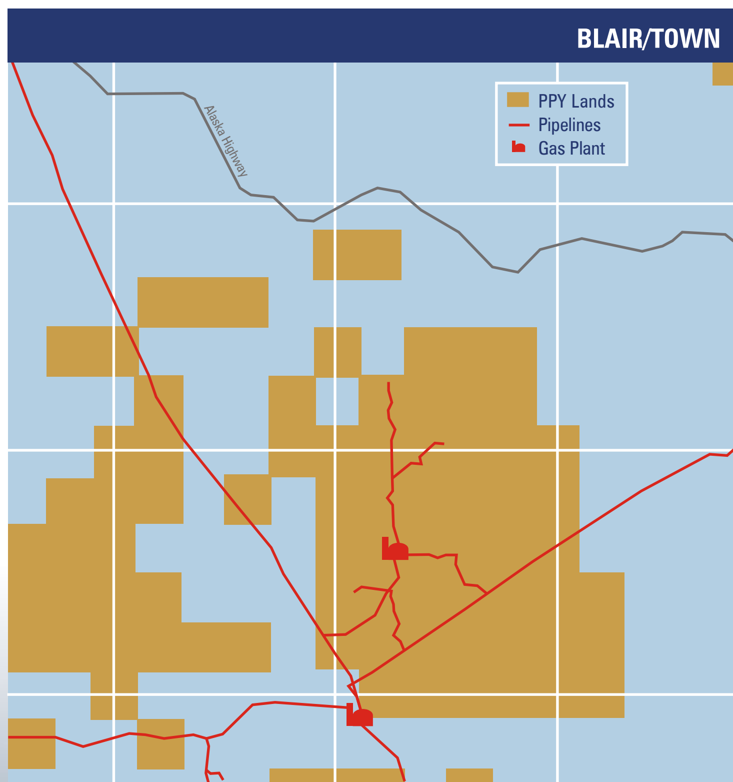
At Cypress, the Montney zone is structurally complex due to tectonic thrusting in this region. As a result, development of this block will proceed at a more cautious pace to limit capital risk. Due to the natural fracturing of the rock, this area may be tested and developed vertically.





Blair/Town

On the Blair/Town block, Painted Pony commenced drilling operations targeting the Montney gas formation in the first quarter of 2010. One (1.0 net) existing vertical well bore was re-entered and deepened into the Montney and 2 (1.3 net) horizontal wells were drilled. The three (2.3 net) wells were successful and tied in to existing infrastructure and placed on production during the second quarter of 2010.

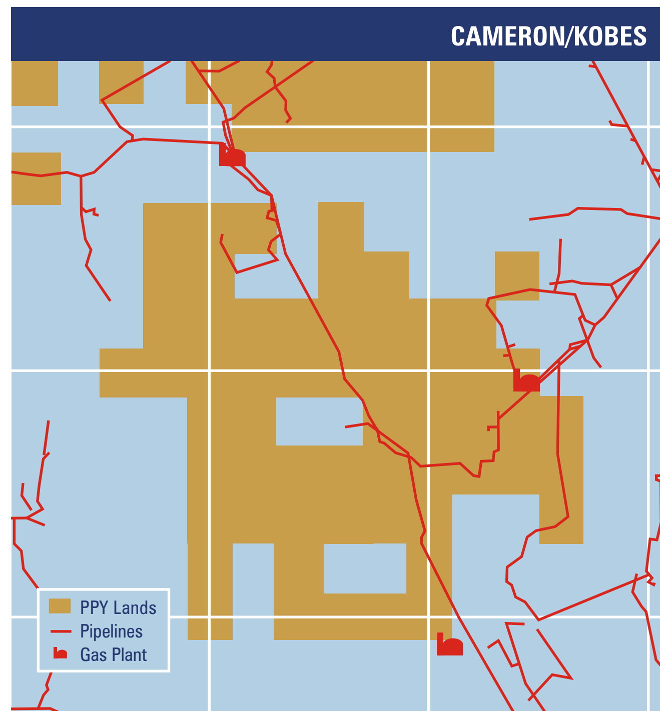


In the fourth quarter of 2010, Painted Pony began a three well (1.3 net) pad drilling program targeting the upper, middle and lower Montney zones. Two (0.8 net) of these wells were completed in 2010, with drilling and completion of the third (0.5 net) well occurring early in 2011. These wells are expected to be placed on production during the second quarter of 2011. The Company intends to continue to develop all three intervals within the Montney in order to quantify the resource in place and de-risk the entire block.

Production from the Blair/Town lands is a mixture of conventional Bluesky/Gething zone and the recent Montney play. Production in the Blair/Town area averaged 633 boe/d (97% gas) for the 2010 year.

Cameron/Kobes

The Cameron block is comprised of Kobes, Gundy and Diaber strike areas. On the Cameron block, under the terms of an on-going farm-out agreement, 6 (1.2 net) horizontal wells were drilled in 2010, to continue the success from the two vertical Montney wells that were drilled in 2009. Of the 2010 wells drilled, all but one was completed during the year. Results have been very encouraging and three of the wells were tied-in and placed on production during 2010. The last two wells came on production early in 2011. Additional drilling and completions have continued in 2011 as the farmee continues to earn the remainder of the block and further delineate the area in the upper, middle and lower Montney. The Company expects to retain an average working interest of 23.7% in the Cameron/Kobes block, if the farmee completes the earning process.



Production from the area in 2010 was 488 boe/d (97% natural gas). Production from the Cameron/Kobes area is also a combination of conventional Bluesky/Gething gas and Montney gas. The Montney zone across the entire area of Blair/Town and Cameron/Kobes contains sweet, low-carbon dioxide gas, with high heat content and an estimated liquids-to-gas ratio of over 20 bbls/mmcf.

Conventional Plays

The primary conventional targets in the area are the Cretaceous Bluesky, Gething and Cadomin zones. At Blair and Gundy, the Company has had consistent success developing the Bluesky interval using vertical wells and three-dimensional seismic to reduce risk. Several deeper Triassic, Permian and Mississippian plays have been pursued in the area by predecessors, targeting thrust sheets with enhanced natural fracturing which enhances productivity. In 2010, 2 (1.0 net) gas wells were drilled in the Bluesky and Cadomin zones.

BUCKINGHORSE SHALE FORMATION

The Buckinghorse shale is a gas-charged, organically rich shale deposit that is believed to be pervasive across Painted Pony lands. The zone is over-pressured, with an approximate thickness of 800 meters. In 2010, Painted Pony drilled 2 (1.0 net) wells targeting the Buckinghorse shale formation. The wells are expected to be fracture stimulated in 2011.

LAND HOLDINGS

Painted Pony focuses on identifying potentially prospective new areas where the Company can aggregate an acreage position on a cost effective basis. When Painted Pony commenced operations in May of 2007, the Company held no land, but had access to two large blocks of land in Saskatchewan through farm-in agreements. Competition for land in both Saskatchewan and British Columbia from other larger industry competitors intensified, and in many areas, prices escalated. In 2008, the Company grew its net land position in Saskatchewan by earning land through executing on farm in arrangements, freehold leasing and participating in crown land sales. In March of 2008, Painted Pony acquired 89,600 net acres of developed and undeveloped land in northeast British Columbia in conjunction with a purchase of producing properties. In 2009, Painted Pony focused on purchasing selective parcels complimentary to existing Company owned lands. By December 31, 2009, the Company had 104,066 net acres of developed and undeveloped lands in British Columbia, of which 80% were undeveloped and 60,145 net acres in Saskatchewan, 97% undeveloped.

In Saskatchewan in 2010, Painted Pony acquired additional lands in its Midale core area and added another potential core area by way of a farm-in at Flat Lake. In British Columbia in 2010, Painted Pony consolidated its large contiguous block at Blair/Town by way of acquisitions at several crown land sales. Acreage was also added by way of a strategic swap with an industry competitor. By December 31, 2010, the Company had 125,192 net acres of developed and undeveloped lands in British Columbia, of which 81% were undeveloped and 77,115 net acres in Saskatchewan, 92% undeveloped. The Company continues to proactively address expiries. Substantially all of Painted Pony's 2009 expiries have been indefinitely continued. A number of applications were made during 2010 to address ongoing continuation of lands in British Columbia. The Company expects these lands to be continued through execution of a work program.

As at December 31, 2010, Painted Pony's detailed land position is as follows:

***Summary of Land** (acres)*

	Undeveloped		Developed		Total	
	Gross	Net	Gross	Net	Gross	Net
Saskatchewan						
Midale/Kisbey/Huntoon	19,982	13,281	3,210	2,255	23,192	15,536
Flat Lake	14,632	5,121	80	28	14,712	5,149
Weyburn	21,982	21,372	361	252	22,343	21,624
Other	33,017	31,263	5,200	3,543	38,217	34,806
	89,613	71,037	8,851	6,078	98,464	77,115
British Columbia						
Blair/Town	73,866	58,290	30,052	15,172	103,918	73,462
Cameron/Kobes	64,435	25,743	7,985	2,901	72,420	28,644
Other	44,925	17,595	14,464	5,491	59,389	23,086
	183,226	101,628	52,501	23,564	235,727	125,192
Total	272,839	172,665	61,352	29,642	334,191	202,307

As at December 31, 2010, in a report prepared by Seaton-Jordan and Associates Ltd. ("Seaton-Jordan"), the Company's undeveloped land in Saskatchewan and British Columbia was valued at $168.1 million. Seaton-Jordan's assessment of the Company's lands was prepared in accordance with National Instrument 51-101 - Standards of Disclosure for Oil and Gas Activities ("NI 51-101").

RESERVES

The Reserves Sub Committee is comprised of independent board members appointed by the Board of Directors of Painted Pony. In accordance with its mandate, this committee has reviewed the reserves report (the "Sproule Report") dated effective December 31, 2010, which was prepared by Sproule Associates Limited ("Sproule") and dated March 15, 2011 using forecast prices and costs. The Sproule Report was prepared in accordance with National Instrument 51-101 ("NI 51-101"). This instrument adopted by the Canadian Securities Administrators, sets out standards of disclosure for oil and gas activities and mandates the application of evaluation standards defined in the Canadian Oil and Gas Evaluation Handbook (COGEH). The information that follows has been derived from the Sproule Report.

The estimates of reserves are subject to revisions as additional reservoir and performance information becomes available, and contains judgments of future events for which the actual results may vary materially. The reader is referred to the Company's Statement of Reserves Data and Other Oil and Gas Information Form, which it is anticipated will be filed before the end of April 2011 on the Company's website and on www.sedar.com. This Annual Report contains extracts of Painted Pony's reserves only.

At December 31, 2010 the Company's proved plus probable working interest reserves were 32,538.7 mboe (weighted 76% gas and 24% oil and natural gas liquids) compared to 6,491.0 mboe (weighted 34% gas and 66% oil and natural gas liquids) as at December 31, 2009, an increase of 401%. At December 31, 2010, Painted Pony's total proved working interest reserves were 11,335.5 mboe, an increase of 187% compared to 3,944.1 mboe at December 31, 2009.

Summary of Company Gross Oil and Gas Working Interest Reserves[(1),(2)]
Forecast Prices and Costs

	As at December 31, 2010				As at December 31, 2009
	Natural gas[(3)] *(mmcf)*	Light and medium oil *(mbbl)*	Natural gas liquids *(mbbl)*	Total *(mboe[(4)])*	Total *(mboe[(4)])*
Proved					
Developed producing	**13,167**	**2,026.0**	**256.0**	**4,476.6**	2,712.8
Developed non-producing	**259**	**2.6**	**2.3**	**48.1**	64.0
Undeveloped	**30,922**	**1,067.5**	**589.7**	**6,810.9**	1,167.3
Total proved	**44,348**	**3,096.1**	**848.0**	**11,335.5**	3,944.1
Probable	**104,028**	**1,871.1**	**1,994.1**	**21,203.2**	2,546.9
Total proved plus probable	**148,376**	**4,967.2**	**2,842.1**	**32,538.7**	6,491.0

(1) Company Gross, being Painted Pony's total working interest reserves before royalties owned by others.
(2) Numbers in this table are subject to rounding error.
(3) Includes non-associated gas, associated gas and solution gas.
(4) Natural gas is converted to barrels of oil equivalent ("boe") at a ratio of six thousand standard cubic feet to one barrel of oil.

"Gross" reserves (being working interest reserves, excluding royalty interest reserves, before deduction of royalty burdens payable) are disclosed. The reserve report was prepared utilizing definitions as set out under NI 51-101.

NET PRESENT VALUE OF FUTURE NET REVENUE

The forecast prices used in the Sproule Report effective December 31, 2010 were Sproule's published Forecast Prices and Costs as at December 31, 2010. The estimated future net revenues are stated before deducting future estimated site restoration costs and reduced for estimated future well abandonment costs, the Saskatchewan Capital Tax and estimated capital for future development associated with the reserves.

In the reserve report, the net total future capital required to bring undeveloped proved plus probable reserves onto production is estimated to be $247 million, an increase of $200 million from 2009, over the life of the reserves.

Summary of Net Present Values of Future Net Revenue (1),(2),(3),(4),(5)
Forecast Prices and Costs *($000s)*
Before Income Taxes

	As at December 31, 2010					As at December 31, 2009	
	0%	5%	10%	15%	20%	0%	10%
Proved							
Developed producing	**144,600**	**123,121**	**108,131**	**97,051**	**88,512**	101,965	73,733
Developed non-producing	**366**	**318**	**278**	**245**	**217**	315	227
Undeveloped	**122,825**	**75,587**	**48,819**	**31,821**	**20,136**	38,659	23,465
Total proved	**267,790**	**199,025**	**157,229**	**129,117**	**108,865**	140,939	97,426
Probable	**484,748**	**292,789**	**196,511**	**140,507**	**104,514**	99,542	47,269
Total proved plus probable	**752,538**	**491,815**	**353,740**	**269,623**	**213,379**	240,481	144,695

(1) Numbers in this table are subject to rounding error.
(2) Values are net of abandonment liabilities.
(3) The net present values of future net revenue do not represent fair market value.
(4) Sproule price decks dated December 31, 2010 and 2009.
(5) The estimated future net revenues are stated before deducting future estimated site restoration costs, and reduced for estimated future well abandonment costs, the Saskatchewan Capital Tax and estimated capital for future development associated with the reserves.

Summary of Pricing and Inflation Rate Assumptions
Forecast Prices and Costs
As at December 31, 2010

	WTI Cushing Oklahoma ($US/bbl)	Edmonton Par price 40° API light crude oil ($Cdn/bbl)	Inflation rates (%/year)	Henry Hub price ($US/mmbtu)	AECO-C Spot ($Cdn/mmbtu)	Exchange rate ($US/$Cdn)
2011	88.40	93.08	1.5	4.44	4.04	0.932
2012	89.14	93.85	1.5	5.01	4.66	0.932
2013	88.77	93.43	1.5	5.32	4.99	0.932
2014	88.88	93.54	1.5	6.80	6.58	0.932
2015	90.22	94.95	1.5	6.90	6.69	0.932
2016	91.57	96.38	1.5	7.00	6.80	0.932
2017	92.94	97.84	1.5	7.11	6.91	0.932
2018	94.34	99.32	1.5	7.21	7.02	0.932
2019	95.75	100.81	1.5	7.32	7.14	0.932
2020	97.19	102.34	1.5	7.43	7.26	0.932
Thereafter	+1.5%/yr	+1.5%/yr	1.5	+1.5%/yr	+1.5%/yr	0.932

RESERVE LIFE INDEX

The reserve life index is calculated by dividing reserves as at the effective date of the Sproule Report (December 31, 2010) by the production during the applicable period, and represents a measure of the amount of time production could be sustained at the production rates based on the reserves at the applicable point in time. Based upon the year-end reserve volumes and the fourth quarter 2010 annualized production rate for Painted Pony, sufficient reserves exist to continue production at that rate for approximately twenty-six years based on proved plus probable reserves, and approximately nine years based on proved reserves.

Reserve Life

Years	Proved	Proved and probable
Natural gas	12.5	41.7
Crude oil and NGLs	5.9	11.6
Total boe	8.9	25.7

PRODUCTION REPLACEMENT RATIO

The production replacement ratio measures the number of times the fourth quarter's annualized production has been replaced by net reserve additions. The 2010 production replacement ratio reflects the significant increase in reserve volumes, especially in the Company's British Columbia Montney gas program.

	2010	2009
Proved basis	**6.7 x**	2.4 x
Proved plus probable basis	**21.4 x**	3.7 x

Net present value of future net revenue does not represent fair market value of the reserves. There is no assurance that the forecast prices and cost assumptions will be attained and variances could be material.

The following Management's Discussion and Analysis ("MD&A") of the consolidated financial results as provided by the management of Painted Pony Petroleum Ltd. ("Painted Pony" or the "Company") should be read in conjunction with the consolidated financial statements and related notes for the year ended December 31, 2010. This commentary is dated March 28, 2011. The financial data presented is in accordance with Canadian generally accepted accounting principles ("GAAP") in Canadian dollars, except where indicated otherwise. These documents, including the Annual Information Form, and additional information about Painted Pony are available on SEDAR at www.sedar.com.

DESCRIPTION OF COMPANY

Painted Pony is a Calgary-based exploration and development company focused on oil in southeast Saskatchewan and natural gas in northeast British Columbia. The Class A and Class B shares of Painted Pony trade on the TSX Venture Exchange under the symbols "PPY.A" and "PPY.B", respectively.

Painted Pony commenced commercial operations on April 3, 2007 upon completion of a financial reorganization as part of an overall restructuring of the Company. On May 23, 2007, subsequent to completion of an initial public offering on May 17, 2007, the Class A shares and Class B shares of Painted Pony Petroleum Ltd. began trading on the TSX Venture Exchange. Painted Pony then commenced an actively operated exploration program.

NON-GAAP MEASURES

Management's Discussion and Analysis contains the term "funds flow from operations", which should not be considered an alternative to, or more meaningful than cash flow from operating activities as determined in accordance with GAAP as an indicator of the Company's performance. Funds flow from operations and funds flow from operations per share (basic and diluted) do not have any standardized meaning prescribed by GAAP and may not be comparable with the calculation of similar measures for other entities. Management uses funds flow from operations to analyze operating performance and considers funds flow from operations to be a key measure as it demonstrates the Company's ability to generate the cash necessary to fund future capital investment and to repay debt. Funds flow from operations per share is calculated using the basic and diluted weighted average number of shares for the period, and after deemed conversion of Class B shares into Class A shares, consistent with the calculations of earnings per share. The Company reconciles funds flow from operations to cash flow from operating activities, which is the most directly comparable measure calculated in accordance with GAAP, as follows:

($000s)

Years ended December 31,	2010	2009
Cash flow from operating activities	**35,360**	12,460
Changes in non-cash working capital	**819**	2,700
Asset retirement expenditures	**100**	50
Funds flow from operations	**36,279**	15,210

Management's Discussion and Analysis also contains other industry benchmarks and terms, such as working capital (deficiency) (calculated as current assets less current liabilities) and operating netbacks (calculated on a per unit basis as oil, gas and natural gas liquids revenues less royalties, transportation, and operating costs), which are not recognized measures under GAAP. Management believes these measures are useful supplemental measures of, firstly, the total net position of current assets and current liabilities of the Company and, secondly, the Company's profitability relative to commodity prices. Readers are cautioned, however, that these measures should not be construed as alternatives to other terms such as current and long-term debt or net income determined in accordance with GAAP as measures of performance. Painted Pony's method of calculating these measures may differ from other companies, and accordingly, may not be comparable to similar measures used by other companies.

FORWARD-LOOKING INFORMATION

This MD&A contains forward-looking statements relating to future events. Forward-looking information is information that does not relate strictly to historical or current facts, and can be identified by words such as "anticipate", "continue", "estimate", "expect", "forecast", "may", "will", "project", "should", "believe", "intend", or similar expressions. These statements represent management's reasonable projections, expectations, and estimates as of the date of this document, but undue reliance should not be placed upon them as they are derived from numerous assumptions. These assumptions are subject to known and unknown risks and uncertainties, including the business risks discussed in the MD&A, which may cause actual performance and financial results to differ materially from any projections of future performance or results expressed or implied by such forward-looking statements.

The forward looking information in this document is subject to significant risks and uncertainties and is based on a number of material factors and assumptions which may prove to be incorrect; including but not limited to the following:

a) volumes in 2011 will be become more weighted towards gas than in 2010;

b) the average oil price expected to be received by the Company in 2011 will be approximately 3% less than the Edmonton par reference price and the natural gas price will be similar to the AECO daily spot price;

c) overall royalties in 2011 will approximate 13% of total revenues, assuming similar commodity prices;

d) net general and administrative costs are expected to inversely vary with capital expenditure levels in each fiscal quarter, reflecting the effect of cost recoveries from operated capital expenditures;

e) as gross Saskatchewan revenues vary, the Saskatchewan resource surcharge tax is expected to correspondingly fluctuate;

f) increased future accretion costs from higher future retirement liabilities are expected to be incurred from incremental wells added through drilling activities and asset acquisitions;

g) the stock-based compensation expense calculation utilizes the Black-Scholes model to estimate option grant costs; however this expense may not represent the actual eventual cash compensation realized by the recipients;

h) Montney gas operations are expected to be conducted on a pad-basis aimed to economize costs resulting in wells commencing production on a periodic schedule;

i) certain lands approaching expiry in British Columbia are expected to be continued through execution of work programs and land continuation applications based on work programs will be completed as necessary to achieve the targeted objectives;

j) investments made in batteries, gathering systems and water disposal facilities are expected to reduce costs incurred while mitigating production disruptions from inclement weather;

k) the tax pools for which tax assets have been recorded will be utilized;

l) available credit facility may be utilized on a periodic basis in 2011;

m) the risk of accounts receivables becoming uncollectible is mitigated by the financial position of the applicable entities; and

n) the Company has sufficient financial resources with which to conduct its capital program; further, this is subject to the additional assumption that the drilling rigs, field service providers, completion and tie-in equipment will be available as required and that the costs of securing such services and equipment will not materially exceed expectations.

This forward-looking information represents our views as of the date of this document and such information should not be relied upon as representing our views as of any date subsequent to the date of this document. We have attempted to identify important factors that could cause actual results, performance or achievements to vary from those current expectations or estimates expressed or implied by the forward-looking information. However, there may be other factors that cause results, performance or achievements not to be as expected or estimated and that could cause actual results, performance or achievements to differ materially from current expectations. Other risks and uncertainties include, but are not limited to, the following:

- *normal risks common to the oil and natural gas industry, including various operational risks in the carrying out of exploration, development and production operations;*
- *risks and uncertainty of oil and gas geological deposits;*
- *revisions, amendments or changes to capital expenditure plans including exploration, development and exploitation projects;*
- *risks as to the availability and pricing of appropriate financing alternatives on acceptable terms;*
- *potential changes in income tax regulations, governmental policies, rules, practices or approval process changes, or delays, or enhancements; and*
- *the Company's ability to attract and retain qualified professional employees.*

Statements relating to "reserves" or "resources" are by their nature deemed to be forward-looking statements, as they involve the implied assessment based on certain estimates and assumptions that the resources and reserves described can be profitably produced in the future.

The reader is further cautioned that the preparation of consolidated financial statements in accordance with GAAP requires management to make certain judgments and estimates that affect the reported amounts of assets, liabilities, revenues and expenses. Estimating reserves is also critical to several accounting estimates and requires judgments and decisions based upon available geological, geophysical, engineering and economic data. These estimates may change, having either a negative or positive effect on net earnings as further information becomes available, and as the economic environment changes.

There can be no assurance that forward-looking information will prove to be accurate, as results and future events could differ materially from those expected or estimated in such statements. Accordingly, readers should not place undue reliance on forward-looking information. From time to time, Painted Pony's management makes estimates and forms opinions on which the forward-looking statements are based. The Company assumes no obligation to update forward-looking statements if circumstances, management's estimates, or opinions change, unless prescribed by securities laws.

BOE PRESENTATION

Barrels of oil equivalent ("boe") may be misleading, particularly if used in isolation. A boe conversion ratio of six thousand cubic feet of gas ("mcf") to one barrel of oil ("bbl") (6 mcf: 1 bbl) is used as an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. All boe conversions in this report are derived by converting natural gas to oil in the ratio of six mcf of gas to one barrel of oil. Readers should be aware that historical results are not necessarily indicative of future performance.

NET EARNINGS AND FUNDS FLOW FROM OPERATIONS

Painted Pony generated funds flow from operations of $36.3 million for the year ended December 31, 2010, compared to $15.2 million for the year ended December 31, 2009. On a basic and diluted per share basis, funds flow from operations for 2010 was $0.76 and $0.74 compared to $0.44 per share, basic and diluted, in 2009.

Cash flow from operating activities was $35.4 million for the year ended December 31, 2010, compared to $12.5 million for 2009.

Painted Pony produced net income of $1.9 million in the year ended December 31, 2010, compared to a net loss of $3.7 million for the year ended December 31, 2009. Net income in 2010 increased compared to 2009 from increased sales volumes and prices combined with reductions in many key expenses. In 2010, non-cash stock-based compensation expenses totaled $4.8 million. In comparison, in 2009, stock-based compensation expenses were $3.5 million, including $1.1 million for share options surrendered for cancellation. In 2009, the Company recorded a future income tax reduction of $1.4 million while recognizing a future income tax asset of $3.1 million. At December 31, 2010, the Company's future tax asset remaining was $0.9 million, which is expected to be utilized during 2011. The net income was $0.04 per basic and diluted share in 2010 compared to a net loss of $0.10 per basic and diluted share in 2009.

SALES VOLUMES

During the year ended December 31, 2010, Painted Pony's sales volumes increased 84% to average 2,848 boe per day compared to 1,552 boe per day for 2009. All of Painted Pony's light oil sales originate from Saskatchewan operations while sales of gas, condensate and NGL's are primarily from assets in British Columbia. Sales volumes in 2010 were weighted 59% towards oil, similar to the 58% in 2009.

Average Daily Sales Volumes

Years ended December 31,	2010	2009
Oil *(bbls/d)*	**1,667**	893
Condensate *(bbls/d)*	**28**	24
NGL's *(bbls/d)*	**34**	17
Gas *(mcf/d)*	**6,718**	3,712
Total *(boe/d)*	**2,848**	1,552

Daily oil sales volumes in 2010 increased 87% compared to 2009. Crude oil sales for the year 2010 were from 118 (83.3 net) wells in the Midale, Huntoon, Kisbey, Weyburn, Manor, and Alameda areas, compared to 65 (40.6 net) wells during 2009.

Natural gas daily sales volumes increased by 81% in 2010 compared to 2009. Gas, condensate and liquids sales during the year ended December 31, 2010 were primarily from 41 (18.6 net) wells in the Blair, Cypress and Cameron areas, compared to sales from 30 (14.1 net) wells during 2009. Minor quantities of gas and NGL products were produced in both 2010 and 2009 in Saskatchewan, as gas conservation began in 2009 from the Kisbey and Weyburn areas and in 2010 from the Midale and Huntoon areas.

The Company anticipates sales volumes in 2011 will be become more weighted towards gas than in 2010 as continued success in delineating the Montney formation in British Columbia would add incremental volumes.*

**This paragraph contains forward-looking information. Please refer to "Forward-looking Information" and "Business Risks, Uncertainties and Forward-looking Information" for a discussion of the risks and uncertainties related to such information.*

REVENUES

Petroleum and natural gas sales increased 102% to $58.3 million foy the year ending December 31, 2010, compared to $28.9 million for 2009. In 2010, oil sales revenues were 81% of total sales dollars compared to 78% in 2009, while oil volumes were 59% and 58% in 2010 and 2009, respectively. In both years, oil sales have contributed disproportionately more to total sales dollars compared to volumes reflecting the relative strength of crude oil prices to gas prices. Commodity prices strengthened somewhat; the Edmonton light reference price increased by 17.2% and the AECO daily spot average price increased by a penny, year over year.

Sales by Product *($000s)*

Years ended December 31,	2010	2009
Oil	**47,361**	22,534
Gas	**9,662**	5,688
Condensate	**757**	517
NGL and sulphur	**503**	156
Total	**58,283**	28,895

Crude oil revenue in 2010 was $47.4 million compared to $22.5 million during 2009. Oil revenues increased 110% year over year. Daily oil production volumes for 2010 increased by 87% over 2009, and the Company's average oil price realized in 2010 increased by 12.6% compared to the 2009 oil price. The Company realized an average oil price of $77.84 per bbl during 2010 compared to $69.15 per bbl in 2009. Painted Pony received an average crude oil price approximately the same as the Edmonton light reference price throughout 2010, as the Company's oil is a premium light crude with low sulphur content.

Revenue from gas, condensate, NGL and sulphur sales totaled $10.9 million during 2010, compared to $6.4 million received during 2009. The Company received an average gas price of $3.94 per mcf in the year ended December 31, 2010, very similar to the AECO daily spot average gas reference price. In 2009, the Company received an average gas price of $4.20 per mcf.

To date, Painted Pony has not undertaken any risk management contracts or commodity price contracts.

While the Company historically tended to receive an average oil price which slightly exceeded or approximated the Edmonton par reference price, expectations for 2011 are for an average oil price approximately 3% less than the reference price reflecting the prices currently paid for crude where the Company tends to deliver the bulk of its oil in Saskatchewan. The Company continues to expect to receive a monthly natural gas price approximately the same as the AECO daily spot price. The average prices reported for Painted Pony's sales are the weighted average net prices, which is reflective of month to month price and sales volume changes.*

**This paragraph contains forward-looking information. Please refer to "Forward-looking Information" and "Business Risks, Uncertainties and Forward-looking Information" for a discussion of the risks and uncertainties related to such information.*

Average Benchmark Prices

Years ended December 31,	2010	2009
Exchange rate *(US$/Cdn$)*	**0.971**	0.881
Oil - WTI *(US$/bbl)*	**79.61**	62.09
- Edmonton par - light oil *($/bbl)*	**77.88**	66.46
Gas - AECO, daily spot *($/mcf)*	**4.00**	3.99

Painted Pony's Realized Prices

Years ended December 31,	2010	2009
Oil *($/bbl)*	**77.84**	69.15
Gas *($/mcf)*	**3.94**	4.20
Condensate *($/bbl)*	**74.09**	58.84
NGL *($/bbl)*	**41.05**	24.22

ROYALTIES

In the 2010 year, total royalties were $7.5 million, or approximately 12.9% of total revenue. For the 2009 year, total royalties were $3.4 million, or approximately 11.9% of revenue. The greater royalty cost is from the growth of sales volumes combined with higher commodity prices.

Painted Pony's producing properties in British Columbia are on crown lands, and in Saskatchewan are primarily on freehold lands. Notwithstanding this, crown royalty expense during 2010 was primarily from the sales of oil from Saskatchewan as gas from British Columbia benefited from provincial crown royalty holidays. In 2010, oil royalties averaged 14.7% (2009: 14.1%) of sales, while gas and associated product royalties averaged 5.0% (2009: 4.2%). For oil, the increase was primarily due to higher commodity prices, while for gas the increase was due to royalty adjustments and amendments in 2009. Freehold royalties were from the sale of oil, gas and liquids in Saskatchewan. Gross overriding royalties were mainly from oil sales on lands earned through farm-ins. In 2011, the Company anticipates overall royalty rates to continue at similar levels.*

** This paragraph contains forward-looking information. Please refer to "Forward-looking Information" and "Business Risks, Uncertainties and Forward-looking Information" for a discussion of the risks and uncertainties related to such information.*

Royalties as a % of Revenue

Years ended December 31,	2010	2009
Crown	**1.4**	1.6
Freehold	**8.3**	7.3
GOR	**3.2**	3.0
	12.9	11.9

Royalties by Type *($000s, except per boe)*

Years ended December 31,	2010	2009
Crown	**806**	459
Freehold	**4,841**	2,125
GOR	**1,882**	857
	7,529	3,441
Royalties *($ per boe)*	**7.25**	6.07

TRANSPORTATION COSTS

Transportation costs for the year ended December 31, 2010 were $3.8 million, compared to $3.0 million for the year ended December 31, 2009.

Transportation by Commodity *($000s, except per unit)*

Years ended December 31,	2010	2009
Oil	**853**	613
Gas and associated liquids	**2,955**	2,402
Net	**3,808**	3,015
Oil *($/bbl)*	**1.40**	1.88
Gas and associated liquids *($/boe)*	**6.85**	9.98
Transportation cost *($/boe)*	**3.66**	5.32

Painted Pony has invested significant energy and resources in reducing Saskatchewan transportation and operating costs throughout 2010 and 2009 through the installation of gathering systems, central treating and water disposal facilities and gas conservation.

In Saskatchewan, in 2010 and 2009, transportation costs were 1.8% and 2.7%, respectively, of gross oil revenues. These charges reflect the cost to truck oil to various sales points, including related costs of addressing occasional capacity issues, and pipeline tariffs. In the second half of 2009, per unit transportation costs began to decline as a result of the newly installed gathering systems and facilities which continued throughout 2010.

In 2009, wells were added to the Kisbey area gathering system, a multi-well oil battery and gathering system in the Midale area was completed and a multi-well oil battery complete with gas conservation was placed on-stream in the Weyburn area. Late in 2009, a multi-well treating and water disposal facility in the Huntoon area was constructed and early in 2010 it was placed on-stream. Conservation of solution gas and liquids associated with this facility commenced in the third quarter. In late 2010, conservation of solution gas and liquids in the Midale area commenced. Electrification of wells previously powered by gas engines continued as well.

In British Columbia, gas gathering, processing and transmission services are generally provided by mid-stream processing companies. These services allow the Company to avoid allocating capital resources for facilities, on a firm-service or interruptible basis. The all-in charges for these services are included in transportation costs. The Company was committed to a firm-service contract for the processing costs associated with the physical delivery of five mmcf per day of natural gas until the end of October 2010. The cost for transporting the gas and field products primarily from the British Columbia properties, averaged $6.85 per boe in the year ended December 31, 2010 and $9.98 per boe during 2009, including costs for excess capacity under the firm service contract. In 2010, the per unit cost reductions are from the increased gas sales volumes combined with the absence of excess capacity charges in the later portion of the year.

OPERATING COSTS

Operating costs for the year ended December 31, 2010 were $7.6 million or $7.28 per boe. This compares to $4.9 million or $8.72 per boe for 2009.

Operating Costs *($000s, except per unit)*

Years ended December 31,	2010	2009
Oil	**5,809**	3,270
Gas and associated liquids	**1,762**	1,669
Production expenses	**7,571**	4,939
Oil *($/bbl)*	**9.55**	10.04
Gas and associated liquids *($/boe)*	**4.09**	6.93
Operating cost *($/boe)*	**7.28**	8.72

Per unit operating costs decreased in 2010 compared to 2009 for both gas and associated liquids and oil.

For the Company's oil producing properties, operating costs are primarily salt water disposal and hauling fees, equipment rentals for gas engines to run the pump jacks if not electrified, fuel and power expenditures and contract operator fees. Throughout 2010 and 2009, Painted Pony frequently rented rig mats to allow access to well sites experiencing wet road conditions to minimize production disruptions. Investments made in batteries, gathering systems and water disposal facilities are expected to reduce costs incurred while mitigating production disruptions from inclement weather.*

**This paragraph contains forward-looking information. Please refer to "Forward-looking Information" and "Business Risks, Uncertainties and Forward-looking Information" for a discussion of the risks and uncertainties related to such information.*

Operating costs for gas and associated liquids are mainly compression fees, contract operating fees, salt water hauling and disposal costs, equipment rentals, glycol and methanol costs, and routine repairs and maintenance expenditures on more mature properties. Per unit gas operating costs were lower in 2010 compared to 2009, reflecting higher production rates and voluntarily shutting in some high-operating cost wells.

OPERATING NETBACKS

For the year ended December 31, 2010, field operating netbacks averaged $37.88 per boe, compared to field operating netbacks of $30.89 per boe during the year ended December 31, 2009. During 2010, Painted Pony's per unit netback for crude oil was 71% of the gross sales price, compared to 55% for gas and related products, or 68% overall.

Combined Field Operating Netback *($ per boe)*

Years ended December 31,	2010	2009
Sales	**56.07**	51.00
Transportation	**(3.66)**	(5.32)
Royalties	**(7.25)**	(6.07)
Operating costs	**(7.28)**	(8.72)
Field operating netback	**37.88**	30.89

Netbacks by Commodity

Years ended December 31,	2010	2009
Oil *($/bbl)*	**55.42**	47.49
Gas and associated products *($/boe)*	**13.11**	8.41

Netbacks from crude oil production in Saskatchewan were $55.42 per bbl for the year ended December 31, 2010, compared to $47.49 per bbl in 2009. The increased netback for crude oil during 2010 was primarily due to prices being 13% higher than the 2009 price, and further enhanced by lower operating and transportation costs on a per boe basis.

The Company monitors netbacks for gas inclusive of associated products. Approximately 58% of associated liquids volumes are from British Columbia properties, which primarily produce gas. Gas and associated product netbacks averaged $13.11 per boe in 2010, compared to $8.41 per boe in 2009. In comparison to the prior year, gas and associated product netbacks in 2010 have increased as a result of lower per unit operating and transportation costs.

GENERAL AND ADMINISTRATIVE

Net general and administrative expenses during the year ended December 31, 2010 were $2.5 million, compared to $2.0 million in 2009, or $2.43 per boe and $3.60 per boe, respectively.

General and Administrative Costs *($000s, except per boe)*

Years ended December 31,	2010	2009
Gross costs	**5,317**	3,578
Capitalized	**(1,474)**	(954)
Recoveries	**(1,320)**	(582)
Net costs	**2,523**	2,042
Net G&A *($ per boe)*	**2.43**	3.60

Gross general and administrative costs in 2010 were 49% greater than in 2009. Expanded operations required incremental personnel and their direct and indirect charges such as rent and office overhead costs and associated fees for professional services, computer maintenance and software. At year end 2010, the Company had eighteen full time personnel compared to sixteen people at the end of 2009, plus full and part time consultants in both years.

The Company's policy of allocating and capitalizing costs associated with new capital projects was unchanged in 2010 compared to 2009. During 2010, the Company allocated $1.3 million of administrative costs to capital projects and operating costs, compared to $0.6 million during 2009. The portion allocated to capital projects was in accordance with common industry practice whereby an operator calculates and allocates overhead to each working interest partner in proportion to their ownership interest, based on 100% of the capital expenditures. Increased cost allocations in 2010 reflect the increased operated capital expenditure levels, compared to the prior year. General and administrative costs capitalized in the year ended December 31, 2010, was $1.5 million, compared to $1.0 million during 2009, directly reflecting increased exploration staff.

OTHER TAXES

Other taxes, which consist entirely of the Saskatchewan resource surcharge, were $0.8 million in 2010, compared to $0.4 million in 2009. As the gross oil sales increase in 2011, capital taxes are expected to correspondingly increase.*

**This paragraph contains forward-looking information. Please refer to "Forward-looking Information" and "Business Risks, Uncertainties and Forward-looking Information" for a discussion of the risks and uncertainties related to such information.*

Other Taxes *($000s)*

Years ended December 31,	2010	2009
Saskatchewan resource surcharge	**822**	382

OTHER INCOME

Painted Pony invests cash in short-term term deposits and interest-bearing deposit accounts, generating interest income. In 2010 and 2009, interest income was comparatively flat at $0.1 million each year.

Other income is processing, compression, salt water disposal fees and rentals of tubular pipe. In 2010 compression fees and tubular pipe rentals charged to third parties increased compared to 2009.

***Other Income** ($000s)*

Years ended December 31,	2010	2009
Interest income	**133**	72
Other income	**116**	62
	249	134

DEPLETION, DEPRECIATION AND ACCRETION

Depletion, depreciation and accretion expense in 2010 totaled $27.2 million and $16.7 million in 2009. On a per boe basis, the charge reduced in 2010 to $26.16 per boe from $29.49 per boe in 2009. In 2010, Painted Pony excluded $44.6 million (2009: $16.4 million) of undeveloped land and $1.0 million (2009: $0.8 million) of seismic costs from the depletion calculation.

***Depletion, Depreciation and Accretion Costs** ($000s, except per boe)*

Years ended December 31,	2010	2009
Depletion	**26,880**	16,506
Depreciation	**61**	38
Accretion	**253**	165
Total	**27,194**	16,709
Depletion, depreciation and accretion *($ per boe)*	**26.16**	29.49

Depletion rates reflect the all-in combined effect of land purchases, the asset acquisitions, investments in facilities and gathering systems plus drilling operations. Depreciation expense was recognized for office equipment, computer hardware and software and office furniture being depreciated on a 20% per annum declining balance basis. Increased accretion costs reflect the higher future retirement liabilities expected to be incurred from the incremental wells added through drilling activities and property acquisitions.*

**This paragraph contains forward-looking information. Please refer to "Forward-looking Information" and "Business Risks, Uncertainties and Forward-looking Information" for a discussion of the risks and uncertainties related to such information.*

STOCK-BASED COMPENSATION

Stock-based compensation costs were $6.1 million in 2010 and $4.5 million in 2009. The Company capitalized $1.3 million during the year ended December 31, 2010 and $0.9 million during 2009. The remainder of $4.8 million for 2010 and $3.5 million for 2009 was expensed. Stock-based compensation expense is a non-cash calculation, utilizing the Black-Scholes model, of the estimated cost associated with options granted to purchase Class A shares. This expense may not represent actual cash compensation realized by the recipients of the options upon the eventual exercise and disposition of these options.*

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In 2009, 1,389,000 options at a weighted average price of $6.15 per share were surrendered by various employees, consultants, officers and directors, and subsequently cancelled. The exercise prices associated with those options were significantly in excess of the trading price of the shares at that time. The decision to surrender the options was entirely voluntarily and no agreements or commitments were made to holders with respect to new options. In accordance with GAAP, all of the unamortized stock-based compensation relating to the options held by employees and directors that would have been recorded over the remaining vesting period was recorded in the period of cancellation. The effect of this cancellation required the recognition of $1.1 million of additional expense in 2009.

CAPITAL EXPENDITURES

Painted Pony expended $107.1 million in 2010 compared to $40.5 million in 2009 on exploration and development capital expenditures carrying out an active program with the participation in 45 (33.7 net) wells at an overall net success rate of 92% plus 6 (1.2 net) joint venture wells.

In Saskatchewan, $56.1 million of exploration and development expenditures was spent as the Company participated in the drilling of 36 (28.6 net) wells. At Huntoon, Midale, Kisbey, Flat Lake, and Weyburn areas 33 (25.8 net) horizontal Bakken oil wells were drilled, 1 (1.0 net) horizontal Mississippian well at Alameda and 2 (1.8 net) exploration wells in the Wapella area. A total of 3 (2.8 net) unsuccessful wells were encountered in the Wapella and Weyburn areas.

Two acquisitions of producing properties and one acquisition of undeveloped land were completed in 2010 in Saskatchewan for an estimated total cost of $12.8 million, including costs and adjustments. In 2009, the Company completed four separate acquisitions of primarily Bakken producing properties and undeveloped land, in Saskatchewan for a total cost of $13.6 million, including closing costs and adjustments.

In British Columbia, the Company invested $51.0 million of exploration and development expenditures to participate in the drilling of 9 (5.1 net) wells. Painted Pony drilled 2 (1.0 net) Buckinghorse shale gas wells, 2 (1.0 net) Bluesky/Cadomin wells, plus in the Blair/Town area, 2 (1.5 net) vertical wells and 3 (1.6 net) horizontal wells targeting the Montney. In addition, under the terms of the Cameron/Kobes joint venture, 6 (1.2 net) horizontal wells targeting the Montney formation were drilled. Painted Pony retains a 20% working interest in each joint venture well after electing to pay 20% of the equipping and tie-in costs.

Capital Expenditures *($000s)*

Years ended December 31,	2010	2009[1]
Lease acquisitions and retention	**27,543**	6,349
Seismic	**355**	804
Drilling and completions	**60,666**	23,943
Facilities and equipment	**18,550**	9,411
Exploration and development	**107,114**	40,507
Head office expenditures	**200**	56
	107,314	40,563
Property acquisition	**12,846**	13,588
Abandonment expenditures	**100**	50
	120,260	54,201
Stock-based compensation costs including tax effect	**1,754**	1,294
Asset retirement costs	**1,278**	508
Total expenditures	**123,292**	56,003

(1) For comparative purposes, 2009 data has been summarized to correspond to 2010 data.

The Company's land position continues to grow. At December 31, 2010, the Company owned 77,115 net acres of land (92% undeveloped) in Saskatchewan and 125,192 net acres of land (81% undeveloped) in British Columbia. Applications were made in 2010 and 2009 to address continuation of land in British Columbia, which is expected to be continued through execution of a work program.*

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CEILING TEST

The Company calculates a ceiling test annually whereby the carrying amount of petroleum and natural gas properties is compared to estimated future cash flows from the production of proved reserves. In 2010, the ceiling test was performed in accordance with the requirements of the CICA AcG-16 "Oil and Gas Accounting - Full Cost". The Company performed a ceiling test calculation at December 31, 2010, resulting in undiscounted future cash flows from proved reserves and unproved properties exceeding the carrying amount of oil and gas assets. Consequently, no impairment in oil and gas assets was identified.

At December 31, 2010, the Company calculated the ceiling test using weighted Canadian-dollar average prices of $94.03 per bbl for light gravity crude oil, $6.63 per mcf for natural gas, $81.52 per bbl for condensate, and $61.15 per bbl for NGL's. The future prices used in the ceiling test calculation are based on a benchmark commodity price forecast used by the Company's independent reserve evaluators as at December 31, 2010 and adjusted for transportation and quality differentials specific to the Company's reserves.

CAPITAL RESOURCES

At December 31, 2010, Painted Pony had a $65 million demand revolving credit facility with a Canadian chartered bank. In March 2011, the credit facility was increased to a $75 million demand revolving credit facility. The availability under the demand revolving credit facility is subject to a review on or before August 1, 2011.

Interest is payable at a floating rate, determined as the lender's prime rate, plus between 0.50% and 2.5%, depending on the Company's net debt to cash flow ratio as defined by the lender, on the outstanding balance. A standby fee is charged on 0.20% to 0.45% of the undrawn portion of the credit facility, depending on the Company's net debt to cash flow ratio as defined by the lender. Security is provided by a first fixed and floating charge debenture of $100 million on all of the Company's assets. Painted Pony has provided a negative pledge and undertaking to provide fixed charges over major petroleum and natural gas reserves in certain circumstances.

At March 28, 2011, Painted Pony has no debt under the credit facility. The Company drew on the demand credit facility briefly during the third quarter of 2010. There can be no assurance that the amount of the available demand credit facility will not be decreased.

LIQUIDITY

As at December 31, 2010, Painted Pony had current assets of $27.3 million and current liabilities of $28.5 million, resulting in a working capital deficiency of $1.2 million. Available cash has been, and is currently, on deposit in a major Canadian financial institution or invested in term deposits. Management has received confirmation from the financial institution that these funds are available on demand.

On February 17, 2011, the Company completed a bought-deal financing of 7,620,000 Class A shares at a price of $10.50 per share for total gross proceeds of $80.0 million.

At December 31, 2010, Painted Pony had a bank credit facility of $65 million, on which no balance was owed at December 31, 2010. In March 2011, the credit facility was increased to $75 million, on which no balance is currently owed. In 2011, the Company may utilize the available credit facility on a periodic basis.*

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Management anticipates that the Company will continue to have adequate liquidity to fund future working capital requirements and capital expenditures through a combination of cash flows, the availability of credit facility and investment capital. There exists uncertainty in the commodity, credit and capital markets, which the Company monitors in conjunction with its financing alternatives. The capital program will be reviewed, and adjusted if believed necessary based on commodity prices, perceived credit and investment capital availability and share price levels to support the Company's objectives of maintaining a net debt to funds flow from operations ratio of one times or less.*

**This paragraph contains forward-looking information. Please refer to "Forward-looking Information" and "Business Risks, Uncertainties and Forward-looking Information" for a discussion of the risks and uncertainties related to such information.*

COMMITMENTS

At December 31, 2010, the Company is committed to an estimated $1.9 million of minimum tolls for transportation of oil through a major carrier system beginning in 2010 and ending in 2015. The Company is also committed to future payments of $2.2 million for office space rental and a proportionate share of operating costs through 2015.

Subsequent to December 31, 2010, the Company further committed to minimum tolls for transportation of oil through a major carrier system estimated to begin in May 2011 and extending to May 2016 for total estimated costs of $1.2 million.*

**This section contains forward-looking information. Please refer to "Forward-looking Information" and "Business Risks, Uncertainties and Forward-looking Information" for a discussion of the risks and uncertainties related to such information.*

The Company's estimated commitments as at December 31, 2010 for the next five years are summarized below:

Commitments *($000s)*	**2011**	**2012**	**2013**	**2014**	**2015**
Transportation of oil	641	522	363	250	82
Operating lease - office space	623	623	443	263	240
Total	1,264	1,145	806	513	322

SHARE CAPITAL

In 2010 and 2009, Painted Pony issued the following shares, exclusive of shares issued on exercise of options:

- *On June 30, 2009, a bought-deal financing for total gross proceeds of $20.0 million at a price of $2.85 per share for 7,000,000 Class A shares was completed.*

- *On November 17, 2009, a bought-deal financing for total gross proceeds of $51.7 million at a price of $5.88 per share for 8,800,000 Class A shares was completed.*

- *On August 25, 2010, a bought-deal financing for total gross proceeds of $44.1 million at a price of $6.48 per share for 6,800,000 Class A shares was completed.*

Insiders purchased shares in each of the above detailed bought-deal financings on the same terms and conditions as other shareholders. As at December 31, 2010, 51,016,700 Class A shares and 1,173,600 Class B shares were issued and outstanding.

The Company is authorized to issue an unlimited number of Preferred Shares, issuable in series. As at December 31, 2010 and March 28, 2011, no Preferred Shares were outstanding.

The Company has a stock option plan (the "Plan") whereby options to purchase Class A Shares may be granted by the Board of Directors to directors, officers, and employees of, and consultants to, the Company. The Plan has reserved for issuance a number of Class A Shares equal to ten percent of the aggregate number of Class A Shares and Class B Shares issued and outstanding from time to time.

In 2010, a total of 10,000 options were forfeited, 135,000 options were exercised and an additional 1,938,920 options were granted. The options are exercisable over a five year period at a weighted-average price of $4.68 per share with generally one-third vesting immediately, one-third vesting one year from the date of grant, and one-third vesting two years from the date of grant. As at December 31, 2010, 4,548,920 options were issued and outstanding.

On February 17, 2011, the Company completed a bought-deal financing of 7,620,000 Class A shares at a price of $10.50 per share for gross proceeds of $80.0 million. In addition, in 2011 to-date, 549,373 Class A shares have been issued pursuant to the exercise of options and 77,980 options expired. As at March 28, 2011, 59,186,073 Class A shares and 1,173,600 Class B shares were issued and outstanding. As at March 28, 2011, 3,921,567 options were issued and outstanding at an average exercise price of $4.77.

INCOME TAXES

During 2010, the Company recorded future income tax expense of $2.4 million, primarily attributed to taxable income during the year. In 2009 the Company recognized a total future tax asset of $3.1 million for the estimated future value of its tax pools. During 2010, $2.2 million of the future tax asset was drawn down, leaving a future tax asset at the end of 2010 of $0.9 million. The Company believes it is more likely than not that these pools will be utilized.*

**This paragraph contains forward-looking information. Please refer to "Forward-looking Information" and "Business Risks, Uncertainties and Forward-looking Information" for a discussion of the risks and uncertainties related to such information.*

SUBSEQUENT EVENTS

On February 17, 2011, the Company issued 7,620,000 Class A shares at a price of $10.50 per share for gross proceeds of $80.0 million by way of a bought-deal financing.

Subsequent to December 31, 2010, the Company committed to an estimated minimum toll of $1.2 million for transportation of oil through a major carrier system, estimated to begin in May 2011 and end in May 2016.

In March 2011, the Company signed a letter of intent to acquire certain southeast Saskatchewan light oil properties from a private company for cash consideration of $7.7 million, before closing adjustments and related costs. The letter of intent is subject to a number of standard conditions and is expected to close on or about April 1, 2011.

DIVIDENDS

The Company has not declared or paid any dividends. Any decision to pay dividends on any of its shares will be made by the Board of Directors on the basis of earnings, financial requirements and other conditions existing at such future time.

FOURTH QUARTER PERFORMANCE

NET EARNINGS AND FUNDS FLOW FROM OPERATIONS

Funds flow from operations during the fourth quarter of 2010 was $10.4 million, an increase of 49% over the comparable quarter in 2009 when funds flow from operations was $7.0 million. On a basic and diluted per share basis, funds flow from operations in the fourth quarter of 2010 was $0.20 and $0.19 compared to $0.17 and $0.16 per share, basic and diluted, in the comparable quarter in 2009.

In the fourth quarter of 2010, cash flow from operating activities was $10.2 million, compared to 2009 fourth quarter cash flow of $6.2 million. The Company reconciles funds flow from operations to cash flow from operating activities, which is the most directly comparable measure calculated in accordance with GAAP, as follows:

($000s)

Three months ended December 31,	2010	2009
Cash flow from operating activities	**10,183**	6,157
Changes in non-cash working capital	**204**	823
Asset retirement expenditures	**7**	1
Funds flow from operations	**10,394**	6,981

In the last quarter of 2010, the Company recorded net earnings of $1.4 million compared to fourth quarter 2009 net earnings of $2.0 million. The fourth quarter 2009 net earnings included a future tax reduction of $1.1 million primarily to recognize future tax assets.

SALES VOLUMES

Sales volumes for the fourth quarter of 2010 averaged 3,443 boe per day compared to 2,006 boe per day in the same 2009 period, an increase of 72%. In the last quarter of 2010, the commodity mix was weighted 51% oil, 47% gas and 2% condensate and NGL's. In comparison, in the fourth quarter of 2009, Painted Pony's sales averaged, 71% oil, 27% gas and 2% associated products.

Average Daily Sales Volumes

Three months ended December 31,	2010	2009
Oil *(bbls/d)*	**1,739**	1,427
Condensate *(bbls/d)*	**34**	23
NGL's *(bbls/d)*	**57**	21
Gas *(mcf/d)*	**9,678**	3,211
Total *(boe/d)*	**3,443**	2,006

Oil sales in the fourth quarter of 2010 averaged 1,739 bbls per day, an increase of 22% compared to the fourth quarter 2009 average oil sales of 1,427 bbls per day. Gas sales in the three months ending December 31, 2010 averaged 9,678 mcf per day, an increase of 201% over the same 2009 quarter, and 22% greater than the 2010 third quarter rate.

Fourth quarter 2010 gas sales are attributable to incremental sales on the Company's operated and joint venture Montney operations subsequent to completion of additional compression and dehydration facilities in the Cameron/Kobes and Gundy/Town areas.

Natural gas liquids sales increased in the third and fourth quarters of 2010 subsequent to the completion of gas conservation facilities in the Huntoon and Midale areas.

REVENUES

During the fourth quarter of 2010, total revenues were $16.6 million, 43% higher than the last quarter of 2009 revenues of $11.6 million. Oil revenues in the last quarter of 2010 grew by 30% compared to the same quarter in 2009, reflecting the 22% increase in oil sales volumes and the 6% increase in the average per unit oil sales price. Gas sales increased in the fourth quarter of 2010 in comparison to 2009 by 124%, reflecting 201% greater volumes somewhat offset by a 26% decrease in the per unit gas sales price.

Sales by Product *($000s)*

Three months ended December 31,	2010	2009
Oil	**12,868**	9,931
Gas	**3,272**	1,461
Condensate, NGL and sulphur	**481**	220
Total	**16,621**	11,612

REALIZED PRICES

For the three months ending December 31, 2010, Painted Pony received an average crude oil price of $80.43 per bbl, 6% higher than the average price of $75.63 per bbl received during the comparable 2009 period. The Edmonton par reference price for light oil during the fourth quarter of 2010 and 2009 respectively was $80.86 per bbl and $77.17 per bbl.

In the fourth quarter of 2010, the Company received an average gas price of $3.67 per mcf compared to $4.94 per mcf received in the fourth quarter of 2009. The AECO daily spot price for the fourth quarter of 2010 was $3.65 per mcf compared to $4.59 per mcf for the fourth quarter of 2009.

Average Benchmark Prices

Three months ended December 31,	2010	2009
Oil - Edmonton par - light oil *($/bbl)*	**80.86**	77.17
Gas - AECO, daily spot *($/mcf)*	**3.65**	4.59

Painted Pony's Realized Prices

Three months ended December 31,	2010	2009
Oil *($/bbl)*	**80.43**	75.63
Gas *($/mcf)*	**3.67**	4.94

For both oil and gas, the average realized sales price per unit approximated, respectively, the Edmonton par price and AECO reference price. In the last quarter of 2010, Painted Pony received an average oil price of $80.43 per bbl, or 1% less than the Edmonton reference price of $80.86 per bbl. Similarly, the average natural gas price the Company received in the fourth quarter of 2010 was $3.67 per mcf, approximating the $3.65 per mcf AECO daily spot price.

ROYALTIES

In the fourth quarter of 2010, the Company paid $2.1 million in royalties, up 36% from the $1.6 million of royalties in the comparable quarter of 2009. Royalties were 12.9% of sales during the fourth quarter of 2010, compared to 13.5% in the last quarter of 2009.

Royalties as a % of Revenue

Three months ended December 31,	2010	2009
Crown	**1.2**	2.1
Freehold	**8.3**	7.8
GOR	**3.4**	3.6
	12.9	13.5

Royalties by Type *($000s, except per unit)*

Three months ended December 31,	2010	2009
Crown	**200**	246
Freehold	**1,384**	905
GOR	**556**	418
	2,140	1,569
Royalties *($ per boe)*	**6.76**	8.50

TRANSPORTATION COSTS

Transportation costs were $1.0 million and $0.7 million, respectively, for the fourth quarters of 2010 and 2009.

Transportation by Commodity *($000s, except per unit)*

Three months ended December 31,	2010	2009
Oil	**231**	207
Gas and associated liquids	**740**	541
Net	**971**	748
Oil *($/bbl)*	**1.44**	1.57
Gas and associated liquids *($/boe)*	**4.72**	10.16
Transportation cost *($/boe)*	**3.07**	4.05

Oil transportation costs per unit in Saskatchewan declined throughout 2010, averaging $1.44 per bbl in the fourth quarter of 2010, compared to $1.57 per bbl in the same period of 2009, as investments in flow-lines in Saskatchewan helped reduce trucking costs.

Transportation costs for gas and associated liquids of $4.72 per boe declined compared to transportation costs of $7.01 per boe in the third quarter of 2010 and $10.16 per boe in the fourth quarter of 2009. Per unit transportation costs for gas and associated liquids began to drop mid-year 2010 as the Company ceased to pay excess capacity charges under a firm service contract as the sale of gas increased.

OPERATING COSTS

In the fourth quarter of 2010, operating costs totaled $2.2 million ($7.10 per boe), compared to $1.7 million ($9.25 per boe) in the last quarter of 2009.

Operating Costs *($000s, except per unit)*

Three months ended December 31,	2010	2009
Oil	**1,743**	1,384
Gas and associated liquids	**507**	323
Production expenses	**2,250**	1,707
Oil *($/bbl)*	**10.89**	10.54
Gas and associated liquids *($/boe)*	**3.23**	6.06
Operating cost *($/boe)*	**7.10**	9.25

Fourth quarter per unit costs for gas properties have decreased in 2010 compared to the prior year, reflecting the voluntary shutting in of higher operating cost gas wells in British Columbia and an increased production base. Per unit costs for oil properties increased in the fourth quarter of 2010 compared to the fourth quarter of 2009, primarily due to workovers conducted during the fourth quarter of 2010, partially offset by lower trucking and salt water disposal costs.

OPERATING NETBACKS

During the fourth quarter of 2010, Painted Pony generated field operating netbacks of $35.54 per boe, compared to $41.10 per boe in the same quarter of 2009.

Combined Field Operating Netback *($/boe)*

Three months ended December 31,	2010	2009
Sales	**52.47**	62.90
Transportation	**(3.07)**	(4.05)
Royalties	**(6.76)**	(8.50)
Operating costs	**(7.10)**	(9.25)
Field operating netback	**35.54**	41.10

Netbacks by Commodity

Three months ended December 31,	2010	2009
Oil *($/bbl)*	**55.83**	52.86
Gas and associated products *($/boe)*	**14.84**	12.14

The field operating netback in the fourth quarter of 2010 declined by 14% in comparison to the fourth quarter of 2009, despite increased netbacks for both oil and gas and associated products, due to the change in production mix, as the higher netback commodity (oil) made up 71% of the product mix in the 2009 period compared to 51% in the fourth quarter of 2010.

GENERAL AND ADMINISTRATIVE

In the fourth quarter of 2010, the net general and administrative costs were $0.7 million ($2.29 per boe) compared to $0.5 million ($2.49 per boe) in the fourth quarter of 2009. Gross general and administrative costs were approximately $0.2 million higher in the fourth quarter of 2010 than in the third quarter, due to a bonus paid in the fourth quarter. On a per production unit basis, net general and administrative costs were lower in the fourth quarter of 2010 reflective of the production volume growth.

***General and Administrative Costs** ($000s, except per boe)*

Three months ended December 31,	2010	2009
Gross costs	**1,591**	865
Capitalized	**(467)**	(209)
Recoveries	**(397)**	(195)
Net costs	**727**	461
Net G&A *($ per boe)*	**2.29**	2.49

OTHER ITEMS

Depletion, depreciation, and accretion expense in the fourth quarter of 2010 was $7.1 million ($22.55 per boe) compared to $5.7 million ($31.06 per boe) in the fourth quarter of 2009, and $24.77 per boe in the third quarter of 2010, reflecting the generation of additional proven reserves throughout 2010.

In the fourth quarter of 2010 and 2009, other taxes, made up of the Saskatchewan resource surcharge were $0.2 million, primarily reflecting oil sales revenues in Saskatchewan.

The Company continued to earn interest income in the fourth quarter of 2010 as available cash balances were invested. Fourth quarter 2010 expense for stock-based compensation was $1.0 million compared to $0.4 million in the fourth quarter of 2009, reflecting the higher exercise price and resulting fair value for options granted in 2010.

Painted Pony exited 2010 with no bank debt. As at December 31, 2009, Painted Pony was also not drawn on the credit facility.

CAPITAL EXPENDITURES

During the fourth quarter of 2010, Painted Pony invested $35.1 million on capital projects. In the comparable 2009 quarter, the Company invested $16.9 million. Painted Pony expended $21.3 million in the fourth quarter of 2010 compared to $16.5 million in the same 2009 period on exploration and development capital expenditures. In the fourth quarter of 2010, exploration and development expenditures in Saskatchewan were $14.9 million to drill 9 (5.5 net) wells, $6.4 million in British Columbia to drill 2 (0.8 net) wells plus 2 (0.4 net) wells drilled under the terms of the British Columbia joint venture. In the fourth quarter of 2010, the Company spent $12.8 million on property acquisitions in Saskatchewan.

***Capital Expenditures** ($000s)*

Three months ended December 31,	2010	2009[1]
Lease acquisitions and retention	**1,732**	5,365
Seismic	**77**	-
Drilling and completions	**12,616**	6,942
Facilities and equipment	**6,917**	4,149
Exploration and development	**21,342**	16,456
Head office expenditures	**15**	27
	21,357	16,483
Property acquisition	**12,846**	1
Abandonment expenditures	**7**	1
	34,210	16,485
Stock-based compensation costs including tax effect	**396**	346
Asset retirement costs	**526**	112
Total expenditures	**35,132**	16,943

(1) For comparative purposes, 2009 data has been summarized to correspond to 2010 data.

OFF BALANCE SHEET ARRANGEMENTS

No off balance sheet arrangements existed as at December 31, 2010 or 2009.

RELATED PARTY TRANSACTIONS

The Company utilizes the services of a law firm in which the Corporate Secretary is a Partner. During the year ended December 31, 2010, the Company incurred $188,000 (2009: $198,000) on services, excluding disbursements. All related party transactions have been measured at the agreed to terms and exchange values, being the consideration established and agreed to by the parties.

FINANCIAL INSTRUMENTS AND OTHER INSTRUMENTS

The fair values of the Company's cash and cash equivalents, accounts receivables and accounts payables and accrued liabilities approximate their carrying amounts due to the short-term nature of these financial instruments. To date, the Company has not participated in any risk management contracts or commodity price contracts.

The Company's accounts receivables are primarily with industry partners and are subject to normal industry credit risks. The Company extends unsecured credit to these entities, and therefore, the collection of any receivables may be affected by changes in the economic environment or other conditions. Management believes the risk is mitigated by the financial position of the entities.*

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PERFORMANCE COMPARED TO GUIDANCE*

Readers are reminded that forward-looking information in this document is subject to significant risks and uncertainties and is based on a number of material factors and assumptions which may prove to be incorrect. A comparison of performance in 2010 and in the fourth quarter of 2010 to previously announced guidance by the Company follows.

- *The Company indicated that while Huntoon gas and NGL sales were restricted in the third quarter of 2010 to approximately 20% of estimated capacity, sales were expected to increase as expanded gas sales line capacity was installed in the fourth quarter 2010. By December, sales of gas and NGL's contributed an incremental 11% of Huntoon sales volumes.*

- *The Company indicated it expected sales volumes in 2010 to be weighted approximately 40% toward gas sales. Actual gas sales in 2010 contributed 39% of total sales volumes.*

- *The Company indicated it generally expected the average oil price in 2010 to be approximately equal to or slightly less than the Edmonton par reference price. In 2010, Painted Pony received a weighted average price of $77.84 per bbl which is approximately the Edmonton par light oil reference price of $77.88 per bbl.*

- *The Company indicated it expected to receive a natural gas price similar to the AECO daily spot price. In 2010, Painted Pony was paid a weighted average price of $3.94 per mcf compared to a $4.00 per mcf AECO daily spot price. Similarly, in the fourth quarter of 2010, Painted Pony received a weighted average price of $3.67 per mcf compared to an AECO price of $3.65 per mcf.*

- *The Company indicated it expected fourth quarter 2010 royalty rates to be similar to the first three quarter rates. In the fourth quarter, overall royalties averaged 12.9% of revenue compared to 13.0% in the first three quarters. In the first three quarters of 2010, oil royalties were 14.5% of sales, while gas and associated product royalties averaged 5.2%. During the fourth quarter of 2010, royalties for oil averaged 15.2% of sales and for gas and associated products, royalties averaged 4.8%. The slightly higher royalties for oil and lower royalties for gas and associated products correlate to the differences in the commodity prices.*

- *The Company indicated it expected the per unit oil transportation costs to decline as additional oil is delivered into the pipelined sales system. Fourth quarter 2010 oil transportation costs averaged $1.44 per bbl compared to third quarter costs of $1.67 per bbl, with some savings attributable to third quarter incremental trucking costs incurred to remedy pipeline restrictions.*

- *The Company indicated it expected per unit gas transportation costs in the fourth quarter of 2010 to approximate the third quarter costs of $7.01 per boe. Actual transportation costs in the fourth quarter averaged $4.72, reflecting savings from increased gas volumes.*

- *The Company indicated it expected at the end of 2010 that gas and liquids conservation would commence in the Midale area and Huntoon gas and NGL sales would increase with the expansion of the gas sales lines. In the Midale area, gas and liquids were sold in December and in the Huntoon area volumes increased in December.*

- *The Company indicated it expected increased sales volumes in the fourth quarter would help minimize per unit general and administration cost increases. The actual net per boe cost for the fourth quarter of 2010 averaged $2.29 compared to $2.48 per boe in the third quarter, despite a 19% increase in gross costs.*

- *The Company indicated it expected that as gross Saskatchewan revenues varied, the Saskatchewan resource surcharge was expected to change accordingly. In the fourth quarter of 2010, as the gross Saskatchewan revenue increased, the expected increase in the resource surcharge was realized.*

- *The Company indicated it expected increased accretion expense from incremental wells as additional drilling and acquisitions result in larger future retirement liabilities. This expectation was realized in the fourth quarter of 2010 due to both drilling activities and acquisitions.*

- *The Company indicated it expected a 50% Cadomin well drilled early in 2010 to be placed on production in the first quarter of 2011. Tie-in is now expected to be later in 2011 as compressor capacity becomes available.*

- *The Company indicated it expected one (0.2 net) vertical well drilled under the joint venture in the Cameron/Kobes area to be on production in the fourth quarter of 2010. This well is not on production yet due to capacity limitations at the area facility. Of the three horizontal wells drilled in the first half of 2010, one (0.2 net) was expected to commence sales late in the fourth quarter. Two of the three wells are currently on production.*

- *The Company indicated a number of continuation applications submitted would allow some lands approaching expiry in British Columbia to be continued through execution of a work program. The Company remains confident in this belief based on pending and completed efforts toward this end. To-date, a number of tracts of land have received continuations through successfully completing work programs.*

- *The Company indicated it believed the work programs forming the basis of continuation applications for lands in British Columbia would be completed. Several projects have been completed and others remain ongoing at this time.*

- *The Company indicated it believed the tax pools for which tax assets have been recorded will be utilized. During the fourth quarter of 2010, a portion of the future tax asset has been utilized, and the Company continues to expect the remaining tax pools will be utilized.*

- *The Company indicated that the available credit facility may be utilized on a periodic basis in 2010. Early in the third quarter of 2010, the revolving facility was utilized on a periodic basis.*

- *The Company indicated it believed the risk of accounts receivables becoming uncollectible is mitigated by the financial position of the applicable entities. To date, no allowance for doubtful accounts has been provided for.*

- *The Company indicated it believed it has sufficient financial resources with which to conduct its capital program; further, this is subject to the additional assumption that the drilling rigs, field service providers, completion and tie in equipment will be available as required and that the costs of securing such services and equipment will not materially exceed expectations. This expectation continues.*

**This section contains forward-looking information. Please refer to "Forward-looking Information" and "Business Risks, Uncertainties and Forward-looking Information" for a discussion of the risks and uncertainties related to such information.*

INTERNATIONAL FINANCIAL REPORTING STANDARDS ("IFRS")

On January 1, 2011 International Financial Reporting Standards ("IFRS") will become the generally accepted accounting principles in Canada. The adoption date of January 1, 2011 will require the restatement, for comparative purposes, of amounts reported by Painted Pony for the year ended December 31, 2010, including the opening balance sheet as at January 1, 2010.

The Company's financial statements up to and including the December 31, 2010 financial statements will be reported in accordance with Canadian Generally Accepted Accounting Principles ("GAAP") as it exists on each reporting date. Financial statements for the quarter ended March 31, 2011, including comparative amounts, will be prepared on an IFRS basis. The conversion to IFRS will require the restatement, for comparative purposes, of amounts reported by the Company for the year ended December 31, 2010, including an opening balance sheet as at January 1, 2010. There are significant differences between IFRS and Canadian GAAP, as well as a number of accounting policy choices and increased disclosure requirements under IFRS. The conversion to IFRS is a significant undertaking and may materially impact the Company's reported financial operating results and position.

During 2009, the Company commenced its IFRS conversion project, established an IFRS transition plan, completed the initial Planning phase of the transition plan, and commenced the other two phases of the transition plan - Analysis and Decision-Making and Implementation.

The project to convert to IFRS is currently staffed by Company employees who are accounting professionals and aided by an accounting professional on a full-time consulting basis. In addition, two external advisors are being utilized to work with the internal accounting professionals, on an as-needed basis, to advise on policy decisions and alternatives. All have attended IFRS educational programs and continue to collectively review and develop the Company's policies for adoption of IFRS. The Company's auditors have been, and will continue to be, involved throughout the process to ensure the Company's policies are in accordance with these new standards. Regular reporting is provided to the Board of Directors.

The second phase, Analysis and Decision-Making, is underway, and involves an in-depth analysis and evaluation of the financial impacts of various alternatives provided for under IFRS, selection of accounting policies, identification of effects on operational and business processes, analysis of disclosure requirements, an analysis of the optional exemptions and mandatory exceptions of IFRS 1, First-Time Adoption of International Financial Reporting Standards (IFRS 1) for full retrospective application upon transition to IFRS; and development of solutions to address the issues identified.

Phase three is Implementation, which is determining business process changes required and establishing a framework for enacting those changes, conducting training programs across the Finance Department and other affected areas of the business, and preparing opening IFRS balances as at January 1, 2010. This phase also involved the compilation of financial information necessary to assemble comparative IFRS financial statements and reconciliations and IFRS internal business processes. Information systems changes that address the Company's needs have been made.

IFRS 1 provides entities adopting IFRS for the first time with a number of optional exemptions and mandatory exceptions in certain areas, to the general requirement of full retrospective application of IFRS. Most adjustments required on transition to IFRS will be made retrospectively against opening retained earnings in the first comparative balance sheet.

The major differences between Canadian GAAP and IFRS applicable to the Company and some preliminary decisions are as follows:

(a) Exploration and evaluation ("E&E") expenditures:

On transition to IFRS, the Company intends to reclassify all E&E expenditures that are currently included in the property and equipment ("PP&E") balance on the consolidated balance sheet. These expenditures include the historical cost of undeveloped land and unevaluated seismic data that relates to exploration projects. These E&E costs under IFRS may either be expensed or capitalized. **The Company has determined that it will capitalize these E&E expenditures.**

Under IFRS, E&E assets are not usually depleted, but must be assessed for impairment when facts or circumstances indicate that an impairment may exist. This is when the facts suggest that the carrying amount of an asset may exceed its recoverable amount. Furthermore, when an E&E asset is transferred to development, an impairment test must be conducted.

(b) Depletion expense:

Under IFRS, the full cost pool under Canadian GAAP must be broken down into economic units and components then depleted. IFRS allows depletion to be calculated using either proven reserves or using proven and probable reserves. Under this election, future development costs associated with the probable reserves are included in the depletion base. **The Company has determined that it will calculate and record depletion using proven plus probable reserves.**

(c) Depreciation and componentization:

Under IFRS, each item of property, plant and equipment with a cost that is significant in relation to the total cost of the item shall be depreciated separately. This standard is primarily intended to refer to facilities where significant components have a useful life different than the remainder of the facility in question. As part of a detailed review of Company assets and the expected life of each, the Company has determined that no facility component is considered significant relative to the total cost of the facility. In addition, the useful life of the facility is considered approximately the same as the reserve life of the fields serviced by the facility. **Accordingly, the Company has determined the use of Componentization for current facilities is not necessary for depreciation purposes at this time.**

(d) Adoption of IFRS 1 exemption:

The IASB has implemented an amendment to IFRS 1 that will permit oil and gas entities to apply IFRS prospectively by utilizing its current reserves at the transition date to allocate the Company's full cost pool, with the provision that an impairment test, under IFRS standards, be conducted at the transition date. Property, plant and equipment values at the amount determined under the entity's previous GAAP can be allocated on a pro-rata basis using reserve volumes or reserve values as of that date. **The Company has determined that it will utilize this IFRS 1 election and allocate the full cost pool carrying value to Cash Generating Unit ("CGU") and component levels using proven plus probable reserve values.**

(e) Impairment of property and equipment:

The full cost pool under Canadian GAAP must be broken down into cash generating units ("CGU's"), which are the smallest group of assets capable of generating independent cash inflows. **The Company has determined that at the year ended December 31, 2009, it has two CGU's, Saskatchewan and British Columbia.** The cash generating units must be tested for impairment when indicators of impairment exist. The impairment test is based on the greater of "value in use" or "fair value less costs to sell."

Under IFRS, the carrying value is compared to value-in-use of the assets which is a discounted cash flow measure. As a result, impairments may be recorded more frequently under IFRS. Should impairment losses occur, they may be reversed in the future if circumstances change.

(f) Provisions and contingent assets and liabilities:

IFRS requires a provision to be recognized when there is a present obligation as a result of a past transaction or event; it is probable that an outflow of resources will be required to settle the obligation; and a reliable estimate can be made of the obligation. The threshold for recognition of a provision under Canadian GAAP is higher (70%) than under IFRS (50%). Therefore, it is possible that some contingent liabilities not recognized under Canadian GAAP may meet the recognition criteria under IFRS. Furthermore, IFRS requires the use of best estimates, mid-points, or probabilistic weighted averages as the measurement method. **The Company has not yet completed the identification of all contingent assets and liabilities which may require recognition under IFRS.**

(g) Asset retirement obligations:

Under Canadian GAAP, the discount rate used in determining the value of asset retirement obligations is the credit adjusted risk-free rate applicable to the Company. Under IFRS, the discount rate used must reflect the risks specific to the obligation or liability; i.e. either cash flows or the interest rate should be risked in calculating the asset retirement obligation. It is expected that the discount rate used for asset retirement obligations under IFRS will be a lower rate than that used under Canadian GAAP, thereby increasing the liability. **Painted Pony has determined it will use the risk-free rate. The appropriate discount rate to be used is still being evaluated.**

Finally, the recalculated accretion expense under IFRS will be classified as interest expense (finance costs), as opposed to accretion expense (depletion, depreciation and accretion expense). As the Company plans to utilize the IFRS 1 full-cost exemption, the Company expects to recognize any adjustment to retained earnings at January 1, 2010. The Company has yet to determine the full impact that IFRS will have on its asset retirement obligation.

(h) Income taxes:

Income taxes prescribes that an entity accounts for the tax consequences of transactions and other events in the same way that it accounts for the transactions and other events themselves. Therefore, where transactions and other events are recognized in earnings, the recognition of deferred tax assets or liabilities which arise from those transactions should also be recorded in earnings. For transactions that are recognized outside of the statement of earnings, either in other comprehensive income or directly in equity, any related tax effects should also be recognized outside the statement of earnings. **The Company is still analyzing the implications of this standard.**

(i) Stock-based compensation expense:

Share-based payment awards will continue to be measured at fair value, with compensation expense under the Company's stock option plans recognized over the service period. Under IFRS, the Company is required to treat each tranche of options as a separate arrangement and utilize a graded fair value model. An optional exemption exists for share-based payments allowing an exemption for those options which vested before Painted Pony's transition date to IFRS. **The Company will use this exemption.**

Additionally, under IFRS, a forfeiture rate must be included in the initial expense calculation, and adjusted prospectively if required, rather than accounting for forfeitures as they occur. For the Company's equity-settled plan, the Company will continue to recognize a corresponding increase in equity.

(j) Disclosures:

IFRS requires significant disclosures for accounting policies, use of IFRS 1 optional exemptions, and use of IFRS 1 mandatory exceptions. It is expected that the IFRS disclosures for the Company will be substantial, as the basis of substance over form reflected in IFRS will require more detailed disclosures than Canadian GAAP requires.

The Company is in the process of finalizing a number of accounting policies as well as preparing IFRS opening balances and related statements including the required disclosures. The Company's external auditors are currently scheduled to commence their procedures early in the second quarter of 2011.

Given the progress of the project and outcomes identified, the Company may revise its intentions between the time of communicating these key milestones and the changeover date. Further, changes in regulation or economic conditions at the date of the changeover or throughout the project could result in changes to the transition plan being communicated here.

The Company continues to monitor standards development as issued by the International Accounting Standards Board ("IASB") and the Accounting Standards Board, as well as regulatory developments as issued by the Canadian Securities Administrators ("CSA"), which may affect the timing, nature or disclosure of the adoption of IFRS.

CRITICAL ACCOUNTING ESTIMATES*

The reader is cautioned that the preparation of financial statements in accordance with GAAP requires management to make certain judgments and estimates that affect the reported amounts of assets, liabilities, revenues and expenses. Estimating reserves is also critical to several accounting estimates and requires judgments and decisions based upon available geological, geophysical, engineering and economic data. Estimated reserves are also utilized by Painted Pony's bank in determining credit facilities. Reserves affect net income through depletion, site restoration and abandonment estimates and the ceiling test calculation. Estimating reserves is very complex, requiring many judgments based on available geological, geophysical, engineering and economic data. Changes in these judgments could have a material impact on the estimated reserves. These estimates may change, having either a negative or positive effect on net earnings as further information becomes available, and as the economic environment changes. Changes in these judgments and estimates could have a material impact on the financial results and financial condition of the Company. The MD&A outlines the accounting policies and practices that are critical to determining Painted Pony's financial results. The Company's management reviews its estimates regularly.

In following the liability method of accounting for income taxes, related assets and liabilities are recognized for the estimated tax consequences between amounts included in the financial statements and their tax base, using substantively enacted future income tax rates. Timing of future revenue streams and future capital spending changes can affect the timing of any temporary differences, and accordingly affect the amount of the future income tax liability calculated at a point in time. These differences could materially impact earnings.

The Black-Scholes option valuation model was developed for use in estimating the fair value of options, which were fully tradable with no vesting restrictions. This option valuation model requires the input of assumptions including the expected stock price volatility. Because the Company's stock options have characteristics significantly different from those of traded options and because changes in the input assumptions can materially affect the calculated fair value, such value is subject to measurement uncertainty.

With the above risks and uncertainties, the reader is cautioned that future events and results may vary substantially from that which the Company currently foresees.

**This section contains forward-looking information. Please refer to "Forward-looking Information" and "Business Risks, Uncertainties and Forward-looking Information" for a discussion of the risks and uncertainties related to such information.*

LEGAL, ENVIRONMENTAL, REMEDIATION AND OTHER CONTINGENT MATTERS

The Company reviews legal, environmental, remediation and other contingent matters to both determine whether a loss is probable based on judgment and interpretation of laws and regulations, and determine that the loss can reasonably be estimated. When the loss is determined, it is charged to earnings. The Company's management monitors known and potential contingent matters and makes appropriate provisions by charges to earnings when warranted by circumstances.

BUSINESS RISKS, UNCERTAINTIES AND FORWARD-LOOKING INFORMATION*

Statements in this document may contain forward-looking information including expectations of future production, components of cash flow and earnings, expected future events and/or financial results that are forward-looking in nature and subject to substantial risks and uncertainties. The reader is cautioned that assumptions used in the preparation of such information may prove to be incorrect. The Company cautions the readers that actual performance will be affected by a number of factors, many of which may respond to changes in economic and political circumstances throughout the world. Events or circumstances may cause actual results to differ materially from those predicted, a result of numerous known and unknown risks, uncertainties, and other factors, many of which are beyond the control of the Company. These risks include, but are not limited to, the risks associated with the oil and gas industry, and changes to commodity prices and interest and foreign exchange rates. Industry related risks could include, but are not limited to, operational risks in exploration, development and production, delays or changes in plans, risks associated with the uncertainty of reserve estimates, health and safety risks and the uncertainty of estimates and projections of production, costs and expenses. These external factors beyond the Company's control may affect the marketability of oil and natural gas produced, industry conditions including changes in laws and regulations, changes in income tax regulations, increased competition, fluctuations in commodity prices, interest rates, and variations in the Canadian/United States dollar exchange rate. The reader is cautioned not to place undue reliance on this forward-looking information.

Painted Pony's production and exploration activities are concentrated in the Western Canadian Sedimentary Basin, where activity is highly competitive and includes a variety of different sized companies ranging from smaller junior producers to the much larger integrated petroleum companies. Painted Pony is subject to the various types of business risks and uncertainties including:

- *Finding and developing oil and natural gas reserves at economic costs;*
- *Production of oil and natural gas in commercial quantities; and*
- *Marketability of oil and natural gas produced.*

In order to reduce exploration risk, the Company strives to employ highly qualified and motivated professional employees with a demonstrated ability to generate quality proprietary geological and geophysical prospects. To help maximize drilling success, Painted Pony combines exploration in areas that afford multi-zone prospect potential, targeting a range of low to moderate risk prospects with some exposure to select high-risk plays with high-reward opportunities. Painted Pony also explores in areas where the Company's officers and employees have significant drilling experience.

The Company mitigates its risk related to producing hydrocarbons through the utilization of the most appropriate technology and information systems. In addition, Painted Pony seeks operational control of its projects, where feasible.

Oil and gas exploration and production can involve environmental risks such as pollution of the environment and destruction of natural habitat, as well as safety risks such as personal injury. In order to mitigate such risks, Painted Pony conducts its operations at high standards and follows safety procedures intended to reduce the potential for personal injury to employees, contractors and the public at large. The Company maintains current insurance coverage for general and comprehensive liability as well as limited pollution liability. The amount and terms of this insurance are reviewed on an ongoing basis and adjusted as necessary to reflect changing corporate requirements, as well as industry standards and government regulations. Painted Pony may periodically use financial or physical delivery hedges to reduce its exposure against the potential adverse impact of commodity price volatility, as governed by formal policies approved by senior management, subject to controls established by the Board of Directors.

**This section contains forward-looking information. Please refer to "Forward-looking Information" and "Business Risks, Uncertainties and Forward-looking Information" for a discussion of the risks and uncertainties related to such information.*

ADDITIONAL INFORMATION

Additional information regarding the Company and its business and operations is available on the Company's profile at www.sedar.com. Copies of the information can also be obtained by contacting the Company at Painted Pony Petroleum Ltd., 300, 602 - 12 Avenue SW., Calgary, Alberta T2R 1J3 (Phone 403 475-0440), by email at info@paintedpony.ca or on the Company's website at www.paintedpony.ca.

SELECTED CONSOLIDATED QUARTERLY INFORMATION

The following table sets forth selected consolidated financial information of the Company for the most recently completed quarters ending at the fourth quarter of 2010.

Quarter ended *(unaudited)* *($000s, except volumes and per share)*	**Mar. 31, 2010**	**June 30, 2010**	**Sept. 30, 2010**	**Dec. 31, 2010**
Gross revenues[1]	**14,146**	**12,752**	**14,764**	**16,621**
Funds flow from operations	**9,166**	**7,647**	**9,072**	**10,394**
Basic, per share	**0.20**	**0.17**	**0.19**	**0.20**
Diluted, per share	**0.20**	**0.16**	**0.18**	**0.19**
Cash flow from operating activities	**9,231**	**8,298**	**7,648**	**10,183**
Net earnings (loss)	**681**	**350**	**(510)**	**1,373**
Basic and diluted, per share	**0.01**	**0.01**	**(0.01)**	**0.03**
Capital expenditures, net	**34,424**	**31,878**	**19,655**	**21,357**
Capital acquisitions, net	**-**	**-**	**-**	**12,846**
Working capital (deficiency)	**15,639**	**(8,592)**	**22,454**	**(1,205)**
Total assets	**185,645**	**173,995**	**218,282**	**234,197**
Long-term liabilities (ARO)[2]	**2,829**	**2,948**	**3,275**	**3,970**
Average daily sales volumes *(boe per day)*	**2,322**	**2,532**	**3,080**	**3,443**

(1) Petroleum and natural gas sales, before royalties and transportation, excluding interest and other income.
(2) Asset retirement obligations.

Quarter ended *(unaudited)* *($000s, except volumes and per share)*	**Mar. 31, 2009**	**June 30, 2009**	**Sept. 30, 2009**	**Dec. 31, 2009**
Gross revenues[1]	4,560	4,889	7,834	11,612
Funds flow from operations	1,890	1,826	4,513	6,981
Basic, per share	0.05	0.06	0.12	0.17
Diluted, per share	0.05	0.06	0.12	0.16
Cash flow from operating activities	1,499	531	4,273	6,157
Net earnings (loss)	(1,598)	(1,965)	(2,046)	1,953
Basic and diluted, per share	(0.05)	(0.06)	(0.05)	0.05
Capital expenditures, net	7,306	4,633	12,141	16,483
Capital acquisitions, net	-	-	13,587	1
Working capital	6,407	22,290	1,096	40,679
Total assets	92,605	108,308	112,861	164,907
Long-term liabilities (ARO)[2]	1,844	1,931	2,278	2,439
Average daily sales volumes *(boe per day)*	1,225	1,313	1,655	2,006

(1) Petroleum and natural gas sales, before royalties and transportation, excluding interest and other income.
(2) Asset retirement obligations.

SELECTED CONSOLIDATED ANNUAL INFORMATION

The following table sets forth selected consolidated annual financial information of the Company for the three most recently completed years ending at December 31, 2010.

Years ended *($000s, except volumes and per share)*	**2010**	**2009**	**2008**
Gross revenues[(1)]	**58,283**	28,895	20,635
Funds flow from operations	**36,279**	15,210	12,758
Basic, per share	**0.76**	0.44	0.38
Diluted, per share	**0.74**	0.44	0.38
Cash flow from operating activities	**35,360**	12,460	13,599
Net earnings (loss)	**1,894**	(3,656)	5,453
Basic and diluted, per share	**0.04**	(0.10)	0.16
Capital expenditures, net	**107,314**	40,563	47,589
Capital acquisitions, net	**12,846**	13,588	21,091
Working capital (deficiency)	**(1,205)**	40,679	11,835
Total assets	**234,197**	164,907	97,194
Long-term liabilities (ARO)[(2)]	**3,970**	2,439	1,766
Average daily sales volumes *(boe per day)*	**2,848**	1,552	761

(1) Petroleum and natural gas sales, before royalties and transportation, excluding interest and other income.
(2) Asset retirement obligations.

Significant factors and trends that have affected the Company's results during the above quarterly and annual periods are as follows:

a) Gross revenues are impacted by both volatile commodity pricing and production volumes, which have generally steadily increased over the quarters and years from drilling and acquisition activities. The Company's successful capital program has generated incremental production volumes, partially offset by normal production declines. The sales prices realized by the Company have generally approximated the Edmonton par light oil prices and AECO daily spot gas prices throughout the above periods. The reference price fluctuations reflect changes in supply and demand by commodity, both internationally and domestically.

b) Funds flow from operations have both increased and decreased over time, reflecting primarily the impact of fluctuating commodity prices on a growing production base. Per production unit operating and transportation costs variations track seasonal weather-related issues. In 2010, improvements in oil and liquids prices combined with higher daily production rates have further bolstered funds flow from operations in comparison to the prior year. In Saskatchewan, the gradual installation of facilities, water handling capabilities and flow lines over the past several years has helped reduce per unit operating and transportation charges. In British Columbia, the increased sales volumes and the termination of excess usage charges in 2010 have also helped reduce per unit operating and transportation charges. Throughout 2009, commodity prices were substantially weaker than during 2008, reducing funds flow from operations. Royalty changes vary due to commodity prices, production levels and the status of the different provincial royalty holiday incentive programs. As the production base in Saskatchewan matures, incremental royalties occur on wells as the maximum volumes provided for under the provincial incentive programs are attained.

c) Cash flow from operating activities has increased or decreased in concert with funds flow from operations and is further impacted by the timing of related accounts payable and receivable settlements.

d) The Company recorded net income in 2010 for the year and each quarter therein except for a net loss in the third quarter. As the Company's share trading price increases, the related stock-based compensation charge for options granted also increases as the trading price as at the date of grant directly impacts the calculation. The Company's utilization of a graded fair value model combined with the immediate vesting of one-third of options granted to date results in a higher stock-based compensation charge for the period of grant compared to each subsequent period of vesting.

   In the third quarter of 2010, $2.0 million of non-cash charges from stock based compensation charges were recognized along with $0.6 million of future income tax expense primarily attributable to share issue costs incurred in the quarter. The net losses in the first three quarters of 2009 were also significantly impacted by stock-based compensation expenses. In the third quarter of 2009, the Company recorded $1.1 million of non-cash stock-based compensation expense for share options surrendered for cancellation. In the third quarter of 2009, a future tax asset was recognized.

   Throughout 2008, net earnings reflected relatively strong commodity prices, lower option grant prices and recognition of the future tax effect from the renouncement of tax pools for flow-through shares issued in 2007.

e) Net capital expenditures fluctuations have reflected both available capital resources and intentional capital spending restraint during weaker economic periods.

f) Net capital acquisitions have occurred when strategic opportunities were identified and completed; specifically in the first quarter of 2008, the third quarter of 2009 and the fourth quarter of 2010.

g) Total assets and long-term liabilities (asset retirement obligations) have generally increased quarter over quarter and year over year, reflecting the execution of the Company's capital program, somewhat offset by depletion.

h) Average daily production has steadily increased since the inception of the Company reflecting the execution of the Company's strategic plan to grow its reserve and production base.

MANAGEMENT'S RESPONSIBILITY FOR CONSOLIDATED FINANCIAL STATEMENTS

The management of Painted Pony Petroleum Ltd. (the "Company") is responsible for the preparation and integrity of the accompanying consolidated financial statements and all other information contained in this report. The consolidated financial statements have been prepared in accordance with generally accepted accounting principles ("GAAP") in Canada and include amounts that are based on management's informed judgments and estimates where necessary.

The Company has established internal accounting control systems which are designed to provide reasonable assurance regarding the reliability of the Company's financial reporting and the preparation of the consolidated financial statements together with the other financial information for external purposes in accordance with Canadian GAAP.

The Board of Directors, through its Audit Committee, monitors management's financial and accounting policies and practices and the preparation of these consolidated financial statements. The Audit Committee meets periodically with the external auditors and management to review the work of each and the propriety of the discharge of their responsibilities.

The Audit Committee reviews the consolidated financial statements of the Company with management and the external auditors prior to submission to the Board of Directors for final approval. The Board of Directors also reviews the consolidated financial statements before they are finalized. The external auditors have full and free access to the Audit Committee to discuss auditing and financial reporting matters. The Audit Committee reviews the independence of the external auditors and pre-approves audit and permitted non-audit services and fees. The Shareholders have appointed KPMG LLP as the external auditors of the Company, and in that capacity, they have audited the consolidated financial statements for the years ended December 31, 2010 and 2009.

Patrick R. Ward
President and CEO

Joan E. Dunne
Vice President, Finance and CFO

March 28, 2011

INDEPENDENT AUDITORS' REPORT

To the Shareholders of Painted Pony Petroleum Ltd.

We have audited the accompanying consolidated financial statements of Painted Pony Petroleum Ltd., which comprise the consolidated balance sheets as at December 31, 2010 and 2009, the consolidated statements of operations, comprehensive income (loss) and retained earnings and cash flows for the years then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

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.

Auditors' Responsibility
Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits 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 our 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, we consider 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 in our audits 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 Painted Pony Petroleum Ltd. 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.

Chartered Accountants

KPMG LLP

Calgary, Canada
March 28, 2011

PAINTED PONY PETROLEUM LTD.

CONSOLIDATED BALANCE SHEETS

($000s)

As at December 31,	2010	2009
ASSETS		
Current assets		
Cash and cash equivalents	**$ 9,748**	$ 46,575
Accounts receivable	**17,200**	5,198
Prepaid expenses and deposits	**320**	324
	27,268	52,097
Long-term assets		
Property and equipment *(notes 4 & 5)*	**206,078**	109,725
Future income tax *(note 12)*	**851**	3,085
	$ 234,197	$ 164,907
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable and accrued liabilities	**$ 28,473**	$ 11,418
Long-term liabilities		
Asset retirement obligations *(note 7)*	**3,970**	2,439
	32,443	13,857
Shareholders' equity		
Capital stock *(note 8)*	**182,795**	139,739
Contributed surplus *(note 9)*	**16,114**	10,360
Retained earnings	**2,845**	951
	201,754	151,050
	$ 234,197	$ 164,907

Commitments *(note 14)*

Subsequent events *(note 17)*

See accompanying notes to the consolidated financial statements.

Approved on behalf of the Board:

Arthur J. G. Madden
Director

Patrick R. Ward
Director

CONSOLIDATED STATEMENTS OF OPERATIONS, COMPREHENSIVE INCOME (LOSS) AND RETAINED EARNINGS

($000s, except per share amounts)

Years ended December 31,	2010	2009
Revenue		
Petroleum and natural gas	$ 58,283	$ 28,895
Royalties	(7,529)	(3,441)
Other	249	134
	51,003	25,588
Expenses		
Operating	7,571	4,939
Transportation	3,808	3,015
General and administrative	2,523	2,042
Other taxes	822	382
Stock-based compensation *(note 8)*	4,773	3,540
Depletion, depreciation and accretion	27,194	16,709
	46,691	30,627
Income (loss) before income taxes	4,312	(5,039)
Future income tax expense (reduction) *(note 12)*	2,418	(1,383)
Net income (loss) and comprehensive income (loss)	1,894	(3,656)
Retained earnings, beginning of year	951	4,607
Retained earnings, end of year	$ 2,845	$ 951
Net income (loss) per share *(note 10)*		
Basic and diluted	$ 0.04	$ (0.10)

See accompanying notes to the consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

($000s)

Years ended December 31,	2010	2009
Cash provided by (used in)		
Operating activities		
Net income (loss) for the year	$ **1,894**	$ (3,656)
Items not affecting cash:		
Stock-based compensation	**4,773**	3,540
Depletion, depreciation and accretion	**27,194**	16,709
Future income tax expense (reduction)	**2,418**	(1,383)
Asset retirement expenditures	**(100)**	(50)
Change in non-cash working capital *(note 11)*	**(819)**	(2,700)
	35,360	12,460
Financing activities		
Issuance of share capital	**44,550**	71,920
Share issuance costs	**(2,453)**	(4,086)
Change in non-cash working capital *(note 11)*	**(64)**	(41)
	42,033	67,793
Investing activities		
Property and equipment additions	**(107,314)**	(40,563)
Property and equipment acquisitions *(note 4)*	**(12,846)**	(13,588)
Change in non-cash working capital *(note 11)*	**5,940**	680
	(114,220)	(53,471)
Change in cash and cash equivalents	**(36,827)**	26,782
Cash and cash equivalents, beginning of year	**46,575**	19,793
Cash and cash equivalents, end of year	$ **9,748**	$ 46,575
Cash and cash equivalents is comprised of:		
Balances with banks	$ **9,748**	$ 46,575

See accompanying notes to the consolidated financial statements.

1. NATURE OF OPERATIONS

Painted Pony Petroleum Ltd.'s (the "Company") principal business activity is the acquisition, exploration, development and production of petroleum and natural gas resources in western Canada.

2. BASIS OF PRESENTATION

The consolidated financial statements of the Company have been prepared by management in accordance with Canadian generally accepted accounting principles ("GAAP"). These consolidated financial statements include the accounts of Painted Pony Petroleum Ltd. and its wholly-owned subsidiaries, Painted Pony Petroleum Corp. and Painted Rock Resources Ltd. All intercompany transactions have been eliminated.

3. SIGNIFICANT ACCOUNTING POLICIES

Use of Estimates

The preparation of consolidated financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the balance sheet date and the reported amounts of revenue and expenses during the period. The consolidated financial statements have, in management's opinion, been properly prepared using careful judgment with reasonable limits of materiality and within the framework of the significant accounting policies summarized below. Actual results could differ from those estimates.

Property and Equipment

(i) Capitalized Costs

The Company follows the Canadian full cost method of accounting for its petroleum and natural gas operations. Under this method, all costs related to the exploration, development and production of petroleum and natural gas reserves are capitalized in a single Canadian cost centre. Costs include lease acquisition costs, geological and geophysical expenses, costs of drilling productive and non-productive wells, production equipment costs, asset retirement costs, general and administrative costs, and stock-based compensation directly related to exploration and development activities. Proceeds from the sale of properties are applied against capitalized costs, without any gain or loss being realized, unless such sale would alter the rate of depletion by more than 20%. Office equipment and furniture and fixtures are recorded at cost.

(ii) Depletion and Depreciation

Petroleum properties, including estimated costs of future development of proved undeveloped reserves, are depleted and amortized using the unit-of-production method based on estimated gross proved petroleum and natural gas reserves as determined by independent engineers. For depletion and amortization purposes, relative volumes of petroleum and natural gas production and reserves are converted at the energy equivalent conversion rate of six thousand cubic feet of natural gas to one barrel of crude oil.

Costs of unproved properties and seismic costs on undeveloped land are initially excluded from petroleum properties for the purpose of calculating depletion. When proved reserves are assigned, or the property or seismic is considered to be impaired, the costs of the property or seismic or the amount of the impairment is added to costs subject to depletion.

Furniture, fixtures, and office equipment are depreciated over their estimated useful life at a declining-balance rate of 20%.

(iii) Ceiling Test

In applying the full cost method, the Company calculates a ceiling test whereby the carrying amount of property and equipment is compared to the sum of the undiscounted cash flows expected to result from the future production of proved reserves and the cost, less any impairment, of unproved properties. Cash flows are based on third party quoted forward prices, adjusted for transportation and quality differentials. Should the ceiling test result in an excess of carrying amount, the Company would then measure the amount of impairment by comparing the carrying amounts of property and equipment to an amount equal to the estimated net present value of future cash flows from proved plus probable reserves and the cost, less any impairment, of unproved properties. The Company's risk-free interest rate is used to arrive at the net present value of the future cash flows. Any excess carrying amount would be recorded as a permanent impairment.

Asset Retirement Obligations

The Company recognizes the fair value of an asset retirement obligation in the period in which it is incurred when a reasonable estimate of the fair value can be made. The fair value is determined through a review of engineering studies, industry guidelines and management's estimate on a site-by-site basis. The fair value of the estimated asset retirement obligations is recorded as a liability, with a corresponding increase in the carrying amount of the related asset. The capitalized amount is depleted on the unit-of-production method based on gross proved reserves. The liability amount is increased each reporting period to reflect the passage of time with the corresponding amount charged to earnings as accretion expense. Actual costs incurred upon the settlement of the asset retirement obligation are charged against the asset retirement obligations to the extent of the liability recorded.

Joint Operations

Substantially all of the exploration and production activities of the Company are conducted jointly with others, and these consolidated financial statements reflect only the Company's proportionate interest in such activities.

Income Taxes

The Company follows the asset and liability method of accounting for income taxes. Under this method, future tax assets and liabilities are recognized for the future tax consequences attributable to differences between financial statement carrying amounts of assets and liabilities and their respective tax basis. Future tax assets and liabilities are measured using substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. A valuation allowance is recorded against any future income tax assets if it is more likely than not that the assets will not be realized. The effect on future tax assets and liabilities of a change in tax rates is recognized in earnings in the period that includes the date of substantive enactment.

Flow-Through Shares

Periodically, the Company may finance a portion of its exploration and development activities through the issuance of flow-through shares. Under the terms of the flow-through share issues, the tax attributes of the related expenditures are renounced to subscribers. Share capital is reduced and the future tax liability is increased by the tax effected amount of the renounced tax deductions at the time of renouncement, which is when the related documentation is filed with the appropriate governmental agency and there is reasonable certainty that the expenditures will be incurred.

Stock-Based Compensation

The Company accounts for stock option agreements using the fair value method. Under this method, the fair value of the stock options, measured at the grant date, is charged to operations over the vesting period, with a corresponding increase in contributed surplus. Upon exercise of the stock options, consideration paid by the option holder, together with the amount recognized in contributed surplus, is credited to share capital. The Company does not incorporate a forfeiture rate for stock options that will not vest, but rather accounts for actual forfeitures as they occur.

Revenue Recognition

Revenue from the sale of crude oil, natural gas and natural gas liquids is recognized based on volumes delivered at contractual delivery points and rates and when collection is reasonable assured. The costs associated with the delivery, including operating, transportation and production-based royalty expenses are recognized in the same period in which the related revenue is earned and recorded.

Per Share Amounts

Basic earnings or loss per share is computed by dividing net income or loss by the weighted average number of Class A and Class B shares outstanding during the period. In addition, Class B shares are converted into Class A shares at $10 divided by the greater of $1.00 and the Current Market Price, defined as the weighted average trading price per share of the Class A shares for the last 30 consecutive trading days as of the balance sheet date. The treasury stock method is used to calculate diluted per share amounts, whereby proceeds from the exercise of in-the-money stock options and the unrecognized future stock-based compensation expense is assumed to be used to purchase Class A shares of the Company at the weighted-average market price during the period.

Cash and Cash Equivalents

The Company considers all highly liquid investments with a maturity of three months or less at the time of purchase to be cash equivalents. These cash equivalents primarily consist of funds on deposit under various terms.

Measurement Uncertainty

The amounts recorded for depletion and depreciation of petroleum properties and the ceiling test calculation are based on estimates of gross proved reserves (as determined by independent engineers) production rates, commodity prices, future costs and other relevant assumptions. The value of the asset retirement obligations is based on the Company's net ownership interests in all wells and facilities, and depends on estimates of current market interest rates, inflation rates, future restoration and reclamation expenditures and timelines. By their nature, these estimates are subject to measurement uncertainty and the effects on the consolidated financial statements of changes in such estimates in future years could be significant.

The calculation of future income tax is based on assumptions, which are subject to uncertainty as to timing as well as the tax rates at which temporary differences are expected to reverse.

The Black-Scholes option valuation model was developed for use in estimating the fair value of options, which were fully tradable with no vesting restrictions. This option valuation model requires the input of assumptions including the expected stock price volatility.

Financial Instruments

All financial instruments are classified into one of the following five categories: held-for-trading (cash and cash equivalents), held-to-maturity (none), loans and receivables (accounts receivable), available-for-sale financial assets (none), and other financial liabilities (accounts payable and accrued liabilities). Initial and subsequent measurement and recognition of changes in the value of financial instruments depends on their initial classification.

- *Held-to-maturity investments, loans and receivables, and other financial liabilities are initially measured at fair value and subsequently measured at amortized cost. Amortization of premiums or discounts and losses due to impairment are included in current period income.*

- *Available-for-sale financial assets are measured at fair value. Revaluation gains and losses are included in other comprehensive income until the asset is removed from the balance sheet or permanent impairment occurs.*
- *Held-for-trading financial instruments are measured at fair value. All gains and losses are included in income in the period in which they arise.*
- *All derivative financial instruments are classified as held-for-trading financial instruments and are measured at fair value. All gains and losses are included in income in the period which they arise.*

International Financial Reporting Standards

In February 2008, the Canadian Accounting Standards Board announced that 2011 is the changeover date for publicly listed companies to use IFRS, replacing Canada's own generally accepted accounting principles. The date is for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The transition date of January 1, 2011 will require the restatement for comparative purposes of amounts reported by the Company for the year ended December 31, 2010. The Company has conducted a review of its financial statements and assessed IFRS and its adoption for 2011.

4. PROPERTY ACQUISITIONS

During the fourth quarter of 2010, the Company completed three separate acquisitions of certain oil properties and undeveloped land (the "Q4 2010 Assets"). Properties were acquired for $12.8 million, including transaction costs and adjustments.

The following table summarizes the fair value of the Q4 2010 Assets acquired at the dates of acquisition.

Consideration:		*($000s)*
Cash	$	12,815
Transaction costs		31
Total consideration	$	12,846
Allocated to:		
Property and equipment	$	13,325
Asset retirement obligations		(479)
	$	12,846

During the third quarter of 2009, the Company completed four separate acquisitions of certain oil properties (the "Q3 2009 Assets"). The properties were acquired for $13.6 million, including transaction costs and adjustments.

The following table summarizes the fair value of the Q3 2009 Assets acquired at the dates of acquisition.

Consideration:		*($000s)*
Cash	$	13,523
Transaction costs		65
Total consideration	$	13,588
Allocated to:		
Property and equipment	$	13,794
Asset retirement obligations		(206)
	$	13,588

5. PROPERTY AND EQUIPMENT

December 31, 2010 *($000s)*	Cost	Accumulated depletion and depreciation	Net book value
Petroleum properties, including exploration and development thereon	**$ 257,686**	**$ 51,945**	**$ 205,741**
Other	**472**	**135**	**337**
	$ 258,158	**$ 52,080**	**$ 206,078**

December 31, 2009 *($000s)*	Cost	Accumulated depletion and depreciation	Net book value
Petroleum properties, including exploration and development thereon	$ 134,592	$ 25,065	$ 109,527
Other	272	74	198
	$ 134,864	$ 25,139	$ 109,725

The Company has included $92.1 million (2009: $27.6 million) for future development costs and excluded $44.6 million (2009: $16.4 million) for undeveloped land and $1.0 million (2009: $0.8 million) for seismic costs from the depletion calculation and the ceiling test. The Company recognized a total of $0.1 million (2009: $0.2 million) of drilling credits as a reduction of property and equipment during 2010.

For the years ended December 31, 2010 and 2009, the Company capitalized general and administrative expenses and stock-based compensation as follows:

($000s) Years ended December 31,	2010	2009
General and administrative	**$ 1,474**	$ 954
Stock-based compensation	**1,286**	938
Total	**$ 2,760**	$ 1,892

The Company performed a ceiling test calculation at December 31, 2010 and determined there was no impairment of its petroleum properties. The Company's future prices, as adjusted for commodity price differentials and transportation specific to the Company's production, used in the ceiling test calculation are as follows:

	Light oil (C$/bbl)	Gas (C$/mcf)	Pentanes Plus (C$/bbl)	NGL's (C$/bbl)	Exchange rate (US$/CAN$)
2011	91.84	4.10	76.94	55.00	0.932
2012	91.80	4.72	74.57	57.17	0.932
2013	91.05	5.09	74.26	57.00	0.932
2014	90.98	6.81	74.47	56.97	0.932
2015	92.49	6.94	75.97	57.74	0.932
2016	94.02	7.05	77.40	58.54	0.932
2017	95.62	7.16	78.71	59.40	0.932
2018	97.27	7.27	80.07	60.32	0.932
2019	99.11	7.39	81.49	61.15	0.932
2020	101.35	7.51	82.91	61.99	0.932
2021	103.20	7.62	84.26	62.98	0.932
2022	104.93	7.72	85.56	64.03	0.932
2023	106.55	7.84	86.81	65.19	0.932
2024	108.16	7.94	87.79	66.27	0.932
2025	109.72	8.03	88.59	67.39	0.932
2026	111.29	8.16	90.08	68.52	0.932
2027	112.85	8.28	91.51	69.64	0.932
2028	114.57	8.40	93.08	70.74	0.932
2029	116.31	8.49	94.79	71.88	0.932
2030	117.93	8.64	96.48	72.99	0.932
Thereafter	+ 1.5%/yr	+ 1.5%/yr	+ 1.5%/yr	+ 1.5%/yr	

6. BANK DEBT

At December 31, 2010 and 2009, the Company had no bank debt. The Company has available a $75 million demand revolving credit facility with a Canadian chartered bank. Security is provided by a first fixed and floating charge demand debenture of $100 million. Painted Pony has provided a negative pledge and undertaking to provide fixed charges over major petroleum and natural gas reserves in certain circumstances. Interest for the demand revolving credit facility is payable at a floating rate determined as the lender's prime rate plus between 0.50% and 2.5%, depending on the Company's net debt to cash flow ratio, as defined by the lender. A standby fee of 0.20% to 0.45% is charged on the undrawn portion of the credit facility, depending on the Company's net debt to cash flow ratio, as defined by the lender. The facility is subject to a review on or before August 1, 2011.

7. ASSET RETIREMENT OBLIGATIONS

The total future asset retirement obligations were estimated by management based on the Company's net ownership in wells and facilities, estimated costs to reclaim and abandon the wells and facilities, and the estimated timing of the costs to be incurred in future periods. The Company has estimated the total undiscounted asset retirement obligations to be $14.3 million as at December 31, 2010 (2009: $8.5 million). These payments are expected to be made over the next 30 years, with the majority estimated to be spent between 2028 and 2030. The Company used a credit-adjusted risk-free rate of 8% and an inflation rate of 2% to calculate the present value of the asset retirement obligations.

The following table reconciles the Company's asset retirement obligations:

($000s)

Years ended December 31,	2010	2009
Obligations, beginning of year	$ 2,439	$ 1,766
Liabilities incurred	899	352
Abandonment expenditures	(100)	(50)
Liabilities acquired on property acquisitions *(note 4)*	479	206
Accretion expense	253	165
Obligations, end of year	$ 3,970	$ 2,439

8. CAPITAL STOCK

a) Authorized

Unlimited Class A shares
Unlimited Class B shares
Unlimited Preferred shares, none outstanding as at December 31, 2010 and 2009

The Class A Shares and the Class B Shares are voting on the basis of one vote per share. There is no fixed dividends payable on either the Class A Shares or the Class B Shares. In the event of the liquidation or dissolution of the Company, the Class B Shares will be converted at the conversion rate (further discussed under "Class B Shares") into Class A Shares and the Class A Shares are entitled to receive, on a pro rata basis, all assets of the Company as are distributable to the holders of shares.

The Class B Shares are convertible, at the option of the Company, at any time after June 30, 2010 and on or before June 30, 2012 into Class A Shares. The number of Class A Shares issued upon conversion of each Class B Share would be equal to $10.00 divided by the greater of $1.00 and the Current Trading Price (as defined - see note 10) of the Class A Shares.

If conversion has not occurred by the close of business on June 30, 2012, the Class B Shares become convertible, at the option of the shareholder, into Class A Shares on the same basis. Any Class B Shares outstanding at the close of business on August 1, 2012 shall be automatically converted into Class A Shares on the same basis.

b) Issued and Outstanding

	Class A shares		Class B shares	
	Number of shares	Amount *($000s)*	Number of shares	Amount *($000s)*
Balance, December 31, 2008	28,222,700	$ 63,284	1,173,600	$ 7,360
Issuance of shares for cash	15,800,000	71,694	-	-
Options exercised	59,000	226	-	-
Transfer from contributed surplus on exercise of options	-	150	-	-
Share issuance costs	-	(4,086)	-	-
Tax effect of share issuance costs	-	1,111	-	-
Balance, December 31, 2009	44,081,700	$ 132,379	1,173,600	$ 7,360
Issuance of shares for cash	6,800,000	44,064	-	-
Options exercised	135,000	486	-	-
Transfer from contributed surplus on exercise of options	-	305	-	-
Share issuance costs	-	(2,453)	-	-
Tax effect of share issuance costs	-	654	-	-
Balance, December 31, 2010	51,016,700	$ 175,435	1,173,600	$ 7,360

On August 25, 2010, the Company completed a financing of 6,800,000 Class A Shares at a price of $6.48 per share on a bought-deal basis for total gross proceeds of $44.1 million. Share issue costs were $2.5 million.

On November 17, 2009, the Company completed a financing of 8,800,000 Class A Shares at a price of $5.88 per share on a bought-deal basis for total gross proceeds of $51.7 million. Share issue costs were $2.8 million.

On June 30, 2009, the Company completed a financing of 7,000,000 Class A Shares at a price of $2.85 per share on a bought-deal basis for total gross proceeds of $20 million. Share issue costs were $1.3 million.

c) Stock Option Plan

The Company has a Stock Option Plan (the "Plan") pursuant to which options to purchase Class A Shares may be granted by the Board of Directors to directors, officers, employees and consultants to the Company. The Plan has reserved for issuance a number of Class A shares equal to 10% of the aggregate number of Class A Shares and Class B Shares issued and outstanding from time to time.

As at December 31, 2010, 4,548,920 options (2009: 2,755,000) are issued and outstanding, at an average exercise price of $4.68 per option (2009: $3.53) and with a weighted-average life of 3.5 years. A total of 2,799,306 of the options granted are vested and the remainder generally vests in equal tranches on the first and second anniversaries of the date of grant. The options generally expire five years from the date of grant.

The following tables summarize information regarding stock options for the years ended December 31, 2010 and 2009:

	Weighted average exercise price	Number
Balance, December 31, 2008	$ 5.03	2,840,000
Granted	3.25	1,422,000
Exercised	3.84	(59,000)
Forfeited and cancelled	6.17	(1,448,000)
Balance, December 31, 2009	$ 3.53	2,755,000
Granted	6.25	1,938,920
Exercised	3.60	(135,000)
Forfeited and cancelled	5.88	(10,000)
Balance, December 31, 2010	$ 4.68	4,548,920

Stock Options, December 31, 2010

Number of options outstanding	Exercise price	Remaining life *(yrs)*	Grant date fair value	Exercisable options	Exercise price
1,197,000	$ 3.97	2.1	$ 2.62	1,197,000	$ 3.97
75,000	$ 1.40	2.9	$ 0.90	75,000	$ 1.40
771,500	$ 2.85	3.6	$ 1.84	503,333	$ 2.85
442,500	$ 3.15	3.6	$ 2.04	290,000	$ 3.15
139,000	$ 5.88	3.9	$ 3.80	92,667	$ 5.88
674,000	$ 5.88	4.0	$ 3.71	224,666	$ 5.88
72,000	$ 5.60	4.4	$ 3.62	24,000	$ 5.60
1,177,920	$ 6.51	4.7	$ 4.21	392,640	$ 6.51
4,548,920	$ 4.68	3.5	$ 3.03	2,799,306	$ 4.20

d) Stock-Based Compensation

The Company accounts for its stock options granted to employees, consultants, officers and directors using the fair value method. In accordance with the Company's incentive stock plan, these options have an exercise price equal to the fair value of the Company's Class A shares at the date of grant using the Black-Scholes option-pricing model. The following weighted-average fair value of the options granted and the assumptions used are as follows:

Years ended December 31,	2010	2009
Fair value per option	$ **4.01**	$ 2.12
Risk free rate *(%)*	**1.93**	1.98
Expected life *(years)*	**5**	5
Expected volatility *(%)*	**80**	80
Expected dividends	**-**	-

9. CONTRIBUTED SURPLUS

($000s)	
Balance, December 31, 2008	$ 6,032
Stock-based compensation *(note 8(d))*	4,478
Transfer to share capital on exercise of options	(150)
Balance, December 31, 2009	$ 10,360
Stock-based compensation *(note 8(d))*	6,059
Transfer to share capital on exercise of options	(305)
Balance, December 31, 2010	$ 16,114

For the year ended December 31, 2010, the Company recorded $6.1 million (2009: $4.5 million) of compensation cost related to stock options issued during the period. During the year ended December 31, 2010, $1.3 million (2009: $0.9 million) was capitalized to petroleum properties and $4.8 million (2009: $3.5 million) was expensed.

10. PER SHARE AMOUNTS

The weighted average number of Class A and Class B shares outstanding during the years ended December 31, 2010 and 2009 was as follows:

Years ended December 31,	2010	2009
Weighted average shares		
Class A - basic	**46,558,897**	32,867,535
Class A - diluted	**47,438,090**	32,867,535
Class B - basic	**1,173,600**	1,173,600
Class B - deemed conversion to Class A	**1,470,312**	2,017,045
Class A & B - basic	**48,029,209**	34,884,580
Class A & B - diluted	**48,908,402**	34,884,580

During the year ended December 31, 2010, nil (2009: 2,755,000) options were excluded in the weighted-average diluted share calculation of Class A shares. Class B shares are converted into Class A shares at $10 divided by the greater of $1.00 and the Current Trading Price, defined as being the weighted-average trading price per share of Class A shares for the last 30 consecutive trading days.

11. CHANGES IN NON-CASH WORKING CAPITAL

($000s)

Years ended December 31,	2010	2009
Accounts receivable	$ (12,002)	$ 624
Prepaid expenses and deposits	4	41
Accounts payable and accrued liabilities	17,055	(2,726)
	$ 5,057	$ (2,061)

The change in non-cash working capital has been allocated to the following activities:

($000s)

Years ended December 31,	2010	2009
Operating	$ (819)	$ (2,700)
Financing	(64)	(41)
Investing	5,940	680
	$ 5,057	$ (2,061)

12. INCOME TAX

The provision for income tax differs from that which would be obtained from applying the combined Canadian federal and provincial income tax rate to the income (loss) before income taxes. The difference results from the following:

($000s)

Years ended December 31,	2010	2009
Income (loss) before income taxes	$ 4,312	$ (5,039)
Combined corporate tax rate	28.87%	29.89%
Computed "expected" income tax expense (reduction)	1,245	(1,506)
Non-deductible expenses	13	9
Stock-based compensation	1,378	1,058
Change in valuation allowance	-	(1,178)
Change in tax rates	(211)	210
Other	(7)	24
Income tax expense (reduction)	$ 2,418	$ (1,383)

The components of the Company's future income tax asset is as follows:

($000s)

Years ended December 31,	2010	2009
Property and equipment	$ (1,696)	$ 967
Share issue costs	1,522	1,489
Asset retirement obligations	1,025	629
	$ 851	$ 3,085

13. RELATED PARTY TRANSACTIONS

The Company utilizes the services of a law firm in which the Corporate Secretary is a Partner. During the year ended December 31, 2010, the Company incurred $188,000 (2009: $198,000) on services obtained from the firm, excluding disbursements. As at December 31, 2010, the Company owes this related party $15,329 (2009: $2,347).

All related party transactions recorded at the agreed to terms and exchange values, being the consideration established and agreed to by the parties.

14. COMMITMENTS

a) At December 31, 2010, the Company is committed to a minimum toll for transportation of oil through a major carrier system beginning May 2010 and ending in May 2015 as follows:

		Amount ($000s)
2011	$	641
2012		522
2013		363
2014		250
2015		82
Total	$	1,858

b) At December 31, 2010, the Company was committed to future payments for office space rental and a proportionate share of operating costs through 2015 as follows:

		Amount ($000s)
2011	$	623
2012		623
2013		443
2014		263
2015		240
Total	$	2,192

15. CAPITAL DISCLOSURES

At December 31, 2010, the Company considers its capital structure to include shareholders' equity, working capital, and available credit facilities. The Company will adjust its capital structure to manage any projected deficiencies of working capital through the issuance of shares, the use of available credit facilities, and/or adjusting its capital spending. The Company monitors its capital spending program based on the current and projected ratios of net debt to funds flow from operations, being cash flow from operating activities adjusted for changes in non-cash working capital and asset retirement expenditures.

The Company's objectives in managing its capital structure are to:

a) create and maintain flexibility to enable the Company to continue to meet its financial obligations; and
b) finance its growth either through internally generated projects, joint interest relationships or asset/corporate acquisitions.

The Company monitors its capital structure using primarily the non-GAAP financial measure of net debt to annualized funds flow from operations ratio. The Company's objective is to maintain a net debt to funds flow from operations ratio of 1:1 or less. At December 31, 2010, the Company's net debt to annualized funds flow from operations ratio is 0.03:1 (2009: nil:nil).

To facilitate the management of this ratio, the Company prepares an annual budget, which is updated as required throughout the year for any significant acquisition, a change in economic circumstances outside the control of the Company, and success or failure of capital deployed. Each of the annual budgets and periodic updates are approved by the Board of Directors. As at December 31, 2010, the Company had no debt and had negative working capital of $1.2 million as detailed below:

($000s)		**As at December 31, 2010**
Current assets	$	27,268
Current liabilities		(28,473)
Net working capital	$	(1,205)

The Company is required to maintain a minimum working capital ratio of 1:1 to remain in compliance with its credit facility. For purposes of this calculation, the working capital ratio is defined as the ratio of current assets plus any undrawn availability under the revolving credit facility to current liabilities less any amount drawn under the credit facility. At December 31, 2010, the Company had a working capital ratio of 3:1, which is greater than the minimum ratio required.

There have been no changes to the way the Company manages capital during the year.

16. FINANCIAL INSTRUMENTS

Management has primary responsibility for monitoring and managing financial instrument risks under direction from the Board of Directors who has the overall responsibility for establishing the Company's risk management framework. For example, when extending credit to purchasers of the Company's products, the Board has delegated responsibility for credit assessment to management, receiving frequent financial and operating reports.

The Company's financial instruments recognized on the balance sheet at December 31, 2010 and 2009 consist of cash and cash equivalents, accounts receivable and accounts payable and accrued liabilities. All of the Company's assets and liabilities are valued as Level 1 assets and liabilities, which are based on observable market data. The fair value of these financial instruments approximates their carrying amounts, based on the short term nature of these instruments.

a) Credit risk: A substantial portion of the Company's accounts receivable are concentrated with a limited number of purchasers of commodities and joint interest partners in the oil and gas industry and are subject to normal industry credit risk. Management considers these concentrations of credit risk to be minimal, as the commodity purchasers are major industry participants, and receivables from partners are protected by effective industry standard legal remedies. Receivables related to the sale of the Company's production are normally collected on the 25th day of the month following delivery.

Accounts receivable was comprised of the following:

($000s) **As at December 31,**		**2010**		**2009**
Sales revenue	**$**	**7,109**	$	4,756
Joint interest		**9,045**		391
Accrued and other		**1,046**		51
Total accounts receivable	**$**	**17,200**	$	5,198

The carrying amounts of cash and cash equivalents and accounts receivable represent the Company's maximum credit exposure. The Company has not experienced any credit loss in the collection of its accounts receivable. The Company has no allowance for doubtful accounts as at December 31, 2010. As at December 31, 2010 the Company estimates its accounts receivable to be aged as follows:

($000s)

As at December 31,		2010		2009
Not past due (less than 30 days)	$	15,339	$	4,964
Past due 31-60 days		1,653		169
Past due 61-90 days		38		46
Past due more than 90 days		170		19
Total accounts receivable	$	17,200	$	5,198

b) Market risk: Market risks are as follows and are largely outside of the control of the Company:

Commodity Prices

The Company is exposed to the risk of volatility of prices for its products, with a corresponding impact on cash flow. Reduced cash flow may result in lower levels of capital being available for field activity, thus compromising the Company's capacity to grow production while at the same time replacing continuous declines from existing properties. In certain circumstances, usually when debt levels are forecast to increase due to capital expenditures exceeding cash flow, or where the Company has financed, in whole or in part, an acquisition using bank debt, the Company may enter into oil and natural gas risk management contracts in order to provide stability to future cash flow. These contracts reduce the fluctuation in production revenue by fixing prices of future deliveries of oil and natural gas. At December 31, 2010 and 2009, the Company had no fixed price contracts or financial instruments associated with future production.

Interest Rates

Interest on the Company's revolving bank facility varies, and is most commonly based on the lender's prime rate. The Company is thus exposed to increased borrowing costs during periods of increasing interest rates, with a corresponding reduction in both cash flows and project economics. The Company had no bank debt at December 31, 2010 and 2009 and has had no interest rate swaps or similar contracts. The Company invests available cash in short-term term deposits or interest bearing accounts from which interest income will vary with changes in prime rates.

For the year ended December 31, 2010, if interest rates had been 0.5% lower than the 2010 weighted-average rate of 0.86% (2009: 0.63%), with all other variables held constant, after tax net earnings for the period would have been $78,000 (2009: $57,000) lower due to lower interest income. An equal and opposite impact would have occurred to net earnings had interest rates been 0.5% higher.

Foreign Exchange

Although the Company's product revenues are denominated in Canadian dollars, the underlying market prices are affected by the exchange rate between the Canadian and the United States dollar. As at December 31, 2010 and 2009, the Company had no contracts in place to manage foreign exchange risk.

Liquidity Risk

Liquidity difficulties would emerge if the Company was unable to meet its financial obligations as they fell due within normal credit terms. This may be the consequence of diminished cash flows resulting from lower product prices, production interruptions, or unexpected operating or capital cost increases. Liquidity difficulties could also occur if the Company's bankers were unable to continue to provide credit at a level and on terms compatible with the Company's capital requirements. Generally the Company will, over a reasonable period of time, limit its capital programs to funds flow from operations, available cash and available credit. In addition, the Company endeavours to maintain its debt at a level to ensure financial flexibility to deal with unforeseen or rapidly changing circumstances.

17. SUBSEQUENT EVENTS

a) On February 17, 2011, the Company issued 7,620,000 Class A shares at a price of $10.50 per share for gross proceeds of $80.0 million by way of a bought-deal financing.

b) In March 2011, the Company signed a letter of intent to acquire certain southeast Saskatchewan light oil properties from a private company for cash consideration of $7.7 million, before closing adjustments and related costs. The letter of intent is subject to a number of standard conditions and the acquisition is expected to close in early April 2011.

c) Subsequent to December 31, 2010, the Company committed to a minimum toll for transportation of oil through a major carrier system, estimated to begin in May 2011 and end in May 2016 as follows:

	Amount *($000s)*
2011	$ 227
2012	292
2013	243
2014	202
2015	153
2016	44
Total	$ 1,161

CORPORATE INFORMATION

BOARD OF DIRECTORS

Ronald R. Talbot, *Chairman*
President
557146 Alberta Inc.
Calgary, Alberta

Kevin D. Angus
Vice President, Exploration
Surge Energy Inc.
Calgary, Alberta

Allan K. Ashton
Chairman of the Board
Ashton Petroleum Consultants
Priddis, Alberta

Glenn R. Carley
Executive Chairman & Director
Galleon Energy Inc.
Calgary, Alberta

Arthur J. G. Madden
Chief Financial Officer
Crown Point Ventures Ltd.
Calgary, Alberta

Patrick R. Ward
President & Chief Executive Officer
Painted Pony Petroleum Ltd.
Calgary, Alberta

OFFICERS

Patrick R. Ward
President & Chief Executive Officer

Joan E. Dunne
Vice President, Finance &
Chief Financial Officer

Michael E. Belenkie
Vice President, Corporate
Development

James H. French
Vice President, Engineering

Bruce M. Mezei
Vice President, Exploration South

James S. Thomson
Vice President, Land

Mary Kay Axford
Controller

Douglas T. McCartney
Partner, Burstall Winger LLP
Corporate Secretary

EXCHANGE LISTING

TSX Venture Exchange
Trading symbols:
Class A Shares: PPY.A
Class B Shares: PPY.B

LEGAL COUNSEL

Burstall Winger LLP

AUDITORS

KPMG LLP

BANKERS

National Bank of Canada

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