ShaMaran petroleum corp

(Formerly Bayou Bend Petroleum Ltd.)

CONSOLIDATED FINANCIAL STATEMENTS

For the years ended December 31, 2009 and 2008

April 22, 2010

MESSAGE TO SHAREHOLDERS

Dear Shareholders:

The year 2009 was an extremely eventful year for the Corporation. After the completion of the sale of substantially all of its U.S. oil and gas properties in May 2009 the Corporation acquired working interests in the Pulkhana, Arbat and the K 42 blocks in the autonomous region of Kurdistan in northern Iraq. The Corporation was renamed ShaMaran Petroleum Corp. and has emerged as a leading Kurdistan focused oil company with a balanced portfolio of appraisal and exploration assets in this under-developed and under-explored major oil region.

The Pulkhana block is an appraisal/development project of an oil field discovered in 1956 while the Arbat and Block K 42 are exploration blocks which are expected to have significant potential. The Corporation has put together an aggressive exploration and appraisal program for 2010 and is planning to shoot 800 line kilometers of 2D seismic in the three blocks and drill an appraisal/ exploration well in the Pulkhana block.

Operations commenced in March of this year with the start of the Pulkhana 2D seismic program. We plan to use this data to pick the first drilling location by mid-year. Further, we have commenced the procurement activities which should enable us to mobilize a drilling rig to the Pulkhana block before the end of the year.

Financing

The Corporation successfully completed an equity financing in September 2009 raising $99.7 million Canadian dollars (net of expenses). The new funds together with the existing capital were utilized to pay the signature and capacity building bonuses for the three blocks acquired by the Corporation in Kurdistan and will fund the work program for 2010.

Board of Directors and Management

During the year, Clinton Colden and John Zaoirny stepped down from the Board and we thank them for the contributions made during their tenure. Alex Schneiter and Cameron Bailey joined the Board during the year, each bringing different expertise and experience which will assist the Corporation in creating shareholder value.

In December 2009, the Corporation undertook certain changes to management in order to strengthen its core operations and retain individuals with the relevant depth of oil and gas experience required to conduct ShaMaran's operations in Kurdistan. Pradeep Kabra was promoted to the position of the President and Chief Executive Officer replacing Keith Hill who remains the Chairman of the Board. In addition, John Ashbridge was appointed as the Chief Operating Officer and Brenden Johnstone was appointed as the Chief Financial Officer. John Ashbridge resigned from his position as Chief Operating Officer in April 2010.

The Board would like to thank Keith Hill for his stewardship of the Corporation during his tenure as Chief Executive Officer and looks forward to his guidance in the future as the Chairman of the Board. We would also like to thank John Ashbridge for his role in ShaMaran.

Outlook

The Corporation has gone through many changes and 2009 was the beginning of a new chapter. We have started our operations in one of the most exciting oil provinces in the world and have the cash resources to carry out our work program for the next year. Further, we are, based on the current reports, optimistic that the regional government of Kurdistan and the federal government of Iraq will come to an agreement on a possible payment mechanism for oil revenues arising from the sale of oil produced from Kurdistan before we start producing and exporting oil from our area. This will be an extremely positive development for the Corporation.

We are proud of the developments at ShaMaran Petroleum over the last 12 months and that we now have an excellent team in place to carry out the operations in Kurdistan. We are beginning a campaign that should generate shareholder value and benefit for all the stakeholders. We are grateful for your support and are sure that we will prove ourselves worthy of your trust.

On behalf of the Board,

"Pradeep Kabra"

Pradeep Kabra
President and CEO

SHAMARAN PETROLEUM CORP.
(formerly Bayou Bend Petroleum Ltd.)

MANAGEMENT DISCUSSION AND ANALYSIS
(Amounts in United States Dollars unless otherwise indicated)
Years Ended December 31, 2009 and 2008

Management's discussion and analysis ("MD&A") of the financial and operating results of ShaMaran Petroleum Corp. (the "Company" or "ShaMaran" and formerly Bayou Bend Petroleum Ltd) should be read in conjunction with the audited consolidated financial statements for the years ended December 31, 2009 and 2008 and related notes thereto, prepared in accordance with Canadian generally accepted accounting principles. The effective date of the MD&A is April 20, 2009. Additional information related to the Company is available on SEDAR at www.sedar.com and on the Company's web-site at www.shamaranpetroleum.com.

Overview

ShaMaran is a Canadian-based oil and gas company with interests in petroleum properties located in the southeastern area of the autonomous region of Kurdistan in Northern Iraq ("Kurdistan"). The Company formerly held interests in petroleum properties in the USA, operating under the name Bayou Bend Petroleum Ltd. and traded on the TSX Venture Exchange under the symbol "BBP". In the fourth quarter of 2009, the Company changed its name to ShaMaran Petroleum Corp., and commenced trading under the symbol "SNM".

Highlights

Operating

The sale of substantially all of the Company's oil and gas properties located in the United States in the Gulf of Mexico was completed in the second quarter of 2009.

Agreements for three separate petroleum properties located in Kurdistan were signed on August 28, 2009, whereby the Company will pursue petroleum exploration and development operations governed by production sharing contracts ("PSCs") signed with the KRG. Entry into the PSCs was approved by the Company's shareholders and the TSX Venture Exchange on October 16, 2009.

The Company is currently in the pre-production stages of its exploration and development campaign corresponding to the three petroleum properties located in Kurdistan. At the date of this MD&A, the Company was in the process of acquiring 2D seismic data in the Pulkhana Block petroleum property.

Financial

The issuance of 140 million common shares of the Company generated net proceeds of Cdn $99,696,000 during the month of October, 2009.

The Company completed in October 2009 all of its Capacity Building and Signature Support payments due to the KRG as required under its Production Sharing Contracts (PSC).

Cash balance of the Company was $63.5 million as at December 31, 2009.

Corporate

Changes to executive management of the Company were effected in December 2009 in order to strengthen core operations and retain individuals with the relevant depth of oil and gas experience required to conduct oil and gas operations in Kurdistan. Refer to the discussion in this MD&A under "Changes in Directors and Officers".

Petroleum Property Acquisitions in Kurdistan

During the year 2009 the Company acquired working interests in each of the Pulkhana Block, the Arbat Block and Block K42 petroleum properties, all located in south eastern Kurdistan.

These petroleum properties lie within the northern extension of the Zagros Folded Belt which is estimated to contain up to 45 billion of Iraq's 115 billion barrels of known reserves. The Kirkuk field lies within this fold belt trend and is one of the world's largest, containing reserves of over 20 billion barrels of oil. The area is underexplored and is currently undergoing a major exploration and development campaign by over 30 mid to large size international oil companies. Iraqi-Kurdistan is one of few regions in the prolific Middle East oil province where international operators have access to production sharing contracts which allow them to share the upside potential with host governments.

Pulkhana Block

The Pulkhana block was one of the original four PSCs awarded in 2003. It was acquired by Petoil Petroleum and Petroleum Products International Exploration and Production Inc ("Petoil"), a Turkish company, and ratified by the Iraq Federal government prior to the Oil and Gas Law Of The Kurdistan Region - Iraq, which was passed in 2007. It is an appraisal/development project of a field which was discovered in 1956 and flowed over 2900 barrels of oil per day from a well which entered two fractured carbonate reservoirs.

The Company is currently in the process of acquiring 250 km of two dimensional seismic data, and plans to drill 3 appraisal wells in the first 3 year exploration sub-period in order to confirm the size and economic viability of the development of the Pulkhana field. The Company will then have the option to continue on to a further two year exploration sub-period and, if development is warranted, a development period of up to 20 years.

The Company is the operator of the project with a 60% undivided interest in the petroleum operations. Petoil retains a 20% interest and the KRG holds the remaining 20%. The Company is required to pay 100% of the minimum financial commitment in respect of the first exploration sub-period, following which the Company will pay 75% of the forward costs. Fiscal terms under the PSC include a 10% royalty and a variable profit split based on a profitability factor to the KRG. The Company has the right to recover costs using up to 40% of the produced oil and 50% of the produced gas.

Capacity building bonuses (social responsibility) of $42.5 million were paid to the KRG on October 23, 2009 and 65 million common shares of ShaMaran are pending to be issued to the KRG, as part of the Company's cost of acquisition and social responsibility to the Kurdistan Region. In addition, the Company paid $15 million on October 23, 2009 to Petoil under the terms of a participation agreement, and is required to carry their costs in respect of the first exploration sub-period.

Arbat Block

The Arbat Block (formerly Block G) is located adjacent to the Miran Block of Heritage and Block 9 recently signed by Talisman Energy Corp. This 973 sq. km exploration block is part of the same structural trend that contains the Miran West discovery of Heritage Oil Plc, and includes five surface anticlines identified by recent field work.

Under the terms of the Arbat PSC, which was also originally approved as part of the Pulkhana approval, the Company is obliged to acquire 350 km of 2D seismic data and drill 2 wells in the first 3 year exploration sub-period.

The Company is the operator of the project and holds a 60% undivided interest in the petroleum operations, the KRG holds a 20% interest and the remaining 20% is a third party interest which the KRG has the option to assign to a third party or parties . The Company is required to pay 100% of the minimum financial commitment in respect of the first exploration sub period or until such time as the KRG's reserved 20% interest has been sold, following which the Company will pay 75% of the forward costs and receive a reimbursement for 25% of the costs incurred to that date. Fiscal terms under the PSC include a 10% royalty and a variable profit split based on a profitability factor to the KRG. The Company has the right to recover costs using up to 45% of the produced oil and 53% of the produced gas.

Capacity building bonuses of $20 million were paid to the KRG on October 23, 2009 and 35 million common shares of ShaMaran are pending to be issued to the KRG.

Block K42

Block K42 is located immediately north of the Pulkhana Block and is on trend with the Jambur field situated to the north west of the Block. It is an exploration block with no seismic or surface mapped prospects. Recent field work indicates the possibility of two buried folds in the Block.

The Company is a party to the K42 Option Agreement between the KRG and Oil Search (Iraq) Limited ("OSIL"), which allows an option to the Company and OSIL to enter into with the KRG a PSC, the terms of which have been agreed in principal, relating to the exploration and development of petroleum resources in the Block K42 contract area located in Kurdistan.

In accordance with the Block K42 PSC, OSIL is the operator and, collectively with the Company, represent the "Contractor". This K42 Option Agreement requires the Contractor to conduct certain seismic services, including the acquisition of 200 kilometers of seismic surveying, within the option period of 18 months commencing October 1, 2009. The option to enter into a PSC may be exercised by providing written notice to the KRG. The Contractor is to pay 100% of all the costs incurred during the option period, 25% of which are to be paid by the Company.

Upon exercise of the option, the Company would acquire not less than an undivided 20% interest in the petroleum operations in respect of the Block K42 contract area, with OSIL holding a 60% interest and the KRG holding the remaining 20%. If either the Company or OSIL elect not to exercise its option in respect of the Contract the other party has the option of acquiring the exiting party's rights and obligations.

Capacity building bonuses of $5 million were paid to the KRG on October 23, 2009. Should the option to enter into a PSC with the KRG be exercised, an additional $20 million is to be paid by the Company to the KRG at that time.

Other Acquisition Costs – Net Profit Interest

The Company incurred $4.5 million of acquisition costs directly related to the acquisition of its interests in Kurdistan, and has entered into agreements for local services whereby certain third parties are entitled to receive a net profit interest in respect of the Pulkhana Block 10 and Arbat Block PSCs.

Netherlands Company – ShaMaran Petroleum BV

The Kurdish projects were originally identified and evaluated by Lundin Petroleum B.V. ("LUPE"), which also provides support to the Company in terms of technical services and certain corporate guarantees. In the fourth quarter of the year 2009, the Company completed the acquisition from LUPE of 100% of the common shares of BBPL International BV, a company incorporated in the Netherlands, in exchange for consideration of $1.00 in cash and 50 million shares of the Company issued at a price of Cdn $0.67 per share, for a total purchase price of $31,965,000. The name of the acquired company was subsequently changed to ShaMaran Petroleum BV.

Changes in Directors and Officers

On July 31, 2009, the Company accepted the resignation of John Zaozirny as a director of the Company. Cameron Bailey and Alexandre Schneiter were subsequently appointed as directors of the Company.

In December 2009, Mr. Pradeep Kabra, who originally joined the Company as Chief Operating Officer on September 30, 2009, was promoted to President and Chief Executive Officer on December 14, 2009, replacing Mr. Keith Hill who remains the Chairman of the Board. In addition, John Ashbridge was appointed as the Chief Operating Officer and Mr. Brenden Johnstone was appointed Chief Financial Officer on December 14, 2009. John Ashbridge resigned from his position as Chief Operating Officer in April 2010.

Selected Annual Information

The following is a summary of selected financial information for the Company:

	December 31		
($000s, except per share data, shares)	2009	2008	2007
Net revenues - continuing operations	-	-	-
Net revenues - discontinued operations	1,658	5,009	2,729
Income (loss) - continuing operations	1,675	(5,294)	17,375
Income (loss) - discontinued operations	1,241	(92,756)	(75,847)
Net income (loss)	2,916	(98,050)	(58,472)
Basic income (loss) per share:			
Continuing operations	0.005	(0.02)	0.06
Discontinued operations	0.005	(0.30)	(0.27)
	0.01	(0.32)	(0.21)
Diluted income (loss) per share:			
Continuing operations	0.005	(0.02)	0.06
Discontinued operations	0.005	(0.30)	(0.27)
	0.01	(0.32)	(0.21)
Total assets	249,999	63,594	166,841
Working Capital Surplus	59,903	41,595	80,120
Shareholder's equity	244,563	54,466	151,665
Common shares outstanding (x 1000)	499,546	308,756	308,256

Summary of principal changes in annual information

Consistent with the refocus of operations in the year 2009, the Company acquired three petroleum properties located in Kurdistan which, combined with the costs associated with initiating the exploration campaign, resulted in capitalized costs of $184,953,000. To finance the acquisitions and future operations the Company raised funds in the fourth quarter of 2009 through the issuance of 140 million shares at Cdn $0.75 per share, resulting in gross proceeds of Cdn $105,000,000 (Cdn $99,696,000 net of fees). As a result of these developments the assets, common shares outstanding, and shareholders’ equity reported at the end of the current year have increased between the years 2009 and 2008. The exploration campaign relating to the Kurdish properties, which represent the continuing operations of the Company, commenced in the fourth quarter of 2009. The continuing operations of the Company currently have no corresponding revenue.

Included in the loss for the year 2008 from discontinued operations is an impairment expense of $56,300,000, primarily related to adjustments to reflect the estimated market value of unproved properties. This loss together with the decrease in working capital over the same period has contributed to a significant decline in assets between the years 2008 and 2007.

Results of Continuing Operations

The various income and expenses from continuing operations are explained as follows:

Exploration costs

The Company incurred exploration costs of $636,000 for the year ended December 31, 2009 and $nil for 2008. The exploration costs were primarily related to fees payable to a related company in respect of a guarantee of the minimum financial obligations under the Pulkhana and Arbat PSCs, which were provided on behalf of the Company.

Depletion, Depreciation and Amortization

Depletion, depreciation and amortization ("DD&A") was $6,000 for the year ended December 31, 2009. For the previous year the comparable amount was $nil. DD&A corresponds to the furniture and IT equipment at the Company's technical and administrative office located in Vésenaz, Switzerland.

General and Administrative Expenses

For the year ended December 31, 2009 general and administrative expenses were $2,378,000 (2008: $469,000), the principal components of which were legal, accounting and audit fees of $652,000 (2008: $145,000), management and consulting fees of $420,000 (2008: $299,000), sponsorships of $522,000 (2008: $nil), and $610,000 (2008: $45,000) for travel and related expenses. The additional professional assistance and travel associated with the acquisition of the Kurdistan petroleum properties and associated equity fundraising activities has given rise to the general increase in general and administrative expenses relative to the comparable amounts in the year 2008.

Stock-Based Compensation

Stock-based compensation was $546,000 for the year ended December 31, 2009. The comparable amount in 2008 was $801,000. The stock-based compensation expense in 2009 results primarily from the issuance of 2,085,000 stock options and the vesting of stock options that were granted in 2009 and 2008. The Company uses the fair value method of accounting for stock options granted to directors, officers, employees and consultants whereby the fair value of all stock options granted is recorded as a charge to operations. The fair value of common share options granted is estimated on the date of grant using the Black-Scholes option pricing model.

Foreign Exchange (Gain) Loss

Foreign exchange gain was $4,943,000 for the year ended December 31, 2009. The Company had a foreign exchange loss of $5,010,000 during 2008. The gain in 2009 results from holding cash and cash equivalents denominated in Canadian dollars, while the Canadian dollar strengthened against the reporting currency of the Company, the United States dollar.

Interest Income

For the year ended December 31, 2009 and 2008, interest income was $310,000 and $986,000, respectively. Interest income represents bank interest earned on cash and investments in marketable securities. The decrease in interest income compared to 2008 results from a decrease in average interest yielding investments held throughout the year, together with a decrease in yield on those investments than was received in the prior year.

Tax expense

For the year ended December 31, 2009 the Company had income tax expense of $12,000, relating to a provision for income tax on service income generated in the newly created Swiss branch entity of ShaMaran group. There was no income tax expense reported in 2008.

Results of Discontinued Operations

The main components in revenue and expense of discontinued operations are explained as follows:

Net revenues

The Company had oil and gas sales, net of royalties, of $1,658,000 and $5,009,000 for the years ended December 31, 2009 and 2008, respectively. The decrease in revenues is a result of the termination of all production and corresponding sales on May 28, 2009, coinciding with the sale of substantially all of the Company's U.S. Gulf of Mexico properties. In addition, commodity prices for sales during the year 2009 were lower than prices earned on 2008 sales.

Expenses

Expenses associated with the Company's discontinued operations were $2,041,000 for the year ended December 31, 2009. In the prior year the comparable amount was $98,835,000. The main components of expenses in the year 2009 were operating exploration and dry-hole costs totaling $1,592,000, general and administrative expenses of $3,072,000, as well as a reclassification of the cumulative foreign currency translation gain of $3,282,000 previously reported as accumulated other comprehensive income. The main components of costs and expenses in the year 2008 were operating exploration and dry-hole costs totaling $25,418,000, general and administrative expenses of $2,894,000, as well as impairment of property expenses of $68,556,000, which included a charge of $56,300,000 to reflect the estimated market value of unproved properties.

Gain on disposal of assets from discontinued operations

In 2009 the Company had a gain of $1,600,000 on disposal of the oil and gas assets located in the United States. The comparable amount for the year 2008 was $nil.

Selected Quarterly Information

The following is a summary of selected quarterly financial information for the Company:

	For the Quarter Ended							
($000s, except per share data)	Dec 31 2009	Sep 30 2009	Jun 30 2009	Mar 31 2009	Dec 31 2008	Sep 30 2008	Jun 30 2008	Mar 31 2008
Net revenues - continuing operations	-	-	-	-	-	-	-	-
Net revenues - discontinued operations	-	-	943	715	1,663	1,583	798	965
Income (loss) - continuing operations	(1,201)	3,197	1,591	(1,912)	(3,523)	(815)	83	(1,039)
Income (loss) - discontinued operations	1,458	(42)	1,972	(2,147)	(68,633)	(15,339)	(5,876)	(2,908)
Net income (loss)	257	3,155	3,563	(4,059)	(72,156)	(16,154)	(5,793)	(3,947)
Basic income (loss) per share:								
Continuing operations	-	0.01	0.01	(0.01)	(0.02)	(0.00)	(0.00)	(0.00)
Discontinued operations	-	-	0.01	(0.01)	(0.22)	(0.05)	(0.02)	(0.01)
	-	0.01	0.02	(0.02)	(0.24)	(0.05)	(0.02)	(0.01)
Diluted income (loss) per share:								
Continuing operations	-	0.01	0.01	(0.01)	(0.02)	(0.00)	(0.00)	(0.00)
Discontinued operations	-	-	0.01	(0.01)	(0.22)	(0.05)	(0.02)	(0.01)
	-	0.01	0.02	(0.02)	(0.24)	(0.05)	(0.02)	(0.01)

Summary of principal changes in fourth quarter information

In the fourth quarter of 2009, the Company commenced its exploration campaign in respect of the Kurdish petroleum properties, constituting the continuing operations of the Company, and which have no corresponding revenue. The net income in the fourth quarter was primarily driven by the reclassification, on the substantial sale of its US operations, of the Company’s cumulative foreign currency translation gain of $3,282,000 previously reported within accumulated other comprehensive income.

Off-Balance Sheet Arrangements

The Company has no off-balance sheet arrangements.

Outstanding Share Data

As of March 31, 2010, the Company had 499,546,088 shares outstanding, 4,885,000 stock options outstanding under its stock-based compensation plan and zero warrants outstanding.

In accordance with the Kurdistan PSCs, the Company is required to issue an additional 100 million shares to the KRG. These shares have been reported as “Shares to be issued” in the Shareholders equity section of the consolidated balance sheet of the Company, as at December 31, 2009, as the issuance was pending subject to certain actions to be performed by the KRG.

The following contingent share consideration may be payable in the future, pending the following circumstances:

- 50 million common shares to the KRG within 30 days of the expiry of the first exploration sub-period, if the Pulkhana PSC is still then in effect;
- 50 million common shares to LUPE upon the approval of a Pulkhana development plan.

Related Party Transactions

Namdo Management Services Ltd. (“Namdo”) provides corporate administrative support and investor relation services to the Company under an agreement which commenced April 1, 2007. For these services Namdo was paid $214,000 during the current year (2008: $264,000). Namdo is a private corporation owned by a shareholder of the Company.

Mile High Holdings Ltd., a private corporation associated to a shareholder of the Company, provided transportation services to the Company in the amount of $385,000 (2008: $nil) related to petroleum property acquisition and fundraising activities.

During the current year, the Company incurred legal fees of $217,000 (2008: $18,000) with a law firm in which an officer of the Company is a partner.

During the year ended December 31, 2008, the Company incurred geological and geophysical (G&G) costs of $469,000, respectively, with a G&G firm in which an officer of the Company is a managing partner. No charges were incurred from this firm in the current year.

The Company receives services from various subsidiary companies of Lundin Petroleum AB (“Lundin”), a shareholder of the Company. Lundin charges during the year were $1,245,000 (2008: $nil) which was comprised of G&G and other technical service costs of $317,000 (2008: $nil), reimbursement for travel and related expenses of $207,000 (2008: $nil), office rental, administrative and building services of $86,000 (2008: $nil), and fees of $635,000 (2008: $nil) relating to a guarantee provided to the KRG on behalf of the Company in respect of its minimum financial commitments, charged at a rate of 3% per annum, and payable semi-annually beginning 30 June 2010.

Amounts owing to related parties as at December 31, 2009 were $1,152,000 (2008: $nil). The Company was owed no amounts by related parties at the reporting dates.

All transactions with related parties are recorded at amounts agreed to by the parties and are made on the same terms and conditions as with non-related parties.

Liquidity and Capital Resources

Working capital at December 31, 2009, totaled $59,903,000, compared to $41,595,000 at December 31, 2008.

Funds provided by continuing operations were $3,574,000 for the year ended December 31, 2009 compared to funds used by continuing operations of $4,491,000 for the year 2008. The primary source of operational funds during 2009 was from the appreciation of the Canadian cash deposits when converted to US dollars.

Net cash provided by financing activities from continuing operations for the year ended December 31, 2009 was $96,598,000 compared to $50,000 for 2008. The source of the funds was the issuance in the 4th quarter of 2009 of 140 million common shares of the Company.

Net cash used by investing activities in continuing operations was $91,230,000 for the year ended December 31, 2009, compared to no movement in funds due to investing activities from continuing operations in 2008. During the year 2009, the primary use of cash by the Company on investing activities in continuing operations was in the acquisition of three petroleum properties in Kurdistan.

Net cash provided by discontinued operations was $9,337,000 for the year ended December 31, 2009, compared to cash used by discontinued operations of $8,852,000 in 2008. The primary source of funds from discontinued operations in the year 2009 was proceeds from the sale of the oil and gas properties located in the United States.

Contributed surplus increased $336,000 for the year ended December 31, 2009, compared to $787,000 in 2008. The increase is due to stock-based compensation for the year offset by the exercise of options. When options are granted, the Black-Scholes option value method is used to calculate a value for the stock options. The offset to the amount that is recorded as stock compensation expense is a credit to contributed surplus. When the options are exercised, the applicable amounts of contributed surplus are transferred to share capital. During the year ended December 31, 2009, 790,000 stock options were exercised. No stock options were exercised during the year 2008.

The Company does not currently generate cash flow from its oil exploration and development operations. The Company has relied upon the issuance of common shares to finance its ongoing oil exploration, development and acquisition activities. Notwithstanding, the Company has sufficient financial resources to fund operations through the 2010 fiscal year. Continuing operations are dependent on discovery of economic oil and gas reserves and ultimately on the attainment of profitable operations.

Commitments

The Kurdish Production Sharing Contracts contemplate a minimum financial commitment in respect of the first exploration sub-period of $61 million for the Pulkhana and Arbat Blocks combined. The PSCs also require funding of certain personnel, training, environmental, and technological assistance projects, during the period the contracts are in effect. As at December 31, 2009 the commitments under the two PSCs were approximately $64 million.

As a party to the K42 Option Agreement the Company was required to contribute to the cost of conducting certain seismic services, including the acquisition of 2D seismic data. The Company estimates as at December 31, 2009 its remaining minimum commitments under the K 42 Option Agreement to be approximately $2 million.

Financial Instruments

The Company's financial instruments consist of cash, cash equivalents, investments, accounts receivable, accounts payable, accrued expenses and advances from joint interest holders.

Cash, cash equivalents and investments are designated as held for trading and are therefore carried at fair value, with unrealized gains or losses recorded in interest income.

The fair values of cash, cash equivalents, accounts receivable, accounts payable, accrued expenses and advances from joint interest holders approximate carrying values because of the short-term nature of these instruments. The fair values of investments are determined directly by reference to quoted market prices.

The Company is exposed in varying degrees to a variety of financial instrument related risks.

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. The Company manages its credit risk through monitoring counterparty ratings and credit limits. The Company is mainly exposed to credit risk on its cash and cash equivalents and accounts receivable. To manage this risk the Company maintains its excess cash on account in instruments having a minimum credit rating of R-1 (mid) or better (as measured by Dominion Bond Rate Services) or the equivalent thereof according to a recognized bond rating service.

Accounts receivable are primarily with joint venture partners in the oil and gas industry and are subject to normal industry credit risks. Joint venture receivables are typically collected within one to two months of the joint venture bill being issued to the partner. The Company mitigates risks arising from joint venture receivables by obtaining partner approval of capital expenditures prior to starting a project.

Liquidity Risk

Liquidity risk is the risk that the Company will incur difficulties meeting its financial obligations as they become 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, without incurring unacceptable losses or risk harm to the Company's reputation.

The Company prepares annual capital expenditure budgets, which are regularly monitored and updated as considered necessary. The Company requires authorizations for expenditure on both operating and non-operating projects to further manage capital expenditures.

Market Risk

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

The significant market risk exposures to which the Company is exposed are foreign currency, commodity price and interest rate risks.

Foreign currency risk – The Company maintains a substantial portion of its cash in Canadian dollars; however, the Company's operations are conducted predominantly in U.S. dollars. The Company's operating results and cash flows are affected to varying degrees by the changes in the Canadian dollar vis-à-vis the U.S. dollar. The Company has not entered into any agreements or purchased any instruments to hedge possible currency risks.

Commodity price risk – The prices that the Company may receive for its crude oil and natural gas production may have a significant impact on its revenue and cash provided by operating activities. Any significant price decline in commodity prices would adversely affect the amount of funds available for capital reinvestment purposes. At this time the Company does not use derivative financial instruments to manage its exposure to this risk.

Interest rate risk – The Company's bank accounts earn interest income at variable rates. The Company's future interest income is exposed to changes in short-term rates.

Uncertainty of title - Although the Company conducts title reviews prior to acquiring an interest in a property, such reviews do not guarantee or certify that an unforeseen defect in the chain of title will not arise that may call into question the Company's interest in the production sharing contracts. Any uncertainty with respect to one or more of the Company's production sharing contracts could have a material adverse effect on the Company's business, prospects and results of operations.

Accounting Policies and Critical Accounting Estimates

Use of Estimates

The consolidated financial statements of the Company have been prepared by management in accordance with accounting principles generally accepted in Canada. In preparing financial statements, management makes informed judgments and estimates that affect the reported amounts of assets and liabilities as of the date of the financial statements and affect the reported amounts of revenues and expenses during the reported period. Specifically, estimates were utilized in calculating depletion, asset retirement obligations, stock-based compensation, amortization and impairment write-downs. Actual results could differ from these estimates and differences could be material.

Accounting for Oil and Gas Operations

The Company follows the successful efforts method of accounting for its oil and gas operations. Under this method acquisition costs of oil and gas properties, costs to drill and equip exploratory wells that find proved reserves and costs of drilling and equipping development wells are capitalized and subject to annual impairment testing.

Exploration well costs are initially capitalized and, if subsequently determined to have not found sufficient reserves to justify commercial production, are charged to exploration expense. Exploration well costs that have found sufficient reserves to justify commercial production, but whose reserves cannot be classified as proved, continue to be capitalized as long as sufficient progress is being made to assess the reserves and economic viability of the well and or related project.

Capitalized costs of proved oil and gas properties are depleted using the unit of production method based on estimated gross proved reserves of petroleum and natural gas as determined by independent engineers. Successful exploratory wells and development costs and acquired resource properties are depleted over proved developed reserves. Acquisition costs of unproved reserves are not depleted or amortized while under active evaluation for commercial reserves.

Costs associated with significant development projects are depleted once commercial production commences.

A revision to the estimate of proved reserves can have a significant impact on earnings as they are a key component in the calculation of depreciation, depletion and accretion.

Producing properties and significant unproved properties are assessed annually, or more frequently as economic events dictate, for potential impairment. The impairment test is initially based on undiscounted future cash flows from proved and risk adjusted probable reserves. If an impairment is identified, fair value is calculated as the present value of estimated expected discounted cash flows from proved and risk-adjusted probable reserves. Any impairment loss is the difference between the carrying value of the petroleum property and its fair value. If it is determined that the estimated fair value is less than the net carrying amount, a write-down to the oil and gas property's fair value is recognized during the period, with a charge to earnings.

Estimates of future cash flows used in the evaluation of impairment of assets are performed based on risk assessments on field and reservoir performance and include assumptions regarding commodity prices, discount rates and future costs.

A substantial portion of the Company's exploration and development activities are conducted jointly with others. The financial statements reflect only the Company's proportionate interests in such activities.

The Company engaged Petrotech Engineering Ltd, an independent geoscience consultancy firm, to evaluate 100% of the Company's reserves data at December 31, 2009. The estimation of reserves is subjective. Forecasts are based on engineering data, future prices, expected future rates of production and the timing of capital expenditures, all of which are subject to uncertainties and interpretations. All of the Company's proved and probable oil and gas reserves at December 31, 2008, were sold to third parties during the first half of 2009, and the Company has no reserves as at December 31, 2009.

International Financial Reporting Standards

In February 2008, the Canadian Accounting Standards Board confirmed that Canadian generally accepted accounting principles (Canadian GAAP) will be converged with International Financial Reporting Standards (IFRS) for fiscal years commencing January 1, 2011. The transition from Canadian GAAP to IFRS will be applicable for the Company for the first quarter of 2011 when the Company will prepare both the current and comparative financial information using IFRS. While IFRS uses a conceptual framework similar to Canadian GAAP, there are significant differences on recognition, measurement and disclosures.

The Company has commenced the process to transition from current Canadian GAAP to IFRS. There are three phases in the process: diagnostic, detailed assessment and design and implementation. The Company's IFRS conversion process is progressing according to a changeover plan and timetable established by management as follows:

Accounting policies (ongoing – to be finalized before IFRS reporting in 2011)

Based on work completed to date, management has determined that the adoption of IFRS is likely to impact the Company's accounting for several areas, including PP&E and income taxes. Matters impacting accounting for PP&E include the evaluation of impairment, accounting for asset retirement obligations, taxation and other adjustments considered to be minor.

The areas impacted by IFRS discussed above should not be regarded as a comprehensive list of changes that will result from the transition to IFRS. Management continues to monitor the development of standards, which are expected to change prior to 2011.

Impairments – Canadian GAAP requires a two-step approach to impairment testing. Undiscounted cash flows are first compared to asset carrying values to determine whether impairment exists. If so, impairment is measured by comparing asset carrying values with fair values calculated using discounted cash flows.

IFRS uses a one-step approach to testing for and measuring of impairment, with asset carrying values compared directly with the higher of fair value less cost to sell and value-in-use (which uses discounted future cash flows). This could lead to additional impairment write-downs where carrying values were previously supported under Canadian GAAP on an undiscounted cash flow basis.

IFRS may result in greater variability in net income and carrying values of PP&E.

Asset Retirement Obligations – Under IFRS, a change in the current market-based discount rate will result in a change in the measurement of the provision, whereas a change in the discount rate alone does not result in a re-measurement of the ARO liability under Canadian GAAP. As market-based discount rates change, IFRS may result in greater volatility in an asset retirement obligation held by the Company, the carrying values of PP&E and net income.

Income taxes – IFRS differs from Canadian GAAP for purposes of recognizing future taxes, specifically in relation to intercompany transfers, asset acquisitions, foreign currency and other areas. Due to these differences and the potential tax effects of other IFRS adjustments, IFRS may cause volatility in future income tax liabilities and net income.

The Company is working to understand the practical application of those IFRS principles considered to impact the Company, in order to quantify the IFRS opening balance sheet adjustments as at January 1, 2010.

Control Environment (Ongoing to 2011 year end reporting)

As the transition to IFRS progresses, changes to the design and implementation of both internal controls over financial reporting and disclosure controls are being made. Additional disclosure controls relating to first-time adoption of IFRS are currently being implemented. The design changes for internal controls over financial reporting will be completed and evaluated by the first quarter of 2011 with operating effectiveness to be evaluated prior to 2011 year-end reporting.

Training and Communication (Ongoing to first quarter 2011 reporting)

Training of those accounting personnel impacted by the transition to IFRS is in process. The Audit Committee receives quarterly updates on project status. More frequent IFRS sessions are held among management to discuss the potential impacts of implementing IFRS.

IT Systems (Ongoing to 2011 year end reporting)

The Company is currently developing and implementing system modifications to support the capture and reporting of IFRS financial information during 2010. Complete systems required to support IFRS reporting are expected to be in place by the first quarter of 2011.

Business Activities (Ongoing to 2011 year end reporting)

Work has commenced to implement changes to the budgeting and forecasting systems to embed the more significant aspects of IFRS within the Company’s planning cycle.

Risks and Uncertainties

The majority of ShaMaran's assets are located in the Kurdistan Region of Iraq. ShaMaran operates in areas which are under foreign governmental sovereignty and is therefore subject to political, economic, and other uncertainties associated with foreign operations, which include (but are not limited to) the exposure of the Company to a change in changes in general government policies and legislation, change in the energy policies or in their administration, changes in fiscal terms of a production sharing contract with the government, inability to export the petroleum produced under contract, adverse determinations or rulings by governmental authorities, nationalization, currency fluctuations and devaluations, as well as risks of loss due to civil strife, acts of war, guerrilla activities and insurrections.

Political Issues

The political and security situation in Iraq is not settled and is volatile. There are major outstanding political issues and differences between the various political factions in Iraq. These differences could adversely impact ShaMaran's interests in the Kurdistan region. In addition, certain borders of the Kurdistan region of Iraq remain the subject of final determination, the result of which may have an adverse effect on ShaMaran's assets.

Legislative Issues

All contracts in Kurdistan issued under the Oil and Gas Law Of The Kurdistan Region - Iraq. No federal Iraqi legislation has been enacted by the Iraq Council of Ministers (Cabinet) and Council of Representatives (Parliament). The lack of legislation, or the enactment of federal legislation contradictory to Kurdistan Region legislation, could have a material adverse impact on ShaMaran's interests in the region.

Marketing, Markets and Transportation

The export of oil and gas from the Kurdistan Region of Iraq remains subject to uncertainties which could have an adverse impact on ShaMaran's ability to export and market such oil and gas. Further, ShaMaran's ability to market its oil and gas may also depend upon its ability to secure transportation and delivery, in view of related issues such as the proximity of its potential production to pipelines and processing facilities. Potential government regulation relating to price, quotas and other aspects of the oil and gas business could also have an adverse impact.

Exploration, Development and Production Risks

Oil and gas operations involve geological, technical and commercial risks which even a combination of experience, knowledge and careful evaluation may not be able to overcome. ShaMaran's success will depend on its ability to find, appraise, develop and commercially produce oil and gas resources and reserves. Future oil and gas exploration may involve risks relating to dry holes, wells which do not produce sufficient petroleum to return a profit after drilling, operating and other costs. In addition operations can be effected by drilling hazards, environmental damage, and other field operating conditions which could adversely affect production and increase the cost of operations. Diligent operations can contribute to maximizing production rates over time but production delays and declines from normal field operating conditions cannot be eliminated and can adversely affect revenue and cash flow levels.

Ability to Execute Exploration and Development Program

ShaMaran has the capacity to execute exploration and development programs in Kurdistan. It is however possible that ShaMaran may not be able to fully execute its desired strategies because of the need to involve and to obtain approvals from the relevant authorities.

Project Risks

ShaMaran's ability to execute projects and market oil and gas will depend upon numerous factors beyond ShaMaran's complete control. Factors such as issues relating to security in the area of operation, adverse legislation in the Kurdistan Region and/or Iraq, the regulation of the oil and gas industry by various levels of government and governmental agencies in the Kurdistan Region and/or Iraq could adversely impact the execution of ShaMaran's projects.

Substantial Capital Requirements

ShaMaran anticipates making substantial capital expenditures in the future for the acquisition, exploration, development and production of oil and gas reserves. ShaMaran's results will impact its access to the capital necessary to undertake or complete future drilling and development programs. ShaMaran's ability to access the equity or debt markets in the future may be affected by any prolonged market instability. There can be no assurance that debt or equity financing, or future cash (if any) generated by operations, would be available or sufficient to meet these requirements or for other corporate purposes or, if debt or equity financing is available, that it will be on terms acceptable to ShaMaran. The inability of ShaMaran to access sufficient capital for its operations could have a material adverse effect on ShaMaran's financial condition, results of operations and prospects.

Additional Funding Requirements

ShaMaran's cash balances may not be sufficient to fund its ongoing activities at all times. From time to time, ShaMaran may require additional financing in order to carry out its oil and gas acquisition, exploration and development activities. Failure to obtain such financing on a timely basis could cause ShaMaran to forfeit its interest in certain properties, miss certain acquisition opportunities and reduce or terminate its operations. ShaMaran's ability to access the equity or debt markets in the future may be affected by any prolonged market instability.

Dilution

ShaMaran may make future acquisitions or enter into financings or other transactions involving the issuance of securities of ShaMaran which may be dilutive to the existing shareholders.

Outlook for the year 2010

ShaMaran's operational activities in 2010 will focus on acquiring seismic in the Pulkhana, Arbat and Block K42, and on commencing in the fourth quarter of 2010 the drilling of an exploration / appraisal well located in the Pulkhana Block. The outlook for the year for the three blocks in Kurdistan is as follows:

Pulkhana block

A total of 250 km of 2D seismic will be acquired in the Block. The seismic acquisition program commenced in March 2010 and is expected to be completed by the end of April 2010. Processing and interpretation of the acquired seismic data should be completed by the end of the second quarter 2010. The data will be used to identify the resource potential in the block and location of the exploration / appraisal well to be drilled on the Pulkhana Block.

The company plans to commence the drilling of its first well in the Pulkhana block in the fourth quarter of 2010. Procurement activities to enable the Company to achieve this have already commenced.

Arbat Block

A total of 350 km of 2D seismic will be acquired in the Block. The seismic acquisition program will be completed by the end of the third quarter 2010. Processing and interpretation of the acquired seismic data should be completed by the end of 2010. The data will be used to identify the resource potential in the Block and location of the future exploration wells in the Block.

Block K42

A total of 200 km of 2D seismic will be acquired in the Block. The seismic acquisition will be completed by the end of the second quarter 2010. Processing and interpretation of the acquired seismic data should be completed by the third quarter of 2010. Based on the results of the seismic data acquired, the Company will decide on whether to exercise its option to enter into a Production Sharing Contract. A decision on the exercise of the option could be taken by the end of the year or in the first quarter of 2011.

Budget

The capital and operating budget for the year 2010 approved by the Board of Directors was for $53.5 million. The budget contains amounts relating to the work programs and administration of the three Kurdistan petroleum properties as follows: $39.5 million for the Pulkhana Block, $11.3 million for the Arbat Block, and $2.8 million (representing 25% of the total) for Block K42.

General

The security situation in the Kurdistan region remains stable with no major reported incidents. The region is seeing a rapid development in infrastructure and a significant increase in the availability of oil and gas services in the country. Management is, based on current reports, optimistic that the regional government of Kurdistan and the federal government of Iraq will come to an agreement on a possible payment mechanism for oil revenues arising from the sale of oil produced from Kurdistan before the Company starts producing and exporting oil. This would be an extremely positive development for the region.

Forward-Looking Statements

This report contains forward-looking statements concerning anticipated developments on the Company’s operations; the adequacy of the Company’s financial resources; financial projections, including, but not limited to, estimates of capital and operating costs, production rates, commodity prices, exchange rates, net present values; and other events and conditions that may occur in the future. Forward-looking statements are frequently, but not always, identified by the words such as “expects,” “anticipates,” “believes,” “intends,” “estimates,” “potential,” “possible,” “budget” and similar expressions, or statements that events, conditions or results “will,” “may,” “could,” or “should” occur or be achieved. Information concerning the interpretation of drill results and reserve estimates also may be deemed to be forward-looking statements, as such information constitutes a prediction of what might be found to be present if and when a project is actually developed. Forward-looking statements are statements about the future and are inherently uncertain, and actual achievements of the Company or other future events or conditions may differ materially from those reflected in the forward-looking statements due to a variety of risks, uncertainties and other factors, including, without limitation, those described in this MD&A.

The Company’s forward-looking statements are based on the beliefs, expectations and opinions of management on the date the statements are made and the Company assumes no obligation to update such forward-looking statements in the future. For the reasons set forth above, investors should not place undue reliance on forward-looking statements.

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AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the consolidated balance sheets of ShaMaran Petroleum Corp. (formerly Bayou Bend Petroleum Ltd.) as at December 31, 2009 and 2008 and the consolidated statements of operations and deficit, other comprehensive income (loss) and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2009 and 2008 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP (signed)

Chartered Accountants

Vancouver, Canada
March 26, 2010

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KPMG Canada provides services to KPMG LLP.

SHAMARAN PETROLEUM CORP.
Consolidated Balance Sheets
Expressed in Thousands of United States Dollars

	As at December 31	
	2009	**2008** [1]
ASSETS		
Current assets		
Cash and cash equivalents	$ 63,565	$ 45,282
Short-term investments	79	79
Accounts receivable	566	1,912
Prepaid expenses and other assets	609	1,546
	64,819	48,819
Property, plant & equipment (note 6)	185,180	-
Property, plant & equipment - held for sale	-	14,775
	$ 249,999	$ 63,594
LIABILITIES		
Current liabilities		
Accounts payable and accrued expenses	$ 3,866	$ 5,636
Net payables to joint venture partners	37	231
Income taxes payable (note 11)	12	-
Asset retirement obligation (note 10)	1,001	1,357
	4,916	7,224
Non-current liabilities		
Asset retirement obligation (note 10)	350	1,904
Other long term liabilities	170	-
	520	1,904
	5,436	9,128
SHAREHOLDERS' EQUITY		
Share capital (note 8a)	379,673	250,899
Shares to be issued (note 9)	61,349	-
Contributed surplus (note 8a)	3,360	3,024
Accumulated other comprehensive income (note 5)	4	3,282
Deficit	(199,823)	(202,739)
	244,563	54,466
	$ 249,999	$ 63,594

Nature of operations (note 1)
Commitments (note 15)

See accompanying notes to the consolidated financial statements.
[1] Restated - see note 2 to the consolidated financial statements.

SHAMARAN PETROLEUM CORP.

Consolidated Statements of Operations and Deficit

Expressed in Thousands of United States Dollars except Per Share Amounts

	For the year ended December 31 2009	For the year ended December 31 2008 [1]
Costs and Expenses		
Exploration	$ 636	$ -
Depletion, depreciation and amortization	6	-
General and administrative	2,378	469
Stock-based compensation (note 8b)	546	801
Foreign exchange (gain) loss	(4,943)	5,010
	(1,377)	6,280
Other income		
Interest income	310	986
Net income (loss) before income taxes	1,687	(5,294)
Income tax expense (note 11)	12	-
Net income (loss) from continuing operations	1,675	(5,294)
Discontinued operations		
Loss from operations (note 4)	(359)	(92,756)
Gain on asset disposals (note 4)	1,600	-
	1,241	(92,756)
Net income (loss)	2,916	(98,050)
Deficit, beginning of year	(202,739)	(104,689)
Deficit, end of year	$ (199,823)	$ (202,739)
Basic income (loss) per share:		
Continuing operations	$ 0.005	$ (0.02)
Discontinued operations	0.005	(0.30)
	$ 0.01	$ (0.32)
Diluted income (loss) per share:		
Continuing operations	$ 0.005	$ (0.02)
Discontinued operations	0.005	(0.30)
	$ 0.01	$ (0.32)
Weighted average number of common shares:		
Basic	346,639	308,745
Diluted	346,639	308,745

See accompanying notes to the consolidated financial statements.

[1] Restated - see note 2 to the consolidated financial statements.

SHAMARAN PETROLEUM CORP.
Consolidated Statements of Other Comprehensive Income
Expressed in Thousands of United States Dollars

	For the year ended December 31	
	2009	**2008**
Net income (loss)	$ 2,916	$ (98,050)
Other comprehensive income:		
Exchange gains arising from translation of financial statements of foreign operation	4	-
Comprehensive income (loss)	$ 2,920	$ (98,050)

See accompanying notes to the consolidated financial statements.

SHAMARAN PETROLEUM CORP.

Consolidated Statements of Cash Flows

Expressed in Thousands of United States Dollars

	For the year ended December 31	
	2009	**2008** [1]
Operating activities of continuing operations		
Net income (loss) from continuing operations	$ 1,675	$ (5,294)
Adjustments for non-cash items:		
Depletion, depreciation and amortization	6	-
Stock-based compensation	546	801
Changes in working capital:		
Accounts receivable	(31)	-
Prepaid expenses	(358)	-
Accounts payable and accrued expenses	1,850	2
Advances from joint venture partners	(126)	-
Income taxes payable	12	-
	3,574	(4,491)
Financing activities of continuing operations		
Proceeds net of costs on issuance of shares	96,598	50
	96,598	50
Investing activities of continuing operations		
Property, plant & equipment	(91,230)	-
	(91,230)	-
Effect of exchange rate changes on cash and cash equivalents	4	-
Cash flows from (used in) continuing operations	8,946	(4,441)
Cash flows from (used in) discontinued operations (note 4)	9,337	(8,852)
Change in cash and cash equivalents	18,283	(13,293)
Cash and cash equivalents - beginning of year	45,282	58,575
Cash and cash equivalents - end of year	$ 63,565	$ 45,282
Supplemental disclosures of non-cash financing and investing activities:		
Acquisition of interests in petroleum properties through the issuance of common stock	$ 93,314	$ -
Interest received	334	2,056
Extinguishment of ARO liability on disposal of related assets	2,348	-
	$ 95,996	$ 2,056

See accompanying notes to the consolidated financial statements.

[1] Restated - see note 2 to the consolidated financial statements.

1. NATURE OF OPERATIONS

ShaMaran Petroleum Corp. (the "Company" and formerly Bayou Bend Petroleum Ltd.) is incorporated under the British Columbia Business Corporations Act.

On May 28, 2009, the Company sold to a third party substantially all of its oil and gas properties located in the United States in the Gulf of Mexico (see note 4).

On October 16, 2009, the Company changed its name to ShaMaran Petroleum Corp. from Bayou Bend Petroleum Ltd. with an effective date of October 21, 2009. The Company's shares trade on the TSX Venture Exchange under the new symbol of "SNM" (formerly "BBP").

The Company is engaged in the business of oil and gas exploration and development, and is currently in the pre-production stages of an exploration and development campaign in respect of petroleum properties located in the Kurdistan Region of Iraq. The Company conducts its operations through wholly owned subsidiary entities.

Oil and gas operations are subject to extensive controls and regulations imposed by various levels of government that may be amended from time to time. The Company's operations may require licenses and permits from various governmental authorities in the countries in which it operates. Under the production sharing contracts the Company has entered into, the Kurdish Regional Government is required to assist in obtaining all permits and licenses from any government agencies in the Kurdistan Region and from any other government administration in Iraq. There can be no assurance that the Company will be able to obtain all necessary licenses and permits that may be required to carry out exploration and development of its projects.

The political and security situation in Iraq is not settled. Issues relating to federalism and the autonomy of the various regions of Iraq could adversely impact the Company's interest in the Kurdistan Region, including the ability to export any hydrocarbons as a result of our activities.

Although the Company conducts title reviews prior to acquiring an interest in a property, such reviews do not guarantee or certify that an unforeseen defect in the chain of title will not arise that may call into question the Company's interest in the production sharing contracts. Any uncertainty with respect to one or more of the Company's production sharing contract interests could have a material adverse effect on the Company's business, prospects and results of operations.

Since inception and typical of exploration and development companies, the Company has incurred losses from operations and negative cash flows from operating activities, and has an accumulated deficit at December 31, 2009. The ability of the Company to successfully carry out its business plan is primarily dependent upon the continued support of its shareholders, the discovery of economically recoverable reserves, the resolution of remaining political disputes in Iraq, and the ability of the Corporation to obtain financing to develop reserves.

2. SIGNIFICANT ACCOUNTING POLICIES

a) Basis of Presentation

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

These consolidated financial statements are prepared in accordance with generally accepted accounting principles in Canada. The significant accounting policies followed by the Company have been applied consistently in the preparation of these consolidated financial statements. These accounting policies are summarized below.

b) Cash and Cash Equivalents

The Company considers cash and cash equivalents to include amounts held in banks and highly liquid investments with remaining maturities at point of purchase of 90 days or less. The Company places its excess cash and cash equivalents with institutions of high-credit worthiness.

c) Short-term investments

Investments are accounted for at fair market value and consist of securities backed by the full credit of the United States Government with maturities of less than one year.

d) Property Plant and Equipment (PP&E)

i. Petroleum Properties

The Company uses the successful efforts method to account for its oil and gas exploration and development costs. Exploration well costs are initially capitalized and, if subsequently determined to have not found sufficient reserves to justify commercial production, are charged to dry hole expense. Exploration well costs that have found sufficient reserves to justify commercial production, but those reserves cannot be classified as proved, continue to be capitalized as long as sufficient progress is being made to assess the reserves and economic viability of the well or related project.

Producing properties and significant unproved properties are assessed annually, or more frequently as economic events dictate, for potential impairment. Any impairment loss is the difference between the carrying value of the asset and its fair value. Fair value is calculated as the present value of estimated expected future cash flows from proved, probable and, as appropriate, possible reserves.

The Company engages independent engineers in order to determine the extent to which it has reserves.

The Company is currently engaged in exploration operations in Kurdistan, as described in note 6. The Company has no reserves to form the basis for an estimate of future net cash flow from the corresponding petroleum properties. The Company has considered the conditions in CICA Accounting Guideline 11 for impairment which includes significant unfavorable economic, legal, regulatory, environmental, political and other factors. In addition, the Company's continued execution of its business plan is a key factor considered as part of the assessment of the recoverability of the carrying amount of the properties. Whenever events or changes in circumstances indicate that the carrying amount of a property in the development stage may be impaired, capitalized costs are written down to the estimated recoverable amount. As at December 31, 2009, $184,953,000 has been capitalized to date related to this project. No revenues have been generated from this project to date and no impairment was identified at December 31, 2009.

ii. Corporate PP&E

Corporate PP&E includes office equipment, furniture and other assets not used directly in petroleum operations, which are stated at historical cost less accumulated depreciation.

iii. Depreciation, Depletion and Amortization (DD&A)

Capitalized costs of proved oil and gas properties are depleted using the unit of production method. For purposes of these calculations, production and reserves of oil are converted to cubic feet of natural gas on an energy equivalent basis at a ratio of one barrel (bbl) of oil to six thousand cubic feet (mcf) of natural gas.

Successful exploratory wells and development costs are depleted over proved developed reserves. However, to the extent significant development costs are incurred in connection with proved undeveloped reserves, such costs are excluded from depletion until the reserves are developed. Acquired resource properties with proved reserves are depleted over proved reserves. Acquisition costs of probable reserves are not depleted or amortized while under active evaluation for commercial reserves. Costs are transferred to depletable costs as proved reserves are recognized. Costs associated with significant development projects are not depleted until commercial production commences.

Corporate PP&E are depreciated using the straight-line method at annual rates of 20% to 25%.

e) Asset Retirement Obligations

The fair value of the statutory, contractual or legal liability associated with the retirement and reclamation of oil and gas properties is recorded when incurred, with a corresponding increase to the carrying amount of the related petroleum properties. The increase to capitalized costs is depleted to earnings on a unit of production basis over the life of the proved reserves for each property. Subsequent changes in the estimated fair value of the asset retirement obligation (ARO) are capitalized and depleted over the remaining useful life of the underlying petroleum properties.

ARO liabilities are carried at their discounted present value and are accreted over time for the change in their present value. Actual expenditures incurred are charged against the accumulated obligation.

f) Revenue Recognition

Revenues from the sale of petroleum and natural gas are recorded when title passes to an external party and collection is reasonably assured.

g) Income Taxes

The Company follows the asset and liability method of accounting for income taxes. Under this method current income taxes are recognized for the estimated income taxes payable for the current year. Future income taxes are recognized for temporary differences between the tax and accounting basis of assets and liabilities and for the benefit of losses available to be carried forward for tax purposes that are likely to be realized.

Future tax assets and liabilities are measured using enacted or 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. The effect of future tax assets and liabilities of a change in tax rates is recognized in income in the period that included the date of enactment or substantive enactment.

h) Stock-Based Compensation

All stock-based awards made to employees and non-employees are measured and recognized using a fair value based method. Accordingly, the fair value of the options at the date of the grant is determined and charged to operations, with the offsetting credit to contributed surplus, on a straight-line basis over the vesting period. If and when the stock options are ultimately exercised, the applicable amounts of contributed surplus are transferred to share capital.

i) Loss per Share

Basic earnings per share is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding during the year. The computation of diluted earnings per share assumes the conversion, exercise or contingent issuance of securities only when such conversion, exercise or issuance would have a dilutive effect on earnings per share. The dilutive effect of outstanding options and warrants and their equivalents is reflected in diluted earnings per share by application of the treasury stock method. The treasury stock method assumes that the proceeds received from the exercise of in-the-money stock options are used to repurchase common shares at the average market price for the reporting period.

j) Joint Interests

Substantially all of the Company’s exploration and development activities are conducted jointly with others. Accordingly, the financial statements reflect only the Company’s proportionate interest in such activities.

k) Use of Estimates

The preparation of consolidated financial statements in accordance with Canadian GAAP requires that management make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. These estimates are subject to measurement uncertainty. Actual results could differ from and affect the results reported in these consolidated financial statements.

In the accounting for oil and gas interests, amounts recorded for depletion and amounts used for impairment test calculations are based on estimates of oil and gas reserves and future cash flows, including development costs. By their nature, the estimates of reserves and the related future cash flows are subject to measurement uncertainty and the impact on the consolidated financial statements of future periods could be material.

l) Foreign Currency Translation

Activities denominated in currencies other than the U.S. dollar are translated using the temporal method. Under this method, monetary assets and liabilities denominated in other currencies are translated into U.S. dollars at the exchange rate in effect at the balance sheet date. Non-monetary assets and liabilities denominated in other currencies are translated at rates in effect on the dates the assets were acquired or liabilities were assumed. Revenues and expenses are translated at rates approximating exchange rates in effect at the time of the transactions. Gains and losses on translation are reflected in the Statement of Operations and Deficit.

The accounts of the Company's self-sustaining foreign operations are translated into U.S. dollars using the current rate method. Assets and liabilities are translated at the exchange rate in effect at the balance sheet date and revenue and expenses are translated at exchange rates which approximate those prevailing at the transaction dates. Gains or losses arising from the translation of the financial statements of the self-sustaining foreign operations are deferred in the accumulated other comprehensive income account in shareholders' equity.

m) Certain prior year information has been reclassified to conform with the current year's presentation.

n) New Accounting Standards

(i) Financial instruments:

Effective for fiscal years ending on or after September 30, 2009, the Company has adopted the enhanced disclosure requirements of amended CICA Section 3862, Financial Instruments - Disclosures. Refer to note 13 for fair value measurement disclosures using a fair value hierarchy that reflects the significance of the inputs in making the measurements.

(ii) Goodwill and intangible assets:

On January 1, 2009, the Company adopted the new requirements of the CICA Handbook Section 3064, Goodwill and Intangible Assets. This new accounting standard, which applies to fiscal years beginning on or after October 1, 2008, replaces Section 3062, Goodwill and Other Intangible Assets. Section 3064 expands on the standards for recognition, measurement, and disclosure of goodwill and intangible assets. The adoption of this new standard did not have any impact on the Company's financial statements, disclosures, or results of operations.

(iii) Credit risk and the fair value of financial assets and liabilities:

On January 23, 2009, the CICA Emerging Issues Committee (EIC) issued EIC-173, Credit Risk and the Fair Value of Financial Assets and Liabilities. EIC-173 is effective for interim and annual financial statements ending on or after January 20, 2009. EIC-173 provides guidance which requires that an entity consider its own credit risk and the credit risk of counterparties when determining the fair value of financial assets and liabilities. Adoption of this guidance is to be applied retrospectively without restatement to prior periods. The Company has evaluated the impact of this new standard and concluded that it does not have a material impact on its financial statements.

3. FUTURE ACCOUNTING STANDARDS

a) International Financial Reporting Standards

In February 2008, the Canadian Accounting Standards Board confirmed that Canadian generally accepted accounting principles (Canadian GAAP) will be converged with International Financial Reporting Standards (IFRS) for fiscal years commencing January 1, 2011. The transition from Canadian GAAP to IFRS will be applicable for the Company for the first quarter of 2011 when the Company will prepare both the current and comparative financial information using IFRS. While IFRS uses a conceptual framework similar to Canadian GAAP, there are significant differences on recognition, measurement and disclosures. While the effects of IFRS have not yet been fully determined, the Company has identified a number of key areas which are likely to be impacted by changes in accounting policy and disclosures, including the accounting for petroleum properties and taxation.

b) Business Combinations

The CICA recently issued Handbook Section 1582, Business Combinations, which replaces Handbook Section 1581, Business Combinations, and establishes revised standards for the recognition, measurement, presentation and disclosure of business acquisitions. This new standard will become effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2011. The Company has determined that adoption of this standard will not have an impact on the Company’s financial statements.

c) Consolidated Financial Statements and Non-Controlling Interests

The CICA recently issued Handbook Section 1601, Consolidated Financial Statements, and Handbook Section 1602, Non-Controlling Interests. These new sections will replace Handbook Section 1600, Consolidated Financial Statements, and establishes new guidance in respect of accounting for non-controlling interests in a subsidiary and for the preparation of consolidated financial statements. These new sections apply to interim and annual consolidated financial statements for years beginning on or after January 1, 2011. The Company has determined that adoption of these sections will not have an impact on the Company’s financial statements.

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4. DISCONTINUED OPERATIONS

On May 28, 2009, the Company sold to a third party substantially all of its petroleum properties located in the United States in the Gulf of Mexico. The sale of these properties, including corresponding asset retirement obligations, was for $12,487,000 in cash. Not included in the purchase price is a deferred payment of up to $8,000,000, which is contingent based on proved reserves as defined at December 31, 2010. The sale resulted in a gain of $1,600,000 reported in the consolidated statement of operations and deficit.

The results of discontinued operations in the Consolidated Statement of Operations and Deficit for the years ended December 31 were as follows:

	2009	2008
Revenues		
Oil and gas sales	$ 1,658	$ 6,723
Royalties	-	(1,714)
	1,658	5,009
Costs and Expenses		
Operating	761	2,202
Exploration	810	10,500
Dry hole costs	21	12,716
Impairment of properties	200	68,556
Accretion	12	55
Depletion, depreciation and amortization	447	1,912
General and administrative	3,072	2,894
Reclassification of cumulative foreign currency translation gain (note 5)	(3,282)	-
	2,041	98,835
Other income		
Interest income	24	1,070
Net loss before income taxes	(359)	(92,756)
Income tax expense	-	-
Discontinued operations		
Loss from operations	(359)	(92,756)
Gain on asset disposals	1,600	-
	$ 1,241	$ (92,756)

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The cash flows relating to discontinued operations in the Consolidated Statement of Cash Flows for the years ended December 31 were as follows:

	2009	2008
Operating activities of discontinued operations		
Income (loss) from discontinued operations	$ 1,241	$ (92,756)
Adjustments for non-cash items:		
Depletion, depreciation and amortization	447	1,912
Impairment of properties	200	68,556
Dry hole costs	21	12,716
Accretion	12	55
Reclassification of cumulative foreign currency translation gain (note 5)	(3,282)	-
Gain on asset disposals	(1,600)	-
Asset retirement obligation	426	1,292
Changes in working capital:		
Accounts receivable	1,377	1,197
Prepaid expenses	1,295	(917)
Accounts payable and accrued expenses	(2,151)	(11,918)
Advances from joint venture partners	163	(163)
	(1,851)	(20,026)
Investing activities of discontinued operations		
Property, plant & equipment	(1,299)	(20,803)
Proceeds from sale of assets	12,487	-
Investments, net	-	31,977
	11,188	11,174
	$ 9,337	$ (8,852)

5. ACCUMULATED OTHER COMPREHENSIVE INCOME

Accumulated other comprehensive income is comprised as follows:

	2009	2008
As at January 1	$ 3,282	$ 3,282
Reclassification of cumulative foreign currency translation gain	(3,282)	
Gain on currency translation of the financial statements of a foreign operation	4	-
As at December 31	$ 4	$ 3,282

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The 2009 financial statements of ShaMaran Petroleum BV, The Hague, Collonge Bellerive Branch have been translated from the functional currency of Swiss Francs into the reporting currency of the Company, with a resulting currency translation gain of $4,000.

Consistent with the sale during the year 2009 of substantially all of its petroleum properties located in the United States, the Company has reclassified the cumulative foreign exchange translation gain which originated in the year 2007. Accordingly, the amount is reflected in the 2009 loss from discontinued operations included in the Consolidated Statement of Operations and Deficit.

6. PROPERTY PLANT AND EQUIPMENT

Property plant and equipment is comprised as follows:

December 31, 2009:		Cost		Accumulated DD&A		Net
Petroleum properties - Kurdistan	$	184,953	$	-	$	184,953
Corporate PP&E		233		(6)		227
	$	185,186	$	(6)	$	185,180

December 31, 2008:		Cost		Accumulated DD&A		Net
Petroleum properties - USA	$	19,717	$	(5,108)	$	14,609
Corporate PP&E		229		(63)		166
PP&E - held for sale	$	19,946	$	(5,171)	$	14,775

During 2009 the Company sold its petroleum properties located in the United States. The remaining United States located petroleum properties retained by the Company are carried at $nil cost. Refer to note 4 for additional information.

On October 16, 2009, the Company completed the acquisition of working interests in three separate exploration and development blocks with the Kurdistan Regional Government ("KRG") in the southeastern area of the autonomous region of Kurdistan in Northern Iraq. In exchange for the working interests the Company paid to various parties cash consideration totaling $90.1 million, and has an obligation as at December 31, 2009 to issue 100 million common shares to the KRG. As of December 31, 2009 these shares remain un-issued by the Company and have been presented as "Shares to be issued" within Shareholder's Equity at a value of $61.3 million. Refer to note 15 for additional information on the working interests.

The acquisition of a company during the year 2009, as described in note 7, has resulted in the capitalization of $31,965,000 in petroleum property costs.

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No depletion has been attributed to the costs of petroleum properties located in Kurdistan, as the related operations are currently in the pre-production exploration stage and, currently, there is no corresponding production or reserves.

7. ACQUISITION

On October 22, 2009 the Company completed the acquisition from Lundin Petroleum B.V. ("LUPE") of 100% of the common shares of BBPL International BV, a company incorporated in the Netherlands, in exchange for consideration of $1.00 in cash and 50 million common shares of the Company issued at a price of Cdn $0.67 per share, for a total purchase price of $31,965,000 The entire purchase price has been allocated to the petroleum properties located in Kurdistan, as described in note 6. An additional 50 million common shares of the Company are issuable to LUPE at such time as a development plan on one of the petroleum properties is approved. The name of the acquired company was subsequently changed to ShaMaran Petroleum BV.

8. SHARE CAPITAL AND CONTRIBUTED SURPLUS

a. Share capital and contributed surplus are comprised as follows:

	No. Shares		Share Capital		Contributed Surplus
Authorized: Unlimited common shares without par value					
Balance - December 31, 2007	308,256,088	$	250,835	$	2,237
Issued - warrants exercised	500,000		50		-
Warrants exercised	-		14		(14)
Stock options granted	-		-		801
Balance - December 31, 2008	308,756,088		250,899		3,024
Issued - private placement	140,000,000		96,250		
Issued - acquisition	50,000,000		31,966		
Issued - options excercised	790,000		558		(210)
Stock options granted	-		-		546
Balance - December 31, 2009	499,546,088	$	379,673	$	3,360

On October 20, 2009, the Company closed a private placement of 140 million common shares at a price of Cdn $0.75 per share. Gross proceeds of the offering were Cdn $105,000,000 (Cdn $99,696,000 net of related fees).

On October 22, 2009, the Company issued 50 million common shares at a price of Cdn $0.67 per share as consideration in the acquisition of a Dutch subsidiary, as indicated in note 7.

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b. Share Options

The Company has an established share purchase option plan whereby a committee of the Company's board of directors may, from time to time, grant up to a total of 10% of the issued share capital to directors, officers, employees or consultants. The number of shares under option at any specific time to any one optionee shall not exceed 5% of the issued and outstanding common shares of the Company. The term of any options granted under the plan will be fixed by the Board of Directors and may not exceed five years from the date of grant. All options granted are subject to a four month hold period from the date of granting. Vesting terms are at the discretion of the Board of Directors. All issued stock options have terms of three to five years and vest over periods of up to three years. The exercise price of an option is not less than the closing price on the TSX Venture Exchange ("the Exchange") on the last trading day preceding the grant date, less the applicable discount, provided that the exercise price will not be less than Cdn $0.10 per share.

Movement in stock options issued and outstanding is as follows:

	Number of Options	Weighted Average Exercise Price
Outstanding at December 31, 2007	3,215,000	Cdn $1.37
Granted	3,660,000	Cdn $0.48
Expired	(250,000)	Cdn $0.75
Cancelled/Forfeited	(5,000)	Cdn $2.15
Outstanding at December 31, 2008	6,620,000	Cdn $0.90
Granted	2,085,000	Cdn $0.66
Exercised	(790,000)	Cdn $0.48
Cancelled/Forfeited	(3,805,000)	Cdn $0.93
Outstanding at December 31, 2009	4,110,000	Cdn $0.82

At December 31, 2009, 2,425,000 options are exercisable at an average exercise price of Cdn $0.82 per share with a weighted average remaining life of 2.38 years.

The incentive stock options issued and outstanding are as follows:

Expiry Date	Number Outstanding at December 31, 2009	Exercise Prices
March 27, 2010	490,000	Cdn $2.15
April 24, 2011	1,235,000	Cdn $0.48
January 18, 2012	300,000	Cdn $1.20
September 10, 2014	1,375,000	Cdn $0.67
September 30, 2014	710,000	Cdn $0.64
	4,110,000	

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Stock Based Compensation

The Company recognizes compensation expense on stock options granted to both employees and non-employees using the fair value method at the date of grant, which the Company records as an expense. The stock option compensation expense is calculated using the Black-Scholes option pricing model. The weighted average fair value of options granted and the assumptions used in their determination are as follows.

	2009	2008
Expected dividend yield	0%	0%
Risk-free interest rate (weighted average)	3.32%	3.06%
Expected stock price volatility (weighted average)	85.77%	94.24%
Expected option life in years (weighted average)	3.98	3.00
Grant date fair value (weighted average)	Cdn $0.48	Cdn $0.29

Stock option compensation expense for the current year was $546,000 (2008: $801,000).

Option pricing models require the input of highly subjective assumptions including the expected price volatility. Changes in the subjective input assumptions can materially affect the fair value estimate, and therefore the existing models do not necessarily provide a reliable single measure of the fair value of the Company's stock options.

c. Warrants

As at January 1, 2008, the Company had share purchase warrants outstanding to purchase 500,000 shares at Cdn $0.10 per share, exercisable by January 9, 2008. These warrants were subsequently exercised on January 8, 2008. As at December 31, 2009 the Company had no share purchase warrants outstanding.

9. SHARES TO BE ISSUED

During the Annual General Meeting of the Company held on October 16, 2009 the shareholders passed a resolution ratifying and approving certain production sharing contracts with the Kurdistan Regional Government (the "KRG"), which resulted in an obligation for the Company to issue 100 million common shares to the KRG as consideration in exchange for the interests in the corresponding petroleum properties, indicated in note 6. The share price at close of business on October 16, 2009 was Cdn $0.63 which has resulted in total consideration of $61,349,000 (Cdn $63,000,000). At December 31, 2009 the issuance of the shares was pending subject to certain actions to be performed by the KRG.

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10. ASSET RETIREMENT OBLIGATION

The total future asset retirement obligation relates to the remaining interests the Company holds in petroleum properties located in the United States, and was estimated based on the Company's remaining net ownership interest in corresponding 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 Company estimates that the remaining asset retirement obligations will be settled between the years 2010 and 2012. A discount factor of 2% was used to calculate the fair value of the asset retirement obligation.

Changes to the asset retirement obligation were as follows:

		2009		2008
Balance, beginning of year	$	3,261	$	1,914
Liabilities incurred during the year		-		753
Revisions of estimated cash flows		426		673
Liabilities settled during the year		(2,348)		(134)
Accretion		12		55
Balance, end of year	$	1,351	$	3,261

11. INCOME TAXES

a. Income tax expense:

The provision for income taxes reflects an effective tax rate which differs from Federal and Provincial statutory tax rates. The main differences for the years ended December 31, are as follows:

		2009		2008 [1]
Income (loss) from continuing operations	$	1,687	$	(5,294)
Corporate income tax rate		30.0%		31.0%
Computed income tax expense (recovery)		506		(1,641)
Increase (decrease) resulting from:				
Non-taxable foreign exchange gain		(1,482)		-
Share issuance costs charged to share capital		(1,402)		-
Non-deductible compensation expense		164		248
Foreign tax rate difference		12		-
Effect of change in tax rates		448		188
Change in valuation allowance		2,254		954
Effect of change in foreign exchange rates		(446)		483
Other		(42)		(232)
Income tax expense from continuing operations	$	12	$	-

[1] Restated – see note 2.

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The components of the future income tax assets as at December 31, are as follows:

		2009		2008
Non-capital losses	$	60,366	$	24,045
Share issue costs carried forward		2,033		1,311
Properties - tax basis over carrying value		1,160		35,544
Exploration expenses		764		685
Future income tax assets before allowance		64,323		61,585
Valuation allowance		(64,323)		(61,585)
Future income tax asset	$	-	$	-

In the year 2009 the Company acquired petroleum properties with tax bases below the carrying value, resulting in a corresponding future tax liability. The Company has assigned a value of $nil to the future tax liability, as this tax shall be discharged under the terms of the Production Sharing Contracts (see also notes 7 and 15).

b. The Company has tax losses and costs as at December 31, which are available to apply to future taxable income as follows:

		2009		2008
Canadian losses from operations	$	7,401	$	1,527
Canadian exploration expenses		3,057		2,636
Canadian unamortized share issue costs		7,577		4,545
U.S. Federal losses from operations		167,188		67,565
U.S. Federal - tax basis in excess of carrying values of properties		3,315		101,556
Total	$	188,538	$	177,829

The Canadian losses from operations may be used to offset future Canadian taxable income and will expire over the period from 2014 to 2029. The Canadian exploration expenses may be carried forward indefinitely to offset future taxable Canadian income. Canadian unamortized share issue costs may offset future taxable Canadian income of years 2010 to 2013. The U.S. Federal losses are available to offset future taxable income in the United States through 2029.

12. RELATED PARTY TRANSACTIONS

Namdo Management Services Ltd. ("Namdo") provides corporate administrative support and investor relation services to the Company under an agreement which commenced April 1, 2007. For these services Namdo was paid $214,000 during the current year (2008: $264,000). Namdo is a private corporation owned by a shareholder of the Company.

Mile High Holdings Ltd., a private corporation associated to a shareholder of the Company, provided transportation services to the Company in the amount of $385,000 (2008: $nil) related to petroleum property acquisition and fundraising activities.

During the current year, the Company incurred legal fees of $217,000 (2008: $18,000) with a law firm in which an officer of the Company is a partner.

During the year ended December 31, 2008, the Company incurred geological and geophysical (G&G) costs of $469,000, respectively, with a G&G firm in which an officer of the Company is a managing partner. No charges were incurred from this firm in the current year.

The Company receives services from various subsidiary companies of Lundin Petroleum AB ("Lundin"), a shareholder of the Company. Total Lundin charges during the year were $1,245,000 (2008: $nil), being comprised of G&G and other technical service costs of $317,000 (2008: $nil), reimbursement for travel and related expenses of $207,000 (2008: $nil), office rental, administrative and building services of $86,000 (2008: $nil), and fees of $635,000 (2008: $nil) relating to a guarantee provided to the KRG on behalf of the Company in respect of its minimum financial commitments (see note 15a), charged at a rate of 3% per annum, and payable semi-annually beginning 30 June 2010.

All transactions with related parties are recorded at amounts agreed to by the parties and are made on the same terms and conditions as with non-related parties.

Amounts owing to related parties as at December 31, 2009 were $1,152,000 (2008: $nil), and include $635,000 (2008: $nil) payable to Lundin in respect of a guarantee on the terms described above. All other amounts owing were due on standard terms of net-30 days. The Company was owed no amounts by related parties at the reporting dates.

13. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

The Company's financial instruments consist of cash and cash equivalents, short-term investments, accounts receivable, accounts payable, accrued expenses and advances from joint interest holders.

Cash and cash equivalents and investments are designated as held for trading and therefore carried at fair value, with unrealized gain or loss recorded in interest income.

The carrying amounts reported in the consolidated balance sheet for short term financial assets and liabilities, which includes accounts receivable, accounts payable, accrued expenses and advances from joint interest holders approximate fair values due to the immediate or short-term maturities of these financial instruments.

The following is a classification of fair value measurements recognized in the consolidated balance sheet using a fair value hierarchy that reflects the significance of the inputs used in making the measurements.

	Fair value measurement at reporting date using:			
Financial assets	December 31, 2009	Quoted prices in active markets identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Held-for trading securities:				
Cash and cash equivalents	$ 63,565	$ 63,565	$ -	$ -
Short-term investments	79	79	-	-
Total	$ 63,644	$ 63,644	$ -	$ -

The Company is exposed in varying degrees to a variety of financial instrument related risks.

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. The Company manages its credit risk through its counterparty ratings and credit limits. The Company is mainly exposed to credit risk on its cash and cash equivalents and accounts receivable. To manage this risk the Company maintains its excess cash on account in instruments having a minimum credit rating of R-1 (mid) or better (as measured by Dominion Bond Rate Services) or the equivalent thereof according to a recognized bond rating service.

Accounts receivable are primarily with joint venture partners in the oil and gas industry and are subject to normal industry credit risks. Joint venture receivables are typically collected within one to two months of the joint venture bill being issued to the partner. The Company mitigates the risk from joint venture receivables by obtaining partner approval of capital expenditures prior to starting a project.

Liquidity Risk

Liquidity risk is the risk that the Company will incur difficulties meeting its financial obligations as they become 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, without incurring unacceptable losses or risk harm to the Company's reputation.

The Company prepares annual capital expenditure budgets, which are regularly monitored and updated as considered necessary. The Company uses authorizations for expenditures on both operating and non-operating projects to further manage capital expenditures.

Market Risk

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

The significant market risk exposures to which the Company is exposed are foreign currency, commodity price and interest rate risks.

Foreign currency risk – The Company maintains a portion of its cash in Canadian dollars. The Company's operations are conducted in U.S. dollars. The Company's operating results and cash flows are affected to varying degrees by the changes in the Canadian dollar vis-à-vis the U.S. dollar. Company expenditures are incurred predominately in U.S. dollars. The Company has not entered into any agreements or purchased any instruments to hedge possible currency risks.

At December 31, 2009, the Company had $58,338,000 denominated in Canadian dollars. As of December 31, 2009, with other variables unchanged, a 1% strengthening of the U.S. dollar against the Canadian dollar would decrease the net income by $552,000 due to this financial asset.

(Tabular Amounts in Thousands, except Share and Per Share Amounts)

Commodity price risk – The prices that the Company received for its crude oil and natural gas production may have had a significant impact on its revenue and cash provided by operating activities. Any significant price decline in commodity prices would have adversely affected the amount of funds available for capital reinvestment purposes. The Company did not use derivative financial instruments to manage its exposure to this risk.

Interest rate risk – The Company's bank accounts earn interest income at variable rates. The Company's future interest income is exposed to changes in short-term rates. At December 31, 2009, the Company had $58,338,000 denominated in Canadian dollars. As of December 31, 2009, with other variables unchanged, a 0.25% weakening of the interest rate on Canadian funds on deposit would decrease the net income by approximately $145,000 due to this financial asset.

14. CAPITAL DISCLOSURE

The Company's objective when managing capital is to safeguard the Company's ability to continue as a going concern such that it can provide returns for shareholders and benefits for other stakeholders.

The Company considers its capital structure to include shareholders' equity and working capital. The Company manages the capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of the underlying assets. In order to maintain or adjust its capital structure, the Company may issue new shares or sell assets to settle liabilities. The Company is not subject to externally imposed capital requirements.

The components of the Company's capital structure as at December 31, are as follows:

	2009	2008
Current assets	$ 64,819	$ 48,819
Current liabilities	(4,916)	(7,224)
Working capital	$ 59,903	$ 41,595
Shareholders' equity	$ 244,563	$ 54,466

15. COMMITMENTS AND CONTINGENCIES

a. Production Sharing Contracts ("PSC"):

The Company entered into two PSCs during the year 2009, which govern its petroleum operations in two separate petroleum exploration and development properties, the Pulkhana Block 10 and the Arbat Block, located in the Kurdistan Region of Iraq.

Under the terms of the Pulkhana PSC, the Company holds a 60% undivided interest in the petroleum operations, Petoil Petroleum and Petroleum Products International Exploration and Production Inc ("Petoil") holds a 20% interest and the remaining 20% is held by the Kurdistan Regional Government (the "KRG"). The Company is required to pay 100% of the minimum financial commitment in respect of the first exploration sub-period, which is 36 months from the commencement of the PSC with option to extend by one year. Under the terms of the Pulkhana PSC, the Company is the operator and collectively with Petoil, represent the "Contractor".

Under the terms of the Arbat PSC, the Company holds a 60% undivided interest in the petroleum operations, the KRG holds a 20% interest and the remaining 20% is a third party interest which the KRG has the option to assign to a third party or parties. The Company is required to pay 100% of the minimum financial commitment in respect of the first exploration sub-period or until such time as the KRG's reserved 20% interest has been sold, following which the Company will pay 75% of the forward costs and receive a reimbursement for 25% of the costs incurred to that date. Under the terms of the Arbat PSC, the Company is the operator and represents the "Contractor".

The PSCs contemplate a minimum financial commitment of $61 million in respect of the first exploration sub-period for the Pulkhana and Arbat Blocks combined. The PSCs also require the Contractor to fund certain personnel, training, environmental, and technological assistance projects, during the period over which the contracts are in effect. As at December 31, 2009 the commitments under the two PSCs were approximately $64 million.

All qualifying petroleum costs incurred by the Contractor shall be recovered from a portion of available petroleum production, defined under the terms of the PSCs. At any time during the exploration period the Contractor has the right to terminate the PSCs, by surrendering the entire contract area.

b. Amendment and Novation Agreement to the Block K42 Option Agreement ("K42 Option Agreement")

During the year 2009 the Company became party to the K42 Option Agreement between the KRG and Oil Search (Iraq) Limited ("OSIL"), which allows an option to the Company and OSIL to enter into with the KRG a PSC relating to the exploration and development of petroleum resources in the Block K42 contract area located in Kurdistan Region of Iraq, the terms of which have been agreed in principle.

In accordance with the K42 Block PSC, OSIL is the operator and, collectively with the Company, represent the "Contractor". Upon exercise of the option, the Company would acquire not less than an undivided 20% interest in the petroleum operations in respect of the K42 Block contract area, with OSIL holding a 60% interest and the KRG holding the remaining 20%. If either the Company or OSIL elect not to exercise its option in respect of the Contract the other party has the option of acquiring the exiting party's rights and obligations.

This K42 Option Agreement requires the Contractor to conduct certain seismic services, including the acquisition of 200 kilometers of seismic surveying, within the option period of 18 months commencing October 1, 2009, which is extendable for a further three months. Provided that the seismic services are completed prior to the expiry of the option period, the option to enter into a PSC may be exercised by providing written notice to the KRG. The Contractor is to pay 100% of all the costs incurred during the option period, 25% of which are to be paid by the Company.

The Company estimates its remaining minimum commitments under the K 42 Option Agreement to be approximately $2 million as at December 31, 2009.

All qualifying petroleum costs incurred by the Contractor during the option period would be recoverable from a portion of available petroleum production, defined under the terms of the PSC.

c. Net Profit Interest

The Company has entered into agreements for local services whereby certain third parties are entitled to receive a net profit interest in respect of the Pulkhana Block 10 and Arbat Block PSCs.

d. Other commitments

The Company has leases for office space which expire during the year 2010. As at December 31, 2009 the future minimum commitments relating to office leases was $69,000.

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TRANSFER AGENT
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Vancouver, British Columbia

STOCK EXCHANGE LISTING
TSX Venture Exchange
Trading Symbol: SNM

INVESTOR RELATIONS
Sophia Shane
Vancouver, British Columbia