# MANAGEMENT'S DISCUSSION AND ANALYSIS

## For the years ended December 31, 2010 and December 31, 2009

This management's discussion and analysis ("MD&A") should be read in conjunction with Tourmaline's consolidated financial statements and related notes for the years ended 2010 and 2009. This MD&A is dated March 22, 2011. Both the consolidated financial statements and the MD&A can be found at www.sedar.com.

The financial information contained herein has been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). All dollar amounts are expressed in Canadian currency, unless otherwise noted.

See "Non-GAAP Financial Measures" for information regarding the following Non-GAAP financial measures used in this MD&A: "funds from operations", "operating netback", "working capital (adjusted for the fair value of financial instruments and future taxes)" and "net debt".

Additional information relating to Tourmaline, including the Company's Annual Information Form (once filed), can be found at www.sedar.com. The Company anticipates filing its 2010 Annual Information Form prior to March 31, 2011.

Forward-Looking Statements - Certain information regarding Tourmaline set forth in this document, including management's assessment of the Company's future plans and operations, contains forward-looking statements that involve substantial known and unknown risks and uncertainties. The use of any of the words "anticipate", "continue", "estimate", "expect", "may", "will", "project", "should", "believe" and similar expressions are intended to identify forward looking statements. Such statements represent Tourmaline's internal projections, estimates or beliefs concerning, among other things, an outlook on the estimated amounts and timing of capital investment, anticipated future debt, production, revenues or other expectations, beliefs, plans, objectives, assumptions, intentions or statements about future events or performance. These statements are only predictions and actual events or results may differ materially. Although Tourmaline believes that the expectations reflected in the forward-looking statements are reasonable, it cannot guarantee future results, levels of activity, performance or achievement since such expectations are inherently subject to significant business, economic, competitive, political and social uncertainties and contingencies. Many factors could cause Tourmaline's actual results to differ materially from those expressed or implied in any forward-looking statements made by, or on behalf of, Tourmaline.

In particular, forward-looking statements included in this MD&A include, but are not limited to, statements with respect to: the size of, and future net revenues from, crude oil, NGL and natural gas reserves; future prospects; the focus of and timing of capital expenditures; expectations regarding the ability to raise capital and to continually add to reserves through acquisitions and development; access to debt and equity markets; projections of market prices and costs; the performance characteristics of the Company's crude oil, NGL and natural gas properties; crude oil, NGL and natural gas production levels and product mix; Tourmaline's future operating and financial results; capital investment programs; supply and demand for crude oil, NGL and natural gas; future royalty rates; drilling, development and completion plans and the results therefrom; future land expiries; dispositions and joint venture arrangements; amount of operating, transportation and general and administrative expenses; treatment under governmental regulatory regimes and tax laws; estimated tax pool balances and anticipated IFRS elections and the impact of the conversion to IFRS. In addition, statements relating to "reserves" are deemed to be forward looking statements, as they involve the implied assessment, based on certain estimates and assumptions, that the reserves described can be profitably produced in the future.

These forward-looking statements are subject to numerous risks and uncertainties, most of which are beyond the Company's control, including the impact of general economic conditions; volatility in market prices for crude oil, NGL and natural gas; industry conditions; currency fluctuation; imprecision of reserve estimates; liabilities inherent in crude oil and natural gas operations; environmental risks; incorrect assessments of the value of acquisitions and exploration and development programs; competition; the lack of availability of qualified personnel or management; changes in income tax laws or changes in tax laws and incentive programs relating to the oil and gas industry; hazards such as fire, explosion, blowouts, cratering, and spills, each of which could result in substantial damage to wells, production facilities, other property and the environment or in personal injury; stock market volatility; ability to access sufficient capital from internal and external sources; completion of the financing on the timing planned and the receipt of applicable approvals; and the other risks considered under "Risk Factors" in Tourmaline's most recent annual information form available at www.sedar.com.

With respect to forward-looking statements contained in this MD&A, Tourmaline has made assumptions regarding: future commodity prices and royalty regimes; availability of skilled labour; timing and amount of capital expenditures; future exchange rates; the impact of increasing competition; conditions in general economic and financial markets; availability of drilling and related equipment and services; effects of regulation by governmental agencies; and future operating costs.

Management has included the above summary of assumptions and risks related to forward-looking information provided in this MD&A in order to provide shareholders with a more complete perspective on Tourmaline's future operations and such information may not be appropriate for other purposes. Tourmaline's actual results, performance or achievement could differ materially from those expressed in, or implied by, these forward-looking statements and, accordingly, no assurance can be given that any of the events anticipated by the forward-looking statements will transpire or occur, or if any of them do so, what benefits that the Company will derive there from. Readers are cautioned that the foregoing lists of factors are not exhaustive.

These forward-looking statements are made as of the date of this MD&A and the Company disclaims any intent or obligation to update publicly any forward-looking statements, whether as a result of new information, future events or results or otherwise, other than as required by applicable securities laws.

Boe Conversions - Per barrel of oil equivalent amounts have been calculated using a conversion rate of six thousand cubic feet of natural gas to one barrel of oil equivalent (6:1). Barrel of oil equivalents (boe) may be misleading, particularly if used in isolation. A boe conversion ratio of 6 mcf:1 bbl is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.

## PRODUCTION

Tourmaline produced 2,111,680 Boe in the fourth quarter of 2010, averaging 22,953 Boe/d compared to an average rate of 7,248 Boe/d during the fourth quarter of 2009. Production on a quarter-over-quarter basis grew as new wells were brought on-stream from the exploration and development program and significant acquisitions. The fourth quarter of 2010 production was 89% natural gas weighted, compared to a natural gas weighting of 86% for the fourth quarter of 2009.

Production for the year ended December 31, 2010 averaged 17,856 Boe/d as compared to 3,455 Boe/d for the year ended December 31, 2009. The significant increase in production is attributable to the Company's exploration and development program and significant acquisitions completed in 2009 and 2010.

| | Three Months Ended | | Year Ended | |
|---|---|---|---|---|
| | **December 31, 2010** | December 31, 2009 | **December 31, 2010** | December 31, 2009 |
| Natural Gas (mcf) | **11,251,067** | 3,454,934 | **34,895,923** | 6,850,937 |
| Crude oil and NGL (bbl) | **236,502** | 90,978 | **701,355** | 119,347 |
| Oil equivalent (boe) | **2,111,680** | 666,800 | **6,517,342** | 1,261,170 |
| Oil equivalent (boepd) | **22,953** | 7,248 | **17,856** | 3,455 |

## REVENUE

Revenue from the sale of crude oil, natural gas and NGL for the quarter ended December 31, 2010 was $64.9 million compared to $23.7 million for the fourth quarter of 2009. Similarly, revenue grew from $36.9 million for the year ended December 31, 2009 to $210.1 million for the year ended December 31, 2010. Revenue growth for the three months and the year ended December 31, 2010, when compared to the same periods in 2009, is comprised of production increases through acquisitions and the Company's exploration and development program offset partially by weaker natural gas prices. Revenue includes all petroleum, natural gas and NGL sales and realized gains on financial instruments.

The realized average natural gas price for the fourth quarter of 2010 was $4.17/Mcf ($5.08/Mcf – 2009) and $4.52/Mcf ($4.24/Mcf – 2009) for the full year. Realized crude oil and NGL prices averaged $75.94/Bbl for the fourth quarter of 2010 ($68.02/Bbl – 2009) and $74.62/Bbl for the full year ended 2010 ($66.10/Bbl – 2009). Realized prices exclude the effect of unrealized gains or losses. Once these gains and losses are realized they are included in the per unit amounts. The natural gas price for the quarter ended December 31, 2010 was 16% (13% – twelve months) higher than the AECO benchmark due to a combination of higher heat content on the Company's Alberta Deep Basin natural gas production and positive commodity contracts.

Tourmaline's Revenue is analyzed as follows:

| | Three Months Ended | | Year Ended | |
|---|---|---|---|---|
| (000s) | **December 31, 2010** | December 31, 2009 | **December 31, 2010** | December 31, 2009 |
| Revenue from: | | | | |
| Natural Gas | **$ 46,958** | $ 17,544 | **$ 157,769** | $ 29,038 |
| Oil and NGL | **17,961** | 6,188 | **52,336** | 7,889 |
| Total revenue from oil, NGL and gas sales | **$ 64,919** | $ 23,732 | **$ 210,105** | $ 36,927 |

***TOURMALINE PRICES:***

| | Three Months Ended | | Year Ended | |
|---|---|---|---|---|
| | **December 31, 2010** | December 31, 2009 | **December 31, 2010** | December 31, 2009 |
| Natural Gas ($/Mcf) | **$ 4.17** | $ 5.08 | **$ 4.52** | $ 4.24 |
| Oil and NGL ($/Bbl) | **$ 75.94** | $ 68.02 | **$ 74.62** | $ 66.10 |
| Oil equivalent ($/Boe) | **$ 30.74** | $ 35.59 | **$ 32.24** | $ 29.28 |

### *BENCHMARK OIL AND GAS PRICES:*

| | Three Months Ended | | Year Ended | |
|---|---|---|---|---|
| | **December 31, 2010** | December 31, 2009 | **December 31, 2010** | December 31, 2009 |
| Natural gas | | | | |
| NYMEX Henry Hub (US$/mcf) | **$ 3.98** | $ 4.93 | **$ 4.38** | $ 4.16 |
| AECO (Cdn$/mcf) | **$ 3.61** | $ 4.62 | **$ 3.99** | $ 3.99 |
| Oil | | | | |
| NYMEX (US$/bbl) | **$ 85.24** | $ 76.13 | **$ 79.61** | $ 62.09 |
| Edmonton Par (Cdn$/bbl) | **$ 80.91** | $ 77.05 | **$ 78.16** | $ 66.83 |

### *RECONCILIATION OF AECO INDEX TO TOURMALINE'S REALIZED GAS PRICES:*

| | Three months ended | | Year Ended | |
|---|---|---|---|---|
| ($/mcf) | **December 31, 2010** | December 31, 2009 | **December 31, 2010** | December 31, 2009 |
| AECO Index | **$ 3.61** | $ 4.62 | **$ 3.99** | $ 3.99 |
| Transportation | **(0.21)** | (0.12) | **(0.18)** | (0.16) |
| Heat/Quality Differential | **0.39** | 0.40 | **0.28** | 0.41 |
| Realized gain | **0.38** | 0.18 | **0.43** | — |
| Tourmaline realized natural gas price | **$ 4.17** | $ 5.08 | **$ 4.52** | $ 4.24 |

### *CURRENCY – EXCHANGE RATES:*

| | Three Months Ended | | Year Ended | |
|---|---|---|---|---|
| | **December 31, 2010** | December 31, 2009 | **December 31, 2010** | December 31, 2009 |
| Cdn/US$ | **$ 0.9874** | $ 0.9469 | **$ 0.9707** | $ 0.8768 |

## ROYALTIES

Tourmaline's Royalties are analyzed as follows:

| | Three Months Ended | | Year Ended | |
|---|---|---|---|---|
| (000s) | **December 31, 2010** | December 31, 2009 | **December 31, 2010** | December 31, 2009 |
| Natural Gas | **$ (698)** | $ 495 | **$ 5,295** | $ 2,420 |
| Oil and NGL | **$ 2,332** | $ 1,665 | **$ 10,335** | $ 2,359 |
| Total Royalties | **$ 1,634** | $ 2,160 | **$ 15,630** | $ 4,779 |

For the year ended December 31, 2010, the average effective royalty rate was 7.4% (three months ended December 31, 2010 – 2.5%), compared to 12.9% for the year ending December 31, 2009 (three months ended December 31, 2009 – 9.1%). The Company benefited from government incentive programs including the Natural Gas Deep Drilling Program and the New Well Royalty Reduction Program. In the quarter the various drilling incentive program credits exceeded the royalties that otherwise would have been paid resulting in a refund of royalties.

## OTHER INCOME

For the quarter ended December 31, 2010, other income was $0.7 million compared to $0.6 million for the same quarter in 2009. Tourmaline built and acquired interests in facilities over 2010, which helped generate third party processing income. Other income for the year ended December 31, 2010 was $1.5 million compared to $2.7 million for the year ended December 31, 2009. The decrease is due to lower investment income during the period, offset partially by an increase in processing income.

## OPERATING EXPENSES

Operating expenses include all periodic lease and field level expenses and exclude income recoveries from processing third party volumes. Operating expenses for the quarter ended December 31, 2010 were $11.6 million or $5.51/Boe, compared to $5.3 million or $7.94/Boe for the same quarter in 2009. Tourmaline's operating expenses in the fourth quarter of 2010 include third party processing, gathering and compression fees of approximately $5.2 million or 45% of total operating costs.

Operating expenses averaged $6.34/Boe for the year ended December 31, 2010 compared to $6.51/Boe for the same period in 2009. The Company has identified a number of opportunities to reduce per unit operating costs and expects to achieve further reductions throughout 2011 as higher-productivity wells are brought on-stream and a greater percentage of Tourmaline's production base is redirected through Company-owned and operated natural gas processing facilities.

## GENERAL & ADMINISTRATIVE EXPENSES

During the fourth quarter of 2010, G&A expenses of $3.2 million, including $1.2 million related to stock-based compensation expense, were incurred. The Company also capitalized direct G&A costs of $2.0 million and stock-based compensation of $1.2 million in the fourth quarter of 2010. Cash G&A expenses per Boe, excluding interest and financing charges, were $0.96/Boe for the fourth quarter of 2010, compared to $1.74/Boe for the same quarter in 2009 as unit efficiencies continue to be realized from a larger production base. The Company expects this trend of reducing G&A per Boe to continue into 2011 as production volumes grow more rapidly than the associated overhead costs.

For the year ended December 31, 2010, G&A expenses totalled $10.0 million (December 31, 2009 – $4.1 million) including $3.2 million (December 31, 2009 – $1.0 million) related to stock-based compensation expense. During the same period, direct G&A costs of $6.3 million (December 31, 2009 – $2.0 million) and stock-based compensation of $2.9 million (December 31, 2009 – $0.9 million) were capitalized. The increase in G&A expenses in 2010 compared to 2009 are primarily due to office staff additions and higher rent expense as the Company increased head office space. The higher total G&A expenses allow the Company to manage the commensurately larger production, reserve and land base. Notwithstanding this, the Company's G&A expenses per Boe continue to trend downward as Tourmaline's production base continues to grow faster than its accompanying G&A costs. Cash G&A costs for 2010, excluding interest and financing charges, were $1.05 per Boe, compared to $2.46 per Boe for 2009. This decrease in per Boe G&A cost is consistent with a growing production base.

G&A Expenses are summarized as follows:

| | Three Months Ended | | Year Ended | |
|---|---|---|---|---|
| (000s) | **December 31, 2010** | December 31, 2009 | **December 31, 2010** | December 31, 2009 |
| G&A expenses | **$ 6,503** | $ 2,665 | **$ 19,907** | $ 6,474 |
| Administrative, operating and capital recovery | **(2,440)** | (19) | **(6,697)** | (1,358) |
| Capitalized G&A | **(2,033)** | (1,539) | **(6,379)** | (2,015) |
| Stock-based compensation | **2,378** | 696 | **6,090** | 1,882 |
| Capitalized stock-based compensation | **(1,188)** | (280) | **(2,893)** | (873) |
| Total G&A, excluding interest and financing charges | **$ 3,220** | $ 1,523 | **$ 10,028** | $ 4,110 |
| Interest and financing charges | **877** | 53 | **1,085** | 53 |
| Total G&A | **$ 4,097** | $ 1,576 | **$ 11,113** | $ 4,163 |

## STOCK-BASED COMPENSATION

Tourmaline uses the fair value method for the determination of all non-cash related stock-based compensation. During 2010, 3,407,000 stock options were granted to employees, officers, directors and key consultants with exercise prices ranging from $15.00 to $20.68, and 20,000 options were exercised. The Company recognized $3.2 million of stock-based compensation expense in 2010 ($1.0 million – 2009) of which $1.2 million was recognized in the fourth quarter.

## DEPRECIATION, DEPLETION AND ACCRETION ("DD&A")

DD&A expense was $41.7 million for the fourth quarter of 2010 compared to $14.4 million for the same period in 2009 due to higher production volumes and a higher DD&A rate per Boe. The per unit DD&A rate for the fourth quarter was $19.74/Boe compared to $21.54/Boe for the fourth quarter of 2009. For the year ended December 31, 2010, DD&A expense was $127.0 million (December 31, 2009 – $23.0 million) with an effective rate of $19.48/Boe (December 31, 2009 – $18.26/Boe). The DD&A rate per Boe in the current year is trending downward due to the nature and size of the acquisitions completed by the Company and recent drilling results.

## CASH FLOW FROM OPERATIONS, FUNDS FROM OPERATIONS AND NET EARNINGS

Funds from operations for 2010 were $135.3 million or $1.10 per diluted share. The Company earned after tax income of $14.6 million ($0.12 per diluted share) for the year ended December 31, 2010, compared to an after tax loss of $2.1 million (a $0.03 loss per diluted share) in the previous year.

For the three months ended December 31, 2010 the Company realized funds from operations in the amount of $45.7 million or $0.34 per diluted share and incurred an after-tax loss of $2.6 million or $0.02 per diluted share. For the same period in 2009 the Company incurred an after-tax loss of $0.4 million.

| | Three Months Ended | | Year Ended | |
|---|---|---|---|---|
| | **December 31, 2010** | December 31, 2009 | **December 31, 2010** | December 31, 2009 |
| Cash flow from operations per share [1] | **$ 0.35** | $ (0.10) | **$ 1.17** | $ (0.01) |
| Funds from operations per share [1][2] | **$ 0.34** | $ 0.12 | **$ 1.10** | $ 0.31 |
| Earnings (loss) per share [1] | **$ (0.02)** | $ — | **$ 0.12** | $ (0.03) |
| Operating netback [2] per share | **$ 22.66** | $ 22.72 | **$ 21.76** | $ 17.58 |

*[1] Fully Diluted*
*[2] See "Non-GAAP Financial Measures"*

## CAPITAL EXPENDITURES

During the three months ended December 31, 2010, the Company invested $217.8 million of cash consideration compared to $125.9 million for the same period in 2009. Expenditures on exploration and production in the fourth quarter of 2010 were $164.7 million compared to $73.5 million in the same quarter of 2009, which is consistent with the Company's aggressive growth strategy. The Company drilled 27 gross (22.09 net) wells, completed 25 gross (17.49 net) wells and tied-in 23 gross (16.83 net) wells. Drilling, completing, equipping and related facilities costs totalled $158.2 million and land and seismic costs were $6.5 million for the fourth quarter of 2010. Included in acquisitions was a significant working interest in a gas processing facility with a net capacity of 45 mmcfpd in the Alberta Deep Basin.

Tourmaline invested $815.9 million of cash consideration for the year ended December 31, 2010 (2009 – $499.3 million). During 2010 the Company drilled 79 gross (57.75 net) wells, completed 98 gross (74.09 net) wells and tied-in 64 gross (44.95 net) wells.

During 2010 Tourmaline issued approximately 8.9 million common shares at an average price of $15.84 per share for corporate and property acquisitions for total consideration of $141.2 million.

Tourmaline disposed of some producing and non-producing properties in 2010, for proceeds of $27.9 million. Included in the proceeds was an investment in a private corporation valued at $3.25 million.

| | Three Months Ended | | Year Ended | |
|---|---|---|---|---|
| (000s) | **December 31, 2010** | December 31, 2009 | **December 31, 2010** | December 31, 2009 |
| Land and seismic | **$ 6,477** | $ 18,969 | **$ 35,842** | $ 32,611 |
| Drilling and completions | **115,616** | 31,798 | **322,928** | 84,828 |
| Facilities | **42,625** | 22,726 | **128,577** | 27,253 |
| Property acquisitions | **53,834** | 59,849 | **343,234** | 360,496 |
| Corporate acquisitions | **—** | (7,911) | **3,156** | (8,655) |
| Property dispositions | **(2,813)** | — | **(24,647)** | — |
| Other | **2,074** | 515 | **6,805** | 2,725 |
| Total | **$ 217,813** | $ 125,946 | **$ 815,895** | $ 499,258 |

## LIQUIDITY AND CAPITAL RESOURCES

At December 31, 2010, Tourmaline had negative working capital of $49.2 million, after adjusting for the fair value of financial instruments and future taxes (the unadjusted working capital deficiency was $37.6 million). Management believes the Company has sufficient liquidity and capital resources to fund its 2011 exploration and development program through expected cash flow from operations and its unutilized bank credit facilities.

Tourmaline issued 6.4 million common shares at a price of $15.00 per share as part of a corporate acquisition which closed in the first quarter of 2010.

On March 19, 2010, Tourmaline closed a private placement equity financing for gross proceeds of approximately $224 million. The transaction included the issuance of 9.5 million Common shares at $18.00 per share and 2.45 million flow-through common shares at $21.60 per share. The net proceeds of approximately $214 million were utilized to acquire properties and to conduct the Company's 2010 exploration and development program.

Tourmaline issued 2.5 million common shares at $18.00 per share on June 1, 2010 as part of a property acquisition that closed in the second quarter of 2010.

On August 12, 2010, the Company issued 1.15 million flow-through common shares at $22.00 per share, for gross proceeds of $25.3 million.

On November 23, 2010 the Company issued 10.85 million common shares (including 850,000 issued on a private placement) at a price of $21.00 per share as part of its initial public offering for total gross proceeds of $227.85 million. Subsequently, on December 23, 2010 the underwriters exercised their over-allotment option and purchased a further 1,500,000 common shares at a price of $21.00 per share for total gross proceeds of $31.5 million.

The Company has a credit facility with two Canadian chartered banks for an extendible revolving term loan in the amount of $165 million, in addition to a $25 million operating line. The facility bears interest on a variable grid currently 250 basis points over the prevailing banker's acceptance rate. Security for the facility includes a general security agreement and a $500 million demand loan debenture secured by a first floating charge over all assets. On July 31, 2011, at the Company's discretion, the facility is available on a non-revolving basis for a period of 365 days, at which time the facility would be due and payable. Alternatively, the facility may be extended for a further 364-day period at the request of the Company and subject to approval by the banks.

A subsidiary of the Company also has a financing arrangement with a Canadian chartered bank for an extendible revolving term loan in the amount of $5 million in addition to a $5 million operating line. The interest rate charged varies based on the amount outstanding. Security for the facility includes a general security agreement and a demand loan debenture secured by a first floating charge over all of the subsidiary's assets. The revolving term credit facility has a 364-day extendible period plus a one-year maturity.

The Company is required to meet certain financial-based covenants to maintain the facilities. The financial covenants include a requirement to ensure the total amount drawn on the facility does not exceed the total borrowing base as defined in each facility's agreement, and that the ratio of earnings adjusted for interest, taxes and other non-cash items to interest expense does not exceed a predetermined amount, as determined by each facility's agreement. As at December 31, 2010 the company was in compliance with these covenants.

As at December 31, 2010, no amounts have been drawn down on existing facilities (2009 – nil).

## FLOW-THROUGH COMMITMENTS

At December 31, 2010 the Company has fully spent the $31.5 million flow-through common share issue commitment undertaken in 2009. The renouncement of the 2009 CEE expenses, along with the related future tax effect of $7.9 million, was recognized in the first quarter of 2010.

On March 19, 2010, the Company issued 2.45 million flow-through common shares committing the Company to spend $52.9 million on eligible capital expenditures by December 31, 2011, all of which has been expended to date.

On August 12, 2010, the Company issued 1.15 million flow-through common shares committing the Company to spend $25.3 million on eligible capital expenditures prior to December 31, 2011, all of which has been expended to date.

## SHARES OUTSTANDING

As at March 22, 2011 the Company has 138,124,395 common shares outstanding and 11,703,667 million stock options granted and outstanding.

## SUBSEQUENT EVENTS

On March 8, 2011 the Company issued 1.58 million common shares, including 0.38 million common shares to insiders in a non-brokered component of the issuance, on a Flow-Through basis at a price of $30.00 per share for total gross proceeds of $47.4 million.

## COMMITMENTS AND CONTRACTUAL OBLIGATIONS

In the normal course of business Tourmaline is obligated to make future payments. These obligations represent contracts and other commitments that are known and non-cancellable.

| Payments due by year (000s) | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|
| Operating leases | $ 2,348 | $ 2,120 | $ 1,758 | $ 1,614 | $ 404 |
| Flow-Through obligations | — | 47,400 | — | — | — |
| Firm transportation agreements | 20,354 | 18,235 | 16,498 | 9,506 | 6,676 |
| | $ 22,702 | $ 67,755 | $ 18,256 | $ 11,120 | $ 7,080 |

## FINANCIAL RISK MANAGEMENT

The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework. The Board has implemented and monitors compliance with risk management policies.

The Company's risk management policies are established to identify and analyze the risks faced by the Company, to set appropriate risk limits and controls, and to monitor risks and adherence to market conditions and the Company's activities.

### (a) Fair value of financial instruments:

Financial instruments comprise cash and cash equivalents, accounts receivable, investments, commodity price risk management contracts, accounts payable and accrued liabilities and bank debt. All of Tourmaline's commodity price risk management contracts and investments in public companies are transacted in active markets. Tourmaline classifies the fair value of these transactions according to the following hierarchy based on the amount of observable inputs used to value the instrument:

- Level 1 – Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions occur in sufficient frequency and volume to provide pricing information on an ongoing basis.

- Level 2 – Pricing inputs are other than quoted prices in active markets included in Level 1. Prices are either directly or indirectly observable as of the reporting date. Level 2 valuations are based on inputs, including quoted forward prices for commodities, time value and volatility factors, which can be substantially observed or corroborated in the marketplace.

- Level 3 – Valuations in this level are those with inputs for the asset or liability that are not based on observable market data.

The fair values of cash and cash equivalents, accounts receivable and accounts payable and accrued liabilities approximate their carrying amounts due to their short-term maturities. The Company's investments held for trading had a fair value based on quoted market price at December 31, 2010 and were classified as Level 1.

The fair value of the risk management contracts (as presented on the balance sheet) are determined by discounting the difference between the contracted price and published forward price curves as at the balance sheet date, using the remaining contracted oil and natural gas volumes, and are considered Level 2.

Bank debt, when in existence, bears interest at a floating market rate and accordingly the fair value would approximate the carrying value.

**(b) Credit risk:**

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Company's receivables from joint venture partners and petroleum and natural gas marketers. As at December 31, 2010 Tourmaline's receivables consisted of $21.1 million from joint venture partners, $23.6 million from petroleum and natural gas marketers and $13.9 million from provincial governments. As of March 22, 2011 $47.0 million of the outstanding accounts receivable outstanding at December 31, 2010 has been collected.

Receivables from petroleum and natural gas marketers are normally collected on the 25th day of the month following production. The Company's policy to mitigate credit risk associated with these balances is to establish marketing relationships with creditworthy purchasers. The Company historically has not experienced any collection issues with its petroleum and natural gas marketers. Joint venture receivables are typically collected within one to three months of the joint venture bill being issued to the partner. The Company attempts to mitigate the risk from joint venture receivables by obtaining partner approval of significant capital expenditures prior to expenditure. However, the receivables are from participants in the petroleum and natural gas sector, and collection of the outstanding balances are dependent on industry factors such as commodity price fluctuations, escalating costs and the risk of unsuccessful drilling. In addition, further risk exists with joint venture partners as disagreements occasionally arise that increase the potential for non-collection. The Company does not typically obtain collateral from petroleum and natural gas marketers or joint venture partners; however, the Company does have the ability to withhold production from joint venture partners in the event of non-payment.

The Company monitors the age of and investigates issues behind its receivables that have been past due for over 90 days. At December 31, 2010 the Company had $1.0 million (2009 – $251,000) over 90 days. The Company is satisfied that these amounts are substantially collectible.

The carrying amount of accounts receivable and cash and cash equivalents and commodity risk management contracts represents the maximum credit exposure. The Company does not have an allowance for doubtful accounts as at December 31, 2010 (2009 – nil) and did not provide for any doubtful accounts nor was it required to write-off any receivables during the year ended December 31, 2010 (2009 – nil).

### (c) Liquidity risk:

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they come due. The Company's approach to managing liquidity is to ensure, as far as possible, that it will have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions without incurring unacceptable losses or risking harm to the Company's reputation. Liquidity risk is mitigated by cash on hand and bank credit facilities.

The Company's accounts payable and accrued liabilities balance at December 31, 2010 is approximately $178.1 million (December 31, 2009 – $86.9 million). It is the Company's policy to pay suppliers within 45-75 days. These terms are consistent with industry practice. As at December 31, 2010 substantially all of the account balances were less than 90 days.

The Company prepares annual capital expenditure budgets, which are regularly monitored and updated as considered necessary. Further, the Company utilizes authorizations for expenditures on both operated and non-operated projects to further manage capital expenditures. The Company also attempts to match its payment cycle with the collection of petroleum and natural gas revenues on the 25th of each month.

### (d) Market risk:

Market risk is the risk that changes in market conditions, such as commodity prices, interest rates or foreign exchange rates will affect the Company's net income or value of financial instruments. The objective of market risk management is to manage and curtail market risk exposure within acceptable limits, while maximizing the Company's returns.

The Company utilizes both financial derivatives and physical delivery sales contracts to manage market risks. All such transactions are conducted in accordance with the risk management policy that has been approved by the Board of Directors.

Currency risk has minimal impact on the value of the financial assets and liabilities on the balance sheet at December 31, 2010. Changes in the US to Canadian exchange rate, however, could influence future petroleum and natural gas prices which could impact the value of certain derivative contracts. This influence cannot be accurately quantified.

Interest rate risk had minimal impact on the Company's balance sheet at December 31, 2010 as there was a nominal average amount of cash in short term investments and only small amounts drawn on the Company's credit facilities over the quarter and over the year ended December 31, 2010.

Commodity price risk is the risk that the fair value or future cash flows will fluctuate as a result of changes in commodity prices. As at December 31, 2010, the Company has entered into certain financial derivative and physical delivery sales contracts in order to manage commodity risk. These instruments are not used for trading or speculative purposes. The Company has not designated its financial derivative contracts as effective accounting hedges, even though the Company considers all commodity contracts to be effective economic hedges. As a result, all such commodity contracts are recorded on the balance sheet at fair value, with changes in the fair value being recognized as an unrealized gain or loss on the consolidated statement of income.

The Company has entered into the following contracts as at December 31, 2010:

| Type of Contract | Quantity | Time Period | Contract Price |
|---|---|---|---|
| AECO Fixed Price | 3,000 gjs/d | April 2010 – March 2011 | Cdn$5.77/gj |
| AECO Fixed Price | 2,000 gjs/d | April 2010 – March 2011 | Cdn$5.72/gj |
| AECO Fixed Price | 3,000 gjs/d | January – December 2011 | Cdn$5.75/gj |
| AECO Fixed Price | 3,000 gjs/d | January – December 2011 | Cdn$5.84/gj |
| AECO Fixed Price | 4,000 gjs/d | February 2010 – December 2011 | Cdn$5.68/gj |
| AECO Fixed Price | 2,000 gjs/d | February 2010 – December 2011 | Cdn$5.72/gj |
| AECO Fixed Price | 2,000 gjs/d | November 2010 – March 2011 | Cdn$6.01/gj average |
| AECO Fixed Price | 2,000 gjs/d | March 2010 – March 2012 | Cdn$5.72/gj average |
| AECO Fixed Price | 2,000 gjs/d | March 2010 – December 2011 | Cdn$5.705/gj |
| AECO Fixed Price | 3,000 gjs/d | March 2010 – March 2011 | Cdn$5.89/gj |
| AECO Fixed Price | 3,000 gjs/d | January 2011 – December 2012 | Cdn$5.53/gj |
| AECO Call Option | 3,000 gjs/d | January – December 2011 | Cdn$6.50/gj strike price |
| AECO Call Option | 3,000 gjs/d | January 2011– December 2012 | Cdn$6.00/gj strike price |
| AECO/Nymex Differential Swap | 3,000 MMbtu/d | November 2010 – October 2011 | Nymex less $0.475/MMbtu |
| AECO/Nymex Differential Swap | 5,000 MMbtu/d | November 2010 – November 2012 | Nymex less $0.62/MMbtu |
| AECO/Nymex Differential Swap | 5,000 MMbtu/d | November 2010 – October 2011 | Nymex less $0.485/MMbtu |
| AECO/Nymex Differential Swap | 3,000 MMbtu/d | November 2010 – October 2012 | Nymex less $0.535/MMbtu |
| AECO/Nymex Differential Swap | 5,000 MMbtu/d | January 2011 – December 2012 | Nymex less $0.475/MMbtu |
| Financial Swap | 100 bbls/d | July 2011 – December 2012 | USD$90.00/bbl |
| Financial Swap | 100 bbls/d | January 2011 – December 2011 | USD$87.85/bbl |
| Costless Collar | 100 bbls/d | September 2010 – August 2012 | US$75/bbl floor – US$96/bbl ceiling |

The fair value of outstanding contracts at December 31, 2010 totals $16.0 million, $14.4 million of which is current.

The following contracts were entered into subsequent to December 31, 2010:

| Type of Contract | Quantity | Time Period | Contract Price |
|---|---|---|---|
| AECO Fixed Price | 3,000 gjs/d | February 2011 – April 2012 | Cdn$4.00/gj |
| Financial Swap | 100 bbls/d | July 2011 – December 2011 | USD$100.10/bbl |
| Financial Swap | 100 bbls/d | July 2011 – June 2012 | USD$101.40/bbl |
| Financial Swap | 100 bbls/d | January 2012 – June 2013 | USD$99.70/bbl |
| Financial Swap | 100 bbls/d | September 2011 – December 2012 | USD$101.00/bbl |
| Financial Swap | 100 bbls/d | January – December 2012 | USD$104.00/bbl |

The following table provides a summary of the unrealized gains and losses on financial instruments for the year ended December 31, 2010:

| | Three Months Ended | | Year Ended | |
|---|---|---|---|---|
| (000s) | **December 31, 2010** | December 31, 2009 | **December 31, 2010** | December 31, 2009 |
| Unrealized gain (loss) on financial instruments | **$ (5,874)** | $ 324 | **$ 15,690** | $ 324 |
| Unrealized gain (loss) on investments held for trading | **187** | (46) | **260** | (46) |
| Total | **$ (5,687)** | $ 278 | **$ 15,950** | $ 278 |

The unrealized gain on derivative contracts has been included on the balance sheet with changes in the fair value included in the unrealized gain on financial instruments on the statement of income. As at December 31, 2010, if the future strip prices for natural gas were $0.10 per mcf higher and prices for oil were $1.00 per bbl higher, with all other variables held constant, before-tax earnings for the year would have been $1.9 million lower. An equal and opposite impact would have occurred to before tax earnings and the fair value of the derivative contracts asset had natural gas prices been $0.10 per mcf lower and oil prices $1.00 per bbl lower.

**(e) Capital management:**

The Company's policy is to maintain a strong capital base to maintain investor, creditor and market confidence and to sustain the future development of the business. The Company considers its capital structure to include shareholders' equity, bank debt and working capital. In order to maintain or adjust the capital structure, the Company may from time to time issue shares and adjust its capital spending to manage current and projected debt levels. The annual and updated budgets are approved by the Board of Directors.

The key measures that the Company utilizes in evaluating its capital structure are net debt, which is defined as long-term bank debt plus working capital (adjusted for the fair value of financial instruments and future taxes), to annualized funds from operations, defined as cash flow from operating activities before changes in non-cash working capital, and the current credit available from its creditors in relation to the Company's budgeted capital program. Net debt to annualized funds from operations represents a measure of the time it is expected to take to pay off the debt if no further capital expenditures were incurred and if funds from operations in the next year was equal to the amount in the most recent quarter annualized.

The Company monitors this ratio and endeavours to maintain it at or below 2.0 to 1.0 in a normalized commodity price environment. This ratio may increase at certain times as a result of acquisitions or low commodity prices. As shown below, as at December 31, 2010, the Company's ratio of net debt to annualized funds from operations was 0.27 to 1.0.

| | As at December 31, | |
|---|---|---|
| (000s) | **2010** | 2009 |
| Net debt: | | |
| Bank debt | **$ —** | $ — |
| Working capital (deficit) | **(37,589)** | 161,514 |
| Future taxes – short-term liability | **2,832** | – |
| Fair Value of financial instruments – short term asset | **(14,413)** | (324) |
| Net debt | **$ (49,170)** | $161,190 |
| Annualized funds from operations: | | |
| Cash flow from operating activities | **$ 46,858** | $ (9,388) |
| Change in non-cash working capital | **(1,169)** | 23,957 |
| Fourth quarter funds from operations | **$ 45,689** | $ 14,569 |
| Annualized fund from operations | **$182,756** | $ 58,276 |
| Net debt to annualized funds from operations | **0.27** | n/a |

## APPLICATION OF CRITICAL ACCOUNTING ESTIMATES

The consolidated financial statements have been prepared in accordance with Canadian GAAP. A summary of significant accounting policies is presented in the December 31, 2010 consolidated financial statements. Certain accounting policies require that management make appropriate decisions with respect to the formulation of estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Management reviews its estimates on a regular basis. The emergence of new information and changed circumstance may result in actual results or changes to estimated amounts that differ materially from current estimates. The following discussion identifies the critical accounting policies and practices of the Company and helps assess the likelihood of materially different results being reported.

## RESERVES

Under the National Instrument 51-101 ("NI 51-101"), "Proved" reserves are defined as those reserves that can be estimated with a high degree of certainty to be recoverable. The level of certainty should result in at least 90% probability that the quantities actually recovered will equal or exceed the estimated Proved reserves. It does not mean that there is a 90% probability that the Proved reserves will be recovered; it means there must be at least 90% probability that the given amount or more will be recovered.

"Proved plus Probable" reserves are the most likely case and are based on a 50% certainty that they will equal or exceed the reserves estimated.

These oil and gas reserve estimates are made using all available geological and reservoir data, as well as historical production data. All of the Company's reserves were evaluated and reported on by independent qualified reserves evaluators. However, revisions can occur as a result of various factors including: actual reservoir performance, changes in price and cost forecasts or, a change in the Company's plans. Reserve changes will impact the financial results as reserves are used in the calculation of depletion and are used to assess whether asset impairment occurs. Reserve changes also affect other non-GAAP measurements such as finding and development costs, recycle ratios and net asset value calculations.

## DEPLETION AND DEPRECIATION

The Company follows the full cost method of accounting for oil and natural gas properties. Under this method, all costs related to the acquisition of, exploration for and development of oil and natural gas reserves are capitalized whether successful or not. Depletion of the capitalized oil and natural gas properties and depreciation of production equipment which includes estimated future development costs are calculated using the unit-of-production method, based on production volumes in relation to estimated proven reserves.

An increase in estimated proved reserves would result in a reduction in depletion expense. A decrease in estimated future development costs would also result in a reduction in depletion expense.

## UNPROVED PROPERTIES

The cost of acquisition and evaluation of unproved properties are initially excluded from depletion calculation. An impairment test is performed on these assets to determine whether the carrying value exceeds the fair value. Any excess in carrying value over fair value is an impairment. When proved reserves are assigned or a property is considered to be impaired, the cost of the property or the amount of the impairment will be added to the capitalized costs for the calculation of depletion.

## CEILING TEST

The ceiling test is a cost recovery test intended to identify and measure potential impairment of the value of assets relative to the cost of those assets as carried on the Company's balance sheet. An impairment loss is recorded if the sum of the undiscounted cash flows (assuming certain commodity prices, operating costs, royalty rates and other deductions) expected from the production of the proved reserves and cost less impairment of unproved properties does not exceed the values of the petroleum and natural gas assets as carried on the Company's balance sheet. An impairment loss is recognized to the extent that the carrying value exceeds the sum of the discounted cash flows expected from the production of proved and probable reserves and the cost less impairment of unproved properties. The cash flows are estimated using the future product prices and costs and are discounted using the risk free rate. By their nature, these estimates are subject to measurement uncertainty and the impact on the financial statements could be material. Any impairment as a result of this ceiling test will be charged to operations as additional depletion and depreciation expense.

A ceiling test was performed quarterly by the Company and at each testing period, the Company's proved and probable reserves had sufficient value under the formula to cover the value of the petroleum and natural gas assets as carried on the Company's balance sheet.

## ASSET RETIREMENT OBLIGATIONS

The Company records a liability for the fair value of legal obligations associated with the retirement of petroleum and natural gas assets. The liability is equal to the discounted fair value of the obligation in the period in which the asset is recorded with an equal offset to the carrying amount of the asset. The liability then accretes to its fair value with the passage of time and the accretion is recognized as an expense in the consolidated financial statements. The total amount of the asset retirement obligation is an estimate based on the Company's net ownership interest in all wells and facilities, the estimated costs to abandon and reclaim the wells and facilities and the estimated timing of the costs to be incurred in future periods. The total amount of the estimated cash flows required to settle the asset retirement obligation, the timing of those cash flows and the discount rate used to calculate the present value of those cash flows are all estimates subject to measurement uncertainty. Any change in these estimates would impact the asset retirement liability and the accretion expense.

## INCOME TAXES

The determination of income and other tax liabilities requires interpretation of complex laws and regulations. All tax filings are subject to audit and potential reassessment after the lapse of considerable time. In addition, the Company estimates when its temporary differences are expected to reverse and recognizes its tax assets and liabilities based on the legislated tax rate in those periods. Accordingly, the actual income tax liability may differ significantly from that estimated and recorded by management.

## STOCK-BASED COMPENSATION

The Company applies the fair value method for valuing stock option grants. This method requires the Company to make estimates of expected stock volatility, the expected hold period prior to exercising options, expected forfeitures of options and expected dividends to be declared by the Company. The calculation of the fair value of stock-based compensation is not adjusted for the value actually received by the optionees. The stock-based compensation expense will not represent the actual fair value received by the optionees as the fair value is estimated at the time of grant and is not adjusted. Due to the time period and the number of estimates involved, it is likely that the actual value of the options will differ from what has been recorded in the financial statements.

## OTHER ESTIMATES

The accrual method of accounting requires management to incorporate certain estimates including estimates of revenues, royalties and operating costs as at a specific reporting date, but for which actual revenues and costs have not yet been received. In addition, estimates are made on capital projects which are in progress or recently completed where actual costs have not been received by the reporting date. The Company obtains the estimates from the individuals with the most knowledge of the activity and from all project documentation received. The estimates are reviewed for reasonableness and compared to past performance to assess the reliability of the estimates. Past estimates are compared to actual results in order to make informed decisions on future estimates.

## FAIR VALUE OF FINANCIAL DERIVATIVES

Tourmaline uses financial derivatives to manage commodity price risk. The fair value of commodity price risk contracts is estimates on Tourmaline's balance sheet with changes in fair value recognized in net income for the period. The fair value of each financial instrument is based on forward prices and therefore any change in commodity prices will impact the fair value and net income for the period.

## DISCLOSURE CONTROLS AND PROCEDURES AND INTERNAL CONTROLS OVER FINANCIAL REPORTING

The Company's Chief Executive Officer and Chief Financial Officer have designed, or caused to be designed under their supervision, disclosure controls and procedures ("DC&P") to provide reasonable assurance that: (i) material information relating to the Company is made known to the Company's Chief Executive Officer and Chief Financial Officer by others, particularly during the periods in which the annual and interim filings are being prepared; and (ii) information required to be disclosed by the Company in its annual filings, interim filings or other reports filed or submitted by it under securities legislation is recorded, processed, summarized and reported within the time period specified in securities legislation. All control systems by their nature have inherent limitations and, therefore, the Company's DC&P are believed to provide reasonable, but not absolute, assurance that the objectives of the control systems are met. The Company's Chief Executive Officer and Chief Financial Officer have designed, or caused to be designed under their supervision, internal controls over financial reporting ("ICFR") to provide reasonable assurance regarding the reliability of the Company's financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP.

Although DC&P and ICFR were in place as of December 31, 2010, the Company was not required to evaluate the effectiveness of DC&P and ICFR, as the Company only became a reporting issuer in November 2010. Management will be required to certify the design of the Company's DC&P and ICFR as of March 31, 2011, and will be required to certify the effectiveness of DC&P and ICFR as of December 31, 2011. The evaluation of ICFR will be based on the framework in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations. Tourmaline is in the final stages of completion of the project to support the certification of the design of DC&P and ICFR, and will continue to work to complete the project to support the certification of effectiveness by December 31, 2011.

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

## BUSINESS RISKS AND UNCERTAINTIES

Tourmaline monitors and complies with current government regulations that affect its activities, although operations may be adversely affected by changes in government policy, regulations or taxation. In addition, Tourmaline maintains a level of liability, property and business interruption insurance which is believed to be adequate for Tourmaline's size and activities, but is unable to obtain insurance to cover all risks within the business or in amounts to cover all possible claims.

See "Forward-Looking Statements" in this MD&A and "Risk Factors" in Tourmaline's most recent annual information form for additional information regarding the risks to which Tourmaline and its business and operations are subject

## IMPACT OF NEW ENVIRONMENTAL REGULATIONS

Environmental legislation, including the Kyoto Accord, the federal government's "EcoACTION" plan and Alberta's Bill 3 – Climate Change and Emissions Management Amendment Act, is evolving in a manner expected to result in stricter standards and enforcement, larger fines and liability and potentially increased capital expenditures and operating costs. Given the evolving nature of the debate related to climate change and the resulting requirements, it is not possible to determine the operational or financial impact of those requirements on Tourmaline.

## INTERNATIONAL FINANCIAL REPORTING STANDARDS ("IFRS")

In February 2008, the CICA Accounting Standards Board ("AcSB") confirmed the changeover to IFRS from Canadian GAAP will be required for publicly accountable enterprises for interim and annual financial statements effective for fiscal years beginning on or after January 1, 2011, including comparatives for 2010. The eventual changeover to IFRS represents a change due to new accounting standards. The transition from current Canadian GAAP to IFRS is a significant undertaking that may materially affect the Company's reported financial position and results of operations.

### Project Status

The Company has completed its preliminary assessment of accounting policy alternatives and continues to evaluate the policies it will adopt. Changes in accounting policies are expected and will impact the financial statements. The impact of potential accounting policy changes cannot yet be quantified as management continues to assess policy choices as a result of anticipated changes in IFRS prior to the conversion date. Tourmaline remains focused on the transition to IFRS and will be ready to prepare financial statements under both Canadian GAAP and IFRS for 2010 to provide for comparative financial statements after the official changeover in 2011. Tourmaline has been working toward the completion of the preliminary opening IFRS balance sheet as well as the conversion of the first quarter 2010 financial statements, although certain issues and have not been concluded and the quantifiable impacts have not yet been determined.

### Areas of Focus

The following discussion provides additional information on the key areas of focus, which Tourmaline expects to have the highest impact in the changeover; however, as certain aspects of the adoption of IFRS remain uncertain, Tourmaline cannot guarantee that this information will not change as the date of transition approaches. The Company will continue to communicate information in relation to its conversion process as it becomes available.

*Accounting for Capital Assets Including Impairment*

Tourmaline is currently determining the Company's accounting policies associated with capital assets under IFRS. When appropriate, the Company is electing to make policy choices that minimize the differences between Tourmaline's capital asset accounting under current Canadian GAAP and IFRS and also that reflect policies which are consistent with its peer entities.

*IFRS 1 Amendment:*

On July 23, 2009, the International Accounting Standards Board ("IASB") issued amendments to IFRS 1, "First-time Adoption of International Financial Reporting Standards" that greatly reduced the amount of effort required upon transition to IFRS for entities, such as Tourmaline, that have historically applied the full-cost method of accounting. Under the amendment, Canadian GAAP full cost pools are allocated to smaller units of account at the transition date of January 1, 2010 based on either reserve volumes or values and, currently, Tourmaline intends to rely on this exemption and perform this allocation based on reserve values.

There are still a number of significant differences associated with accounting for capital assets under IFRS versus Canadian GAAP which will impact the Company. Under Canadian GAAP's full-cost accounting, expenditures related to oil and gas assets are aggregated on a country-by-country basis for depletion and impairment testing purposes.

*Exploration and Evaluation assets ("E&E"):*

- The Company's undeveloped land balance as at December 31, 2009 will be the largest component of the opening balance of E&E at January 1, 2010. This and any other exploratory assets will be separately disclosed on the balance sheet and in the notes to the financial statements.
- E&E assets will be assessed for impairment on January 1, 2010, and thereafter, when amounts are transferred to Development assets and when indicators exist.

*Development assets:*

- The Company's net book value of property, plant and equipment excluding E&E as at December 31, 2009 will be the opening cost of Development assets at January 1, 2010.
- A gain or loss must be calculated upon the sale, swap or transfer of assets.

- Depletion and Depreciation will be calculated at the "Component" level.
- Impairment will be assessed at the CGU level. Impairment of Development assets occurs when the net book value exceeds the recoverable amount; the recoverable amount will likely be calculated using a discounted cash flow model. The excess of the carrying amount over the recoverable amount is expensed during the period of impairment.

Development assets will be assessed for impairment at January 1, 2010, and thereafter when indicators exist.

Under IFRS, the unit of account for both depletion and impairment testing is significantly smaller and accordingly, non-cash impairments are more likely under IFRS than under Canadian GAAP full-cost accounting. Tourmaline's current accounting systems and processes are capable of accounting for capital assets at the more detailed level required under IFRS.

*Deferred Income Taxes*

Tourmaline has been closely monitoring the progress associated with the IASB's exposure draft to replace International Accounting Standard ("IAS") 12 "Income Taxes." In October 2009, the IASB decided it would not proceed with the exposure draft and instead would consider a limited scope project to amend IAS 12. Accordingly, Tourmaline is evaluating the differences between the current version of IAS 12 and the relevant Canadian GAAP requirements.

*Asset Retirement Obligations*

A major difference between current Canadian standards and IFRS appears to be the discount rate used to measure the asset retirement obligation. Under current Canadian standards a credit adjusted risk free rate is used in calculating the provision. Under IFRS, a risk free rate should be used when the expected cash flows are risked. Within the industry, there has been a debate on whether there should be a risk component applied to conventional property estimated cash outflows used in determining the provision. The Company is monitoring this matter and will be deciding which rate is the most appropriate in its circumstances. A lower discount rate will increase the provision on transition to IFRS with a corresponding charge to retained earnings or deficit.

*Business Combinations*

The Company did not elect to early adopt the newly issued Handbook section 1582, which has been aligned with IFRS 3, therefore there will be two major differences in the purchase price allocations of business combinations that have occurred during 2010 upon conversion to IFRS. The first is that the consideration paid in the contract between the deal close and the reporting date, if it involved financial instruments other than cash, must be measured at fair value. The second difference will be that transaction costs incurred by the Company that are directly related to the acquisition must be expensed in the period incurred, whereas under current GAAP they have been capitalized as part of the cost of the acquisition. The full impact of these changes has not yet been quantified.

Tourmaline also intends to apply the "First Time Adoption of IFRS" ("IFRS 1") exemption to value business combinations at the amounts determined under Canadian GAAP, rather than applying the IFRS rules retrospectively.

### Issues Associated with the Initial Adoption of IFRS

Aside from the exemptions discussed above, Tourmaline has not yet ultimately concluded what other available exemptions it will take upon transition to IFRS. Tourmaline has conducted a review of its accounting systems and processes and, as a result of a various upgrades that have been completed over recent years, the Company's current systems and processes will accommodate the transition to IFRS. Tourmaline has established internal controls associated with the IFRS transition which include approvals at various stages of the project and the Company continues to work closely with its advising public accounting firm in relation to the IFRS conversion.

## NON-GAAP FINANCIAL MEASURES

This MD&A includes references to financial measures commonly used in the oil and gas industry such as "funds from operations", "operating netback", "working capital (adjusted for the fair value of financial instruments and future taxes)" and "net debt", which do not have any standardized meaning prescribed by GAAP. Management believes that in addition to net income, funds from operations, operating netback, net debt and working capital (adjusted for the fair value of financial instruments and future taxes) are useful supplemental measures as they demonstrate Tourmaline's ability to generate the cash necessary to repay debt or fund future growth through capital investment. Readers are cautioned, however, that these measures should not be construed as an alternative to net income determined in accordance with GAAP as an indication of Tourmaline's performance. Tourmaline's method of calculating these measures may differ from other companies and accordingly, they may not be comparable to measures used by other companies. For these purposes, Tourmaline defines funds from operations as cash provided by operations before changes in non-cash operating working capital, defines operating netback as revenue less royalties and operating expenses and defines working capital (adjusted for the fair value of financial instruments and future taxes) as working capital adjusted for the fair value of financial instruments and future taxes. Net debt is defined as long-term bank debt plus working capital (adjusted for the fair value of financial instruments and future taxes).

### Funds from Operations

A summary of the reconciliation of funds from operations to cash flow from operating activities is set forth below:

| | Three Months Ended December 31, | | Year Ended December 31, | |
|---|---|---|---|---|
| (000s) | **2010** | 2009 | **2010** | 2009 |
| Cash flow from operating activities (per GAAP) | **$ 46,858** | $ (9,388) | **$ 144,857** | $ (514) |
| Change in non-cash working capital | **(1,169)** | 23,957 | **(9,517)** | 22,236 |
| Funds from operations | **$ 45,689** | $ 14,569 | **$ 135,340** | $ 21,722 |

### Operating Netback

Operating netback is calculated on a per boe basis and is defined as revenue less royalties, transportation costs and operating expenses, as shown below:

| | Three Months Ended December 31, | | Year Ended December 31, | |
|---|---|---|---|---|
| ($/Boe) | **2010** | 2009 | **2010** | 2009 |
| Revenue, excluding processing fee income | **$ 30.74** | $ 35.59 | **$ 32.24** | $ 29.28 |
| Royalties | **(0.77)** | (3.24) | **(2.40)** | (3.79) |
| Transportation costs | **(1.80)** | (1.69) | **(1.74)** | (1.40) |
| Operating expenses | **(5.51)** | (7.94) | **(6.34)** | (6.51) |
| Operating Netback | **$ 22.66** | $ 22.72 | **$ 21.76** | $ 17.58 |

## Working Capital (Adjusted for the Fair Value of Financial Instruments and Future Taxes)

A summary of the reconciliation of working capital to working capital (adjusted for the fair value of financial instruments and future taxes) is set forth below.

| | As at December 31, | |
|---|---|---|
| (000s) | **2010** | 2009 |
| Working capital (deficit) | **$ (37,589)** | $ 161,514 |
| Future taxes – short-term liability | **2,832** | — |
| Fair Value of financial instruments – short term asset | **(14,413)** | (324) |
| Working capital (deficit) (adjusted for the fair value of financial instruments and future taxes) | **$ (49,170)** | $ 161,190 |

**Net Debt**

A summary of the reconciliation of net debt is set forth below.

| | As at December 31 | |
|---|---|---|
| (000s) | **2010** | 2009 |
| Bank Debt | **$ —** | $ — |
| Working capital (deficit) | **(37,589)** | 161,514 |
| Future taxes – short-term liability | **2,832** | — |
| Fair Value of financial instruments – short term asset | **(14,413)** | (324) |
| Net debt | **$(49,170)** | $161,190 |

## SELECTED QUARTERLY INFORMATION

| | **2010** | | | | 2009 | | | |
|---|---|---|---|---|---|---|---|---|
| | **Q4** | Q3 | Q2 | Q1 | Q4 | Q3 | Q2 | Q1 |
| **Production** | | | | | | | | |
| Crude oil and NGL (bbls) | **236,502** | 147,997 | 178,787 | 138,068 | 90,978 | 21,168 | 6,026 | 1,175 |
| Gas (mcf) | **11,251,067** | 9,502,337 | 8,693,492 | 5,449,027 | 3,454,934 | 2,067,940 | 1,160,021 | 168,042 |
| Oil equivalent (boe) | **2,111,680** | 1,731,720 | 1,627,702 | 1,046,239 | 666,800 | 365,825 | 199,363 | 29,182 |
| Crude oil and NGL (bbls/d) | **2,571** | 1,609 | 1,965 | 1,534 | 989 | 230 | 66 | 13 |
| Gas (mcf/d) | **122,294** | 103,286 | 95,533 | 60,545 | 37,554 | 22,478 | 12,747 | 1,867 |
| Oil equivalent (boe/d) | **22,953** | 18,823 | 17,887 | 11,625 | 7,248 | 3,976 | 2,191 | 324 |
| **Financial** ($000s, unless otherwise noted) | | | | | | | | |
| Gross revenue, net of royalties | **58,345** | 54,232 | 46,634 | 52,749 | 22,765 | 6,132 | 4,591 | 1,639 |
| Cash flow from operating activities | **46,858** | 41,163 | 34,713 | 22,123 | (9,388) | 7,331 | 981 | 562 |
| Funds from operations [1] | **45,689** | 31,728 | 34,015 | 23,908 | 14,569 | 3,342 | 3,074 | 737 |
| Per diluted share | **0.34** | 0.25 | 0.27 | 0.21 | 0.12 | 0.05 | 0.05 | 0.01 |
| Net (loss)/earnings | **(2,593)** | 4,463 | (672) | 13,354 | (369) | (2,081) | 235 | 94 |
| Per share (basic and diluted) | **(0.02)** | 0.04 | (0.01) | 0.12 | 0.00 | (0.03) | 0.00 | 0.00 |
| Total assets | **1,786,849** | 1,540,236 | 1,411,166 | 1,375,112 | 1,003,882 | 561,339 | 495,317 | 331,267 |
| Working capital | **(37,589)** | (65,154) | (13,083) | 243,607 | 161,514 | 84,622 | 314,613 | 274,163 |
| Working capital (adjusted for the fair value of financial instruments and future taxes) [1] | **(49,170)** | (78,314) | (22,075) | 234,362 | 161,514 | 84,622 | 313,901 | 274,163 |
| Capital expenditures | **217,813** | 152,422 | 286,898 | 158,762 | 125,946 | 234,352 | 97,643 | 41,317 |
| Basic outstanding shares (000s) | **136,191** | 123,841 | 122,691 | 120,191 | 101,809 | 73,553 | 70,000 | 53,000 |
| **Per Unit** | | | | | | | | |
| Gas ($/mcf) | **4.17** | 4.36 | 4.61 | 5.41 | 5.08 | 3.05 | 3.76 | 4.86 |
| Crude oil and NGL ($/bbl) | **75.94** | 70.49 | 72.49 | 78.29 | 68.02 | 61.27 | 58.29 | 44.77 |
| Revenue ($/boe) | **30.74** | 29.94 | 32.58 | 38.53 | 35.59 | 20.80 | 23.66 | 29.79 |
| Operating netback ($/boe) | **22.66** | 19.12 | 21.82 | 24.16 | 22.72 | 9.91 | 14.98 | 13.63 |

*(1) See Non-GAAP Financial Measures*
*(2) Certain amounts have been restated for purchase price adjustments relating to property acquisitions which occurred in prior periods.*

The changes to the financial information summarized above are due primarily to the continuing growth in the Company's crude oil, natural gas and NGL production over the periods, from the acquisition of producing properties and from the Companies' exploration and development activities.

## SELECTED ANNUAL INFORMATION

| | 2010 | 2009 | 2008 |
|---|---|---|---|
| **Production** | | | |
| Crude oil and NGL (bbls) | **701,355** | 119,347 | — |
| Gas (mcf) | **34,895,923** | 6,850,937 | — |
| Oil equivalent (boe) | **6,517,342** | 1,261,170 | — |
| Crude oil and NGL (bbls/d) | **1,922** | 327 | — |
| Gas (mcf/d) | **95,605** | 18,770 | — |
| Oil equivalent (boe/d) | **17,856** | 3,455 | — |
| **Financial** ($000s, unless otherwise noted) | | | |
| Gross revenue, net of royalties | **211,960** | 35,127 | 1,237 |
| Cash flow from operating activities | **144,857** | (514) | 522 |
| Funds from operations [1] | **135,340** | 21,722 | 802 |
| Per diluted share | **1.10** | 0.31 | 0.04 |
| Net earnings (loss) | **14,552** | (2,121) | 438 |
| Per share (basic and diluted) | **0.12** | (0.03) | 0.02 |
| Total assets | **1,786,849** | 1,003,882 | 321,779 |
| Working capital | **(37,589)** | 161,514 | 314,743 |
| Working capital (adjusted for the fair value of financial instruments and future taxes)[1] | **(49,170)** | 161,190 | 314,743 |
| Capital expenditures | **815,895** | 499,258 | 3,575 |
| Basic outstanding shares (000s) | **136,191** | 101,809 | 53,000 |
| **Per Unit** | | | |
| Gas ($/mcf) | **4.52** | 4.24 | — |
| Crude oil and NGL ($/bbl) | **74.62** | 66.10 | — |
| Revenue ($/boe) | **32.24** | 29.28 | — |
| Operating netback ($/boe) | **21.76** | 17.58 | — |

*(1) See Non-GAAP Financial measures*

The changes to the financial information summarized above are due primarily to the continuing growth in the Company's crude oil, natural gas and NGL production over the periods, from the acquisition of producing properties and from the Companies' exploration and development activities.