



Shamaran Petroleum Corp

2010 Annual Report

Prepared by Management

SHAMARAN PETROLEUM CORP.

MANAGEMENT DISCUSSION AND ANALYSIS

For the years ended December 31, 2010 and 2009

(Expressed in United States Dollars unless otherwise indicated)

Management's discussion and analysis ("MD&A") of the financial and operating results of ShaMaran Petroleum Corp. ("ShaMaran", and formerly Bayou Bend Petroleum Ltd, together with its subsidiaries the "Company") is prepared as of April 7, 2011. The MD&A should be read in conjunction with the audited consolidated financial statements for the years ended December 31, 2010 and 2009, and related notes thereto. These financial statements have been prepared in accordance with Canadian generally accepted accounting principles. Unless otherwise stated herein, all dollar amounts are expressed in US dollars ("USD").

Overview

ShaMaran is a Canadian-based oil and gas company with interests in four petroleum properties located in Kurdistan in Northern Iraq ("Kurdistan"). The Company is currently in the pre-production stages of its exploration and development program relating the petroleum properties. ShaMaran trades on the TSX Venture Exchange under the symbol "SNM".

Highlights

- In April 2010 the Company completed the acquisition of 291.4 km of 2D seismic data in the Pulkhana Block. The seismic campaign was completed on schedule and within budget.
- Seismic acquisition of 232 km of 2D seismic data in Block K42 was concluded in May 2010. Processing and interpretation of the data was completed at the end of the year 2010 and resulted in the identification of a significant 4-way dip-closed prospect.
- In August 2010, the Company acquired a 33.5% stake in General Exploration Partners Inc, a company which holds an 80% working interest in the Atrush Block Oil and Gas Exploration Area in Kurdistan. As a result ShaMaran has a 26.8% indirect interest in the Atrush Block.
- In August 2010, the Company executed agreements to amend the Pulkhana Block 10 and the Arbat Block Production Sharing Contracts ("PSCs"), which waive the Company of its previous contractual requirement to issue 150 million common shares to the Kurdistan Regional Government of Iraq ("KRG") in exchange for 20% of the Company's profit oil share (produced oil, less royalty and cost oil) from the two PSCs as capacity building payments to the KRG.
- The Company raised \$47.8 million net cash proceeds through a private placement of 111 million common shares in September 2010.
- In October 2010, the Company completed the acquisition of 429.1 km of two dimensional ("2D") seismic data on the Arbat Block in eastern Kurdistan.
- The first exploration well on the Atrush Block was spudded on October 5, 2010, and a total depth of 3,400 meters was reached on January 21, 2011. A comprehensive well testing program was commenced on January 30, 2011 with drill stem tests planned for ten (10) potential hydrocarbon zones. The Company will make a further announcement at the conclusion of all testing expected to be in the second week of April 2011.
- In March 2011 the Company received a Detailed Property Report ("the Report") from its third party auditors, McDaniel & Associates Consultants Ltd. The Report includes 82,461 Mboe as best estimate of *Gross Estimated Contingent Resources* and 287,555 Mboe as the unrisksed best estimate of *Gross Estimated Prospective Resources* net to ShaMaran for all four of the Company's assets. These estimates are based on information prior to the appraisal drilling of Pulkhana and results from the Atrush-1 well.
- On April 3, 2011 the Company spudded its first well, Pulkhana 9, with a planned total depth of approximately 2,700 meters and targets the proven Euphrates/Upper Jaddala and Shiranish oil reservoirs, as well as evaluating a further potential reservoir in the Lower Jaddala.

- Cash balance of the Company was \$58.7 million as at December 31, 2010.

Operations in Kurdistan

The Company has direct working interests in each of the Pulkhana Block, the Arbat Block and Block K42 and has an indirect interest in the Atrush Block. All petroleum properties are located in Kurdistan within the northern extension of the Zagros Folded Belt. The area is currently undergoing a major exploration and development campaign by over 30 mid to large size international oil companies.

Pulkhana Block

The Pulkhana Block is a 529 square km appraisal/development area located in southern Kurdistan. In 1956 the Pulkhana 5 discovery well entered two fractured carbonate reservoirs and successfully flow tested to surface a cumulative rate of over 2,900 barrels of oil per day.

The Company completed the acquisition of 291.4 km of 2D seismic data in April 2010. The seismic campaign was completed on schedule and within budget. Processing and interpretation of the seismic data was completed in July 2010 in preparation for drilling a well on this Block. The seismic program was successful in delineating the structure of the Pulkhana oilfield.

On April 3, 2011 the Company spudded its first well, Pulkhana 9, which will be drilled approximately 2.8 km northwest of Pulkhana 5. Planned total depth is approximately 2,700 meters and the well is targeting the proven Euphrates/Upper Jaddala and Shiranish oil reservoirs, as well as evaluating a further potential reservoir in the Lower Jaddala.

ShaMaran plans to drill 3 wells in the first exploration phase of three years 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 phase and, if development is warranted, a development period of up to 20 years with an automatic right to a five year extension.

The Company is the operator of the project with a 60% undivided interest in the production sharing contract. Petoil Petroleum and Petroleum Products International Exploration and Production Inc. retains a 20% interest in the PSC 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 phase, following which the Company will pay 75% of the forward costs. Fiscal terms under the PSC include a 10% royalty, a variable profit split, based on a percentage share to the KRG and a capacity building payment equal to 20% of the Company's profit oil share (produced oil, less royalty and cost oil) to be paid to the KRG. The 20% capacity building payment is a result of an amendment made to the PSC in August 2010, relieving the Company of its previous contractual requirement to issue 150 million common shares of the Company to the KRG. The Company has the right to recover costs using up to 40% of the available crude oil (produced oil less royalty oil) and 50% of the produced gas.

Refer also to the discussion under "Commitments" in this MD&A.

Arbat Block

The Arbat Block (formerly Block G) is a 973 square km exploration area located in eastern Kurdistan. The Block contains both surface anticlines and subsurface structures all identified by recent field work and 2D seismic. The Block also has a number of oil seeps, several of which were discovered during the seismic operations now complete.

The Company completed the acquisition of 429.1 km of 2D seismic data in October 2010. The seismic campaign was completed on schedule and within budget. Processing and interpretation of the seismic data was completed in December 2010, and the Company has received Ministry of Natural Resources (“MNR”) approval for the location of the first commitment exploration well (designated Arbat-A). Tendering and preparations are now underway to enable drilling scheduled to commence in the 4th quarter of this year.

The Company is the operator of the project and holds a 60% undivided interest in the production sharing contract, 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, a variable profit split, based on a percentage share to the KRG and a capacity building payment equal to 20% of the Company’s profit oil share (produced oil, less royalty and cost oil) to be paid to the KRG. The 20% capacity building payment is a result of an amendment made to the PSC in August 2010, relieving the Company of its previous contractual requirement to issue 150 million common shares of the Company to the KRG. The Company has the right to recover costs using up to 45% of the available crude oil (produced oil less royalty oil) and 53% of the produced gas.

Refer also to discussion under “Commitments” in this MD&A.

Block K42

Block K42 is a 505 square km exploration area located in the South of Kurdistan immediately northeast of the Pulkhana Block, and is on trend with the Jambur field situated to the north west of the Block. The producing Jambur field has estimated oil reserves in excess of one billion barrels and is connected to export infrastructure.

A campaign to acquire 232.0 km of 2D seismic data on this Block was completed in May 2010. Processing and interpretation of the seismic data was completed in December 2010. The seismic program resulted in the identification of a significant 4-way dip-closed prospect.

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 a PSC with the KRG, 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 November 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 production sharing contract 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.

Refer also to discussion under “Commitments” in this MD&A.

Atrush Block

The Atrush Block is a 269 square km exploration area in the north of Kurdistan located immediately north and adjacent to the major Shaikan discovery announced by Gulf Keystone Petroleum Ltd. in January 2010. The Atrush Block is also adjacent to and on trend with the recent Bijeel oil discovery to the east, operated by Kalegran Limited (MOL). The 2D seismic data over the Atrush Block indicates that the Atrush structure is similar to the Shaikan structure. The Shaikan discovery was announced as multiple stacked oil reservoirs in the Cretaceous, Jurassic and Triassic sections and tested individually at flow rates up to 7,000 bopd.

In August 2010 the Company acquired a 33.5% shareholding in General Exploration Partners Inc ("GEP"). GEP is the operator of the Atrush Block PSC, holding an 80% working interest in the Block, with the remaining 20% third party interest ("TPI") being held by the KRG. In October 2010, Marathon Oil Corporation was assigned the 20% TPI.

The Atrush 1 exploration well was spudded on October 5, 2010 and completed drilling to a total depth of 3,400 meters on January 21, 2011. Hydrocarbons shows with oil returns over shakers were recorded while drilling the Cretaceous and the Jurassic, and the RFT pressures taken in the 12-1/4" hole section appear to show a common oil gradient within three of the Jurassic intervals. A comprehensive well testing program was commenced on January 30, 2011 with Drill Stem Tests planned for ten (10) potential hydrocarbon zones. The Company will make a further announcement at the conclusion of all testing, expected to be in the second week of April 2011.

Under the terms of PSC, the KRG has the option of participating as a Contractor Entity with an undivided interest in the petroleum operations and all the other rights, duties, obligations and liabilities of the Contractor in the PSC, of up to 25% and not less than 5%. If this option is exercised, the government will become liable for their share of the petroleum costs incurred on or after the first commercial declaration date. Fiscal terms under the PSC include a 10% royalty, a variable profit split, based on a percentage share to the KRG and a capacity building payment equal to 30% of profit oil (produced oil, less royalty and cost oil) to be paid to the KRG. GEP has the right to recover costs using up to 40% of the available oil (produced oil less royalty oil) and 55% of the produced gas.

Refer also to discussion under "Commitments" in this MD&A.

Changes in Directors and Officers

In April 2010, Mr. Pradeep Kabra, President and Chief Executive Officer, was appointed as a director of the Company. In the same month John Ashbridge resigned from his position as Chief Operating Officer.

Selected Annual Information

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

(\$000s, except per share data)

	For the year ended December 31,		
	<u>2010</u>	<u>2009</u>	<u>2008</u>
Continuing operations			
Depreciation	(139)	(6)	(469)
General and administrative	(594)	(2'378)	-
Stock based compensation	(514)	(546)	(801)
Guarantee fees	(1'353)	(636)	-
Interest income	416	310	986
Loss from investment in company	(27)	-	-
Foreign exchange gain / (loss)	2'215	4'943	(5'010)
Income tax	(81)	(12)	-
Net income / (loss) from continuing operations	<u>(77)</u>	<u>1'675</u>	<u>(5'294)</u>
Discontinued operations			
Net revenues	-	1'658	5'009
Expenses	(1'044)	(2'041)	(98'835)
Interest income	7	24	1'070
Gain loss on sale of assets	77	1'600	-
Net income / (loss) from discontinued operations	<u>(960)</u>	<u>1'241</u>	<u>(92'756)</u>
Net income/(loss)	<u>(1'037)</u>	<u>2'916</u>	<u>(98'050)</u>
 Basic income / (loss), \$ per share:			
Continuing operations	-	0.005	(0.02)
Discontinued operations	-	0.005	(0.30)
	<u>-</u>	<u>0.01</u>	<u>(0.32)</u>
 Diluted income / (loss), \$ per share:			
Continuing operations	-	0.005	(0.02)
Discontinued operations	-	0.005	(0.30)
	<u>-</u>	<u>0.01</u>	<u>(0.32)</u>
 Total assets	 256'489	 249'999	 63'594
Working capital surplus	41'364	59'903	41'595
Shareholders' equity	235'518	244'563	54'466
Common shares outstanding (x 1000)	623'182	499'546	308'756

Summary of principal changes in annual information

The Company spent \$26,900 on property plant and equipment carrying out the first full year of operations in Kurdistan in 2010, consisting primarily of the acquisition of seismic data on 3 blocks and site preparation and purchase of tangible well equipment for the Pulkhana 9 appraisal well to be drilled in the year 2011. As a result of executing agreements with the KRG in August 2010 to amend the Pulkhana and Arbat Block PSCs the obligation to issue 150 million shares of the Company to the KRG was waived in lieu a contribution of 20% of the Company's profit oil share resulting in a reduction to equity and assets by \$61,349, which is the value of shares due to be issued prior to the amendment. In the same month the Company acquired a 33.5% interest in GEP worth \$45.1 million in exchange for cash consideration of \$24.3 million, 12.5 million shares of the Company valued at \$5 million and an obligation to fund in full the subsequent \$15.8 million of operational costs of GEP. To finance the acquisition the Company raised funds in September 2010 through the issuance of 111 million shares at Cdn \$0.45 per share, resulting in gross proceeds of Cdn \$50 (Cdn \$49,301 net of issuance costs). As a result of these developments the total assets, common shares outstanding, and shareholders' equity reported at the end of the year 2010 has increased relative to the amount in 2009. The income and expenses of the Company are explained in detail below.

Results of Continuing Operations

The continuing operations of the Company are currently in the exploration stages and generate no revenue. The expenses and other income are explained as follows:

Depletion, Depreciation and Amortization

In \$000

	For the year ended December 31,	
	2010	2009
Depletion, depreciation and amortization	139	6

Depletion, depreciation and amortization corresponds to cost of use of the furniture and IT equipment at the Company's technical and administrative offices located in Switzerland and Kurdistan.

General and Administrative Expenses

In \$000

	For the year ended December 31,	
	2010	2009
Salaries and benefits	2,526	279
Management and consulting fees	1,053	494
Sponsorship expense	485	523
General and other office expenses	416	63
Listing costs and investor relations	414	136
Travel expenses	327	649
Legal, accounting and audit fees	196	660
Expenses capitalized as oil and gas assets	(4,823)	(426)
Total general and administrative expenses	594	2,378

The general increase over the prior year in the components of G&A expenses is due to the increase in support activity associated with a full year of operations in Kurdistan relative to approximately four months of activity only in the year 2009. However, the reduction in total G&A costs vs. the comparative amount in 2009 is owing to a significant increase in the amount of expense capitalized as oil and gas assets in the year 2010 compared to the amount capitalized in the year 2009, again corresponding to the increased level of operational activity in Kurdistan.

Stock-Based Compensation*In \$000*

	For the year ended December 31,	
	2010	2009
Stock-based compensation	514	546

The stock-based compensation expense in the years 2010 and 2009 results from the vesting of stock options granted in the years from 2007 to 2010. A total of 1,390,000 stock options were granted during the year ended December 31, 2010 (2009: 2,085,000). 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*In \$000*

	For the year ended December 31,	
	2010	2009
Foreign exchange gain	2,215	4,943

The gain in 2010 results primarily from holding cash and cash equivalents denominated in Canadian dollars while the Canadian dollar strengthened during the reporting period against the reporting currency of the Company, the United States dollar.

Guarantee fees*In \$000*

	For the year ended December 31,	
	2010	2009
Guarantee fees	1,353	636

The Company has incurred fees in respect of a guarantee of the minimum financial obligations under the Pulkhana and Arbat PSCs. The guarantee became effective on August 29, 2009 and has been provided to the KRG by a related company on behalf of ShaMaran. Refer also to the discussion under "Related Party Transactions" in this MD&A.

Interest income*In \$000*

	For the year ended December 31,	
	2010	2009
Interest income	416	310

Interest income represents bank interest earned on cash and investments in marketable securities. The increase in the amount relative to the prior year is primarily due to higher interest rates on average throughout the year 2010.

Loss from investment in Company*In \$000*

	For the year ended December 31,	
	2010	2009
Loss from investment in GEP	27	-

The loss relates to the Company's pro-rata portion of the net loss incurred by GEP since the Company acquired its 33.5% interest on August 27, 2010.

Tax expense*In \$000*

	For the year ended December 31,	
	2010	2009
Tax expense	81	12

Income tax expense in 2010 relates to a provision for income tax on service income generated in the Swiss entity of the Company, which was created in the fourth quarter of 2009. The amount reported in 2010 has increased relative to 2009 as a result of a higher tax base corresponding to the first full year of services.

Results of Discontinued Operations

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

Net revenues*In \$000*

	For the year ended December 31,	
	2010	2009
Oil and gas sales	-	2,089
Royalties	-	(431)
Net revenue	-	1,658

The decrease in revenues is a result of the termination of all production and corresponding sales coinciding with the sale of substantially all of the Company's United States Gulf of Mexico properties that concluded May 28, 2009.

Expenses*In \$000*

	For the year ended December 31,	
	2010	2009
Asset retirement obligation	340	-
Management and consulting fees	308	455
Legal, accounting and audit fees	246	385
General and other office expenses	150	1,072
Operating, exploration and dry-hole costs	-	1,592
Salaries and benefits	-	1,160
Depletion, depreciation and amortization	-	447
Impairment	-	200
Accretion	-	12
Foreign exchange gain	-	(3,282)
Total expenses	1,044	2,041

The decrease in total expenses relative to the prior year corresponds to the reduction in activity associated with the Company's United States based operations, which follows from the sale in 2009 of substantially all of the properties located there. The \$340 asset retirement obligation ("ARO") expense in 2010 is due to an increase in the provision for ARO reported at the year ended December 31, 2009, and is based on the Company's portion of a program approved during the year 2010 to decommission and remediate the relevant property.

Interest income*In \$000*

	For the year ended December 31,	
	2010	2009
Interest income	7	24

Interest income represents bank interest earned on cash and investments in marketable securities.

Gain on disposal of assets from discontinued operations

In \$000

For the year ended December 31,
2010 2009

Gain on asset disposal	77	1,600
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The Company had a gain of \$77 in the year 2010 relating to the disposal of all remaining inventories located in the United States. In the year 2009 the Company realized a gain of \$1,600 on the disposal of substantially all oil and gas properties located in the United States.

Selected Quarterly Information

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

(\$000s, except per share data)

	For the Quarter Ended							
	Dec 31	Sep 30	Jun 30	Mar 31	Dec 31	Sep 30	Jun 30	Mar 31
	2010	2010	2010	2010	2009	2009	2009	2009
Continuing operations								
Depreciation	(43)	(41)	(29)	(26)	(6)	-	-	-
General and administrative	628	(643)	(360)	(219)	(556)	(642)	(595)	(595)
Stock based compensation	(126)	(70)	(114)	(204)	(99)	(366)	(81)	-
Guarantee fees	9	(456)	(448)	(458)	(636)	-	-	-
Interest income	177	99	74	66	76	62	52	129
Income / (loss) on investment in comp.	46	(73)	-	-	-	-	-	-
Foreign exchange gain / (loss)	1'784	501	(1'764)	1'694	32	4'143	2'214	(1'446)
Income tax	(38)	(16)	(14)	(13)	(12)	-	-	-
Net inc. / (loss) from continuing ops.	2'437	(699)	(2'655)	840	(1'201)	3'197	1'590	(1'912)
Discontinued operations								
Net revenues	-	-	-	-	-	-	943	715
Expenses	(77)	(48)	(729)	(190)	1'459	119	(748)	(2'861)
Interest income	4	-	1	2	3	12	-	-
Gain loss on sale of assets	-	-	-	77	(4)	(173)	1'777	-
Net inc. / (loss) from discontinued ops.	(73)	(48)	(728)	(111)	1'458	(42)	1'972	(2'146)
Net income / (loss)	2'364	(747)	(3'383)	729	257	3'155	3'562	(4'058)
Basic income / (loss), \$ per share:								
Continuing operations	-	-	(0.01)	-	-	0.01	0.01	(0.01)
Discontinued operations	-	-	-	-	-	-	0.01	(0.01)
	-	-	(0.01)	-	-	0.01	0.02	(0.02)
Diluted income / (loss), \$ per share:								
Continuing operations	-	-	(0.01)	-	-	0.01	0.01	(0.01)
Discontinued operations	-	-	-	-	-	-	0.01	(0.01)
	-	-	(0.01)	-	-	0.01	0.02	(0.02)

Summary of principal changes in fourth quarter information

In the fourth quarter of 2010, the Company continued its exploration campaign in respect of its petroleum properties in Kurdistan, constituting the continuing operations of the Company which currently have no corresponding revenue. The net income in the fourth quarter was primarily driven by the cumulative foreign currency translation gain of \$1,784 and the reclassification to general and administrative expenses of a credit in the amount of \$816 relating to capitalized expenses, which was previously recorded as a long term liability.

Off-Balance Sheet Arrangements

The Company has no off-balance sheet arrangements.

Outstanding Share Data

As of December 31, 2010, the Company had 623,182,194 shares outstanding, 4,560,000 stock options outstanding under its stock-based compensation plan, and zero warrants outstanding.

In August 2010, the Company executed agreements with the KRG to amend the Pulkhana Block 10 and the Arbat Block PSCs. The amendments relieve the Company of its previous contractual requirement to issue 150 million common shares of the Company to the KRG requiring the Company to contribute 20% of its profit oil share (produced oil, less royalty and cost oil) from the Pulkhana Block 10 PSC and the Arbat Block PSC as capacity building payments to the Government. At December 31, 2010, the amount previously recognized as shares to be issued of \$61,349 was reversed with a corresponding decrease to the cost of the Company's petroleum properties reported on the consolidated balance sheet within property, plant and equipment assets.

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. The Company incurred fees for these services and associated reimbursable costs of \$185 during the year 2010 (2009: \$214). Namdo is a private corporation owned by a shareholder of the Company. There was no amount owing to this related party at December 31, 2010 (2009: Nil).

Mile High Holdings Ltd., a private corporation associated with a shareholder of the Company, provided transportation services to the Company relating to its fundraising activities in the amount of \$152 during year ended December 31, 2010 (2009: \$385). There was \$12 owing to this related party at December 31, 2010 (2009: \$385).

During the year ended December 31, 2010, the Company incurred legal fees of \$41 (2009: \$217) with a law firm in which an officer of the Company is a partner. There was no amount owing to this related party at December 31, 2010 (2009: Nil).

The Company receives services from various subsidiary companies of Lundin Petroleum AB ("Lundin"), a shareholder of the Company. Lundin charges for the year ended December 31, 2010 were \$2,673 (2009: \$1,245). The charges were comprised of G&G and other technical service costs of \$382 (2009: \$317), reimbursement for Company travel and related expenses of \$601 (2009: \$207), office rental, administrative and building services of \$328 (2009: \$86), and charges of \$1,362 (2009: \$635) 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 through to June 30, 2010, thereafter charged at 1.5% per annum, and payable semi-annually. The amount owing to Lundin at December 31, 2010 was \$214 (2009: \$767).

Total amounts owing to related parties as at December 31, 2010 was \$226 (2009: \$1,152). 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, 2010 totaled \$41,364, compared to \$59,903 at December 31, 2009.

Funds used in continuing operations in 2010 were \$4,796, while there was a net inflow in funds of \$8,946 from continuing operations in the previous year. The primary components of the movement in funds are discussed in the following paragraphs.

The Company has an inflow of funds of \$47,826 from financing activities in continuing operations during the year ended December 31, 2010, compared to a net inflow of funds of \$96,598 in 2009. The substantial portion of the inflow of funds in the year 2010 came from the issuance in September of 111,111,106 common shares at CAD \$0.45 per share less brokerage fees and other issuance costs.

Net cash used in investing activities in continuing operations was \$53,566 compared to funds used in 2009 in the amount of \$91,230. During 2010, the main components of cash used by investing activities in continuing operations were in funding the investment in GEP in the amount of \$26,666, and \$26,900 used to fund exploration costs associated with the seismic acquisition and drilling programs of the Company's petroleum properties in Kurdistan.

Net cash used in discontinued operations was \$85 for year ended December 31, 2010 and net inflow of cash in discontinued operations was \$9,337 for the year ended December 31, 2009. The primary use of funds in 2010 was in payments made towards settling outstanding accounts and for professional and consulting fees relating to the close-out of operations in the United States, while the Company received funds in respect of the sale of all remaining inventories in the United States and in respect of an insurance claim for hurricane damages associated with the Company's discontinued operations.

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. The Company has sufficient financial resources to fund its commitments under the current agreed work plan. Continuing operations are dependent on discovery of economic oil and gas reserves and ultimately on the attainment of profitable operations.

Contributed surplus increased by \$507 in the year ended December 31, 2010 (2009: \$336) due to stock-based compensation expensed and exercised during the year. When options are granted, the Black-Scholes option value method is used to calculate a value for the stock options. When the options are exercised, the applicable amounts of contributed surplus are transferred to share capital. There were 25,000 options exercised during 2010 (2009: 790,000).

Commitments

Production Sharing Contracts

The Company had a combined \$61.0 million minimum financial commitment in respect of the first exploration sub-period relating to the PSCs governing its petroleum operations in two separate petroleum exploration and development properties, the Pulkhana Block 10 ("Pulkhana Block") and the Arbat Block, located in the Kurdistan Region of Iraq. The PSCs also require the Company to fund certain personnel, training, environmental, and technological assistance projects, during the period over which the contracts are in effect. As at December 31, 2010, the Company had executed \$11.0 million of its minimum financial obligations through the completion of its 2D seismic acquisition program in both Blocks.

Block K42

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 that it has concluded its remaining minimum commitments under the K42 Option Agreement at December 31, 2010.

Investment in GEP

As part of the acquisition of GEP, the Company agreed obligation to contribute the next \$15.8 million in cash which will be required to fund GEP's oil exploration and development operations. The amount of this obligation which remained at the end of the year 2010 was \$12.6 million.

Financial Instruments

The Company's financial instruments consist of cash, cash equivalents, short-term investments, accounts receivable, accounts payable, accrued expenses and net payable to joint venture partner.

Cash, cash equivalents and short-term 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 net payable to joint venture partner approximate carrying values because of the short-term nature of these instruments. The fair values of short-term 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 from 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 United States dollars. The Company's operating results and cash flows are affected to varying degrees by the changes in the Canadian dollar relative to the United States 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 inflows from 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.

Risks and Uncertainties

The majority of ShaMaran's assets are located in Kurdistan. 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 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 significant outstanding political issues and differences between the various political factions in Iraq. These differences could adversely impact ShaMaran's interests in Kurdistan. In addition, certain borders of Kurdistan 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 are 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 Kurdistan 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. 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.

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 obtaining approvals from relevant authorities, issues relating to security in the area of operation, adverse legislation in Kurdistan and/or Iraq, the regulation of the oil and gas industry by various levels of government and governmental agencies in Kurdistan 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.

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 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. Therefore, 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 Company engaged McDaniel & Associates Consultants Ltd (“McDaniel”), an independent geoscience consultancy firm, to evaluate 100% of the Company’s reserves and resource data at December 31, 2010. The conclusions of this evaluation have been presented in a Detailed Property Report, which has been prepared in accordance with standards set out in the Canadian National Instrument NI 51-101 and Canadian Oil and Gas Evaluation Handbook (COGEH). Prior to the appraisal drilling of Pulkhana and Total Depth of the Atrush-1 well McDaniel estimate the following Contingent & Prospective Resources net to ShaMaran for all four of the Company’s assets:

COMPANY GROSS ESTIMATED CONTINGENT RESOURCES AS OF DECEMBER 31, 2010
MBBL, MMCF (1) (2) (3) (4)

	Low Estimate (1C)	Best Estimate (2C)	High Estimate (3C)	Mean (3) Estimate
Crude Oil (Mbbbl)	28,232	81,736	236,232	113,835
Natural Gas (MMcf)	1,254	4,350	14,231	6,574
Total Company (Mboe)	28,441	82,461	238,604	114,931

- (1) There is no certainty that it will be commercially viable to produce any portion of the resources.
- (2) Company Gross resources are based on working interest share of the property gross resources.
- (3) The statistical mean is provided in addition to the standard 1C, 2C and 3C resource categories
- (4) Based on arithmetic aggregation of the low (P90) and high (P10) estimates for the individual fields; statistically therefore the low (1C) estimate presented above has a greater than 90 percent chance of being exceeded and the high (3C) estimate has a lower than 10 percent chance of being exceeded.

The Company’s crude oil, condensate and natural gas prospective resources as of December 31, 2010 were estimated to be as follows:

COMPANY GROSS ESTIMATED PROSPECTIVE RESOURCES AS OF DECEMBER 31, 2010
MBBL, MMCF (1) (2) (3) (4)

	Unrisked Low Estimate	Unrisked Best Estimate	Unrisked Mean Estimate	Unrisked High Estimate	Risked (2) Mean Estimate
Crude Oil (Mbbbl)	121,719	196,585	217,600	338,311	103,549
Natural Gas (MMcf)	243,095	508,430	600,219	1,066,892	141,185
Condensate (Mbbbl)	2,598	6,232	7,800	14,953	2,265
Total Company (Mboe)	164,833	287,555	325,436	531,099	129,345

- (1) There is no certainty that any portion of the resources will be discovered. If discovered, there is no certainty that it will be economically viable or technically feasible to produce any portion of the resources.
- (2) These are partially risked prospective resources that have been risked for chance of discovery, but have not been risked for chance of development.
- (3) Based on arithmetic aggregation of the low (P90) and high (P10) estimates for the individual prospects; statistically therefore the low estimate presented above has a greater than 90 percent chance of being exceeded and the high estimate has a lower than 10 percent chance of being exceeded.
- (4) Company Gross resources are based on working interest share of the property gross resources.

The estimation of reserves and resources 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. The Company had no reserves at December 31, 2010.

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 is in the process of transitioning 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, investments 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 could be subject to change prior to adoption in 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 asset retirement obligations 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 have completed and are in process of being evaluated, 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 and will be ongoing. 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 has concluded all system modifications necessary to support the capture and reporting of IFRS financial information during.

Business Activities (Ongoing to 2011 year end reporting)

All changes to the budgeting and forecasting systems to embed the more significant aspects of IFRS within the Company's planning cycle are now in place.

Outlook

The outlook for the four blocks in Kurdistan for the year 2011 is as follows:

Pulkhana block

Pulkhana-9 was spudded on April 3, 2011 and is planned to be drilled to a Total Depth of 2700m which is estimated to take approximately 90 days. The well is designed to appraise the proven Euphrates/Jaddala & Shiranish oil reservoirs as well as appraise possible upside in the Jeribe & Lower Jaddala formations.

Shamaran has also received Ministry of Natural Resources ("MNR") approval for the Pulkhana-10 and preparations are being made to enable drilling of this well. The Company is tendering for a workover rig for the planned third quarter workover of Pulkhana-8 and at the same time progressing with the feasibility study and design for the Pulkhana Early Production Facility ("EPF") planned to be installed by the end of the year 2011. The first 3 wells (Pulkhana 8, 9 & 10) will be connected to the EPF, with the possibility to expand as future development wells are drilled.

Arbat Block

Following completion of seismic interpretation the Company has received MNR approval for the location of the first commitment exploration well (designated Arbat-A). Tendering and preparations are underway to enable drilling to commence in the 4th quarter of this year.

Atrush

Atrush 1 was drilled to a total depth of 3,400 meters on January 21, 2011. The comprehensive well testing program commenced on January 30, 2011 is expected to be concluded in the second week of April 2011. Evaluation of the results of the testing program will be a significant factor towards determining the future program for the Atrush Block.

Block K42

Processing of the 232.0 km acquired 2D seismic data is complete. The Company plans to exercise its option later in the year 2011 to enter into a Production Sharing Contract.

New Ventures

The Company is currently pursuing new opportunities in the region.

Budget

The capital and operating budget approved by the Board of Directors for the year 2011 was for \$122.9 million. The budget contains amounts relating to the work programs of the four Kurdistan petroleum properties as follows: \$49.5 million for the Pulkhana Block, \$16.5 million for the Atrush Block, \$30.7 million for the Arbat Block, \$21.6 million for Block K42, and \$4.6 million in corporate costs. The Company currently has sufficient funds to meet its existing contractual commitments under the approved budget and plans to seek additional funding to finance the remainder of the capital and operating budget.

General

The security situation in Kurdistan 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.

Additional Information

Additional information related to the Company is available on SEDAR at www.sedar.com and on the Company's website at www.shamaranpetroleum.com.



Independent Auditor's report

7 April 2011

To the Shareholders of ShaMaran Petroleum Corporation

We have audited the accompanying consolidated financial statements of ShaMaran Petroleum Corporation, which comprise the consolidated balance sheet as at 31 December 2010, the consolidated statements of operations and deficit, comprehensive income and cash flows for the year then ended, and the related notes including a summary of significant accounting policies.

Management's responsibility for the consolidated financial statements

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

Auditor's responsibility

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

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

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

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Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of ShaMaran Petroleum Corporation as at 31 December 2010, and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Other matter

The financial statements of ShaMaran Petroleum Corporation for the year ended 31 December 2009 were audited by another auditor who expressed an unmodified opinion on those statements on 26 March 2010.

(signed) PricewaterhouseCoopers LLP
Chartered Accountants, Licensed Public Accountants
London

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SHAMARAN PETROLEUM CORP.
Consolidated Balance Sheets
(Expressed in thousands of United States Dollars)

	Note	As at December 31,	
		2010	2009
ASSETS			
Current assets			
Cash and cash equivalents	6	58,684	63,565
Accounts receivable		124	31
Inventory	8	2,656	-
Prepaid expenses and other assets		447	376
Discontinued operations	4	74	847
		61,985	64,819
Non-current assets			
Investment in company	7	44,282	-
Property, plant and equipment	9	150,222	185,180
		194,504	185,180
		256,489	249,999
LIABILITIES			
Current liabilities			
Accounts payable and accrued expenses		5,142	2,050
Net payable to joint venture partner		14	37
Income taxes payable		103	12
Deferred consideration	7	12,643	-
Discontinued operations	4	2,719	2,817
		20,621	4,916
Non-current liabilities			
Other long-term liabilities		-	170
Discontinued operations	4	350	350
		350	520
		20,971	5,436
SHAREHOLDERS' EQUITY			
Share capital	10	432,506	379,673
Shares to be issued	10	-	61,349
Contributed surplus	10	3,867	3,360
Accumulated other comprehensive income	5	5	4
Deficit		(200,860)	(199,823)
		235,518	244,563
		256,489	249,999

Commitments and contingencies (note 15)

See accompanying notes to the Consolidated Financial Statements.

Approved on behalf of the Board:

Cameron Bailey, Director

Keith Hill, Director

SHAMARAN PETROLEUM CORP.
Consolidated Statement of Operations and Deficit
(Expressed in thousands of United States Dollars, except for per share data)

	Note	For the year ended December 31,	
		2010	2009
Expenses			
Depreciation		139	6
General and administrative		594	2,378
Stock-based compensation	10	514	546
		1,247	2,930
Other expenses/(income)			
Guarantee fees	12	1,353	636
Interest income		(416)	(310)
Loss from investment in company	7	27	-
Foreign exchange gain		(2,215)	(4,943)
		(1,251)	(4,617)
Net income before income taxes			
		4	1,687
Income tax expense	11	81	12
Net (loss)/income from continuing operations			
		(77)	1,675
Discontinued operations			
Loss from operations	4	(1,037)	(359)
Gain on asset disposal	4	77	1,600
		(960)	1,241
Net (loss)/income			
		(1,037)	2,916
Deficit, beginning of the year			
		(199,823)	(202,739)
Deficit, end of the year			
		(200,860)	(199,823)
Basic income per share:			
Continuing operations		0.00	0.005
Discontinued operations		0.00	0.005
		0.00	0.01
Diluted income per share:			
Continuing operations		0.00	0.005
Discontinued operations		0.00	0.005
		0.00	0.01
Weighted average number of common shares:			
Continuing operations		536,164	346,639
Discontinued operations		536,164	346,639

See accompanying notes to the Consolidated Financial Statements.

SHAMARAN PETROLEUM CORP.
Consolidated Statement of Comprehensive Income
(Expressed in thousands of United States Dollars)

	For the year ended December 31,	
	2010	2009
Net (loss)/income	(1,037)	2,916
Other comprehensive income:		
Exchange gains arising from translation of the financial statements of a foreign operation	1	4
Comprehensive (loss)/income	(1,036)	2,920

See accompanying notes to the Consolidated Financial Statements.

SHAMARAN PETROLEUM CORP.
Consolidated Statement of Cash Flows
(Expressed in thousands of United States Dollars)

	Note	For the year ended December 31,	
		2010	2009
Operating activities of continuing operations			
Net (loss)/income from continuing operations		(77)	1,675
Adjustments for non-cash items:			
Depreciation		139	6
Stock-based compensation		514	546
Loss from investment in company		27	-
Exchange gains		(2,215)	(4,943)
Changes in working capital:			
Accounts receivable		(93)	(31)
Short term investments		-	(358)
Prepaid expenses and other assets		(71)	-
Accounts receivable from joint venture partner		-	(126)
Inventories		(2,656)	-
Accounts payable and accrued expenses		3,092	1,850
Net payable to joint venture partner		(23)	-
Income taxes payable		91	12
		(1,272)	(1,369)
Investment activities of continuing operations			
Property, plant and equipment		(26,900)	(91,230)
Investment in company		(26,666)	-
		(53,566)	(91,230)
Financing activities of continuing operations			
Proceeds net of costs on issuance of shares		47,826	96,598
		47,826	96,598
Effect of exchange rate changes on cash and cash equivalents		2,216	4,947
Cash flows from/(used in) continuing operations		(4,796)	8,946
Cash flows from/(used in) discontinued operations	4	(85)	9,337
Change in cash and cash equivalents		(4,881)	18,283
Cash and cash equivalents, beginning of the year		63,565	45,282
Cash and cash equivalents, end of the year		58,684	63,565

See accompanying notes to the Consolidated Financial Statements.

SHAMARAN PETROLEUM CORP.
Notes to the Consolidated Financial Statements
For the years ended December 31, 2010 and 2009
(Expressed in thousands of United States Dollars unless otherwise indicated)

1. NATURE OF OPERATIONS

ShaMaran Petroleum Corp. (“ShaMaran” and formerly Bayou Bend Petroleum Ltd., together with its subsidiaries the “Company”) is incorporated under the British Columbia Business Corporations Act.

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 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 (“Kurdistan”). 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.

2. SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of Presentation

These Consolidated Financial Statements include the accounts of the Company and its wholly owned subsidiaries and its proportionate interest in joint ventures, and have been prepared in accordance with generally accepted accounting principles in Canada.

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. The financial results relating to these properties have been reported as discontinued operations. Refer to note 4.

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.

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(b) Going concern

These Consolidated Financial Statements have been prepared assuming that the Company will into the foreseeable future be able to realize its assets and liabilities as they come due in the normal course of business. The ability of the Company to continue as a going concern and 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 uncertainties in Iraq, and the ability of the Company to obtain financing to develop reserves.

In the absence of current production revenues, the Company is currently dependent upon its existing financial resources which include approximately \$58.7 million of cash and cash equivalents as at December 31, 2010 to satisfy its obligations and finance its exploration and evaluation programme in Kurdistan. Failure to meet these exploration and evaluation commitments could put the related licence interests at risk of forfeiture.

The Directors believe that based on the forecasts and projections they have prepared, the resources available will be sufficient for the Company and its subsidiaries to satisfy its contractual obligations and commitments and to continue as a going concern for the foreseeable future, being at least the next 12 months. Due to high levels of planned expenditure as a result of the significant exploration campaign over the next 12 months, the Company may require additional financing. The Company has a number of financing possibilities which it believes it would be able to pursue if and when required. Nevertheless, the possibility remains that the Company's operations and the availability of additional finance could be significantly affected by adverse exploration and appraisal results, geopolitical events in the region, macroeconomic conditions or other risks.

(c) 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.

(d) Short-term investments

Short-term 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.

(e) Investment

The Company uses the equity method to account for its 33.5% investment in General Exploration Partners Inc on the basis that it has significant influence in the operating, financing, and investing decisions of this company.

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(f) Inventories

Inventories of drilling equipment and consumable materials are stated at the lower of cost or net realizable value, cost being determined on a first-in, first-out ("FIFO") method. Net realizable value represents the estimated selling price less all estimated costs of completion and costs to be incurred in marketing, selling and distribution.

(g) Property Plant and Equipment (PP&E)

i. Petroleum Properties

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.

Expenses incurred which are recoverable as Petroleum Costs under the terms of the Company's Production Sharing Contracts are capitalized with a resulting reduction to general and administrative expense. In the current year the Company has capitalized such expenses in the amount of \$4,823 (2009: \$426).

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 reserve evaluators 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 9. 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, 2010 the Company has capitalized \$149,692 (2009: \$184,953) related to this project. No revenues have been generated from this project to date and no impairment was identified at December 31, 2010.

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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 as follows:

- Computer and information technology assets over 3 years
- Furniture and fixtures over 5 years.

(h) 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.

(i) 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.

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(j) 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.

(k) 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.

(l) 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.

(m) 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.

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(n) 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.

(o) 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.

(p) Changes in 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.

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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.

(q) Comparability

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

3. FUTURE ACCOUNTING STANDARDS

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 key areas which are likely to be impacted by changes in accounting policy and disclosures, including the accounting for petroleum properties, income taxes, and asset retirement obligations.

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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 financial position of discontinued operations included within the Consolidated Balance Sheet is as follows:

	As at December 31,	
	2010	2009
ASSETS		
Current assets		
Short-term investments	-	79
Accounts receivable	59	535
Prepaid expenses and other assets	15	233
	74	847
LIABILITIES		
Current liabilities		
Accounts payable and accrued expenses	1,378	1,816
Asset retirement obligation	1,341	1,001
	2,719	2,817
Non-current liabilities		
Asset retirement obligation	350	350
	3,069	3,167
NET LIABILITIES	2,995	2,320

The current and non-current portion of the Company's asset retirement obligation ("ARO") pertaining to discontinued operations relate to the remaining interests the Company holds in petroleum properties located in the United States. The liability was determined based on the Company's remaining net ownership interest in the corresponding wells and facilities, agreed and estimated costs to abandon and reclaim the wells and facilities and the estimated timing of the costs to be incurred in future periods. In the year 2010 the Company agreed to a program to decommission and remediate a property which has resulted in an increase by \$340 in the ARO included as a current liability.

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4. DISCONTINUED OPERATIONS (continued)

The results of discontinued operations included in the Consolidated Statement of Operations and Deficit are as follows:

	For the year ended December 31,	
	2010	2009
Revenue		
Oil and gas sales	-	2,089
Royalties	-	(431)
Net revenues	-	1,658
Expenses		
Operating	-	761
Exploration	-	810
Dry hole costs	-	21
Asset retirement obligation	340	200
Accretion	-	12
Depletion, depreciation and amortization	-	447
Foreign exchange gain	-	(3,282)
General and administrative	704	3,072
	1,044	2,041
Other income		
Interest income	7	24
Net loss	(1,037)	(359)
Discontinued operations		
Loss from operations	(1,037)	(359)
Gain on asset disposals	77	1,600
Net income / (loss)	(960)	1,241

During the year ended December 31, 2010 the remaining inventories in the United States from discontinued operations were sold for gross proceeds of \$277, and a resulting gain of \$77. In the comparable period in 2009 the Company sold substantially all of its oil and gas properties located in the United States for gross proceeds of \$12,487 and a resulting gain on asset disposals of \$1,600.

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4. DISCONTINUED OPERATIONS (continued)

The cash flows relating to discontinued operations in the Consolidated Statement of Cash Flows are as follows:

	For the year ended December 31,	
	2010	2009
Operating activities of discontinued operations		
Income / (loss) from discontinued operations	(960)	1,241
Adjustments for non-cash items:		
Depletion, depreciation and amortization	-	447
Impairment of properties	-	200
Dry hole costs	-	21
Accretion	-	12
Gain on asset disposals	(77)	(1,600)
Unrealized foreign exchange gain	-	(3,282)
Changes in working capital:		
Accounts receivable	476	1,377
Accounts receivable from joint venture partner	-	163
Short term investments	79	1,295
Prepaid expenses	218	-
Accounts payable and accrued expenses	(438)	(2,151)
Asset retirement obligation	340	426
	(362)	(1,851)
Investing activities of discontinued operations		
Property, plant & equipment	-	(1,299)
Proceeds from sale of assets	277	12,487
	277	11,188
Cash flows from/(used in) discontinued operations	(85)	9,337

5. ACCUMULATED OTHER COMPREHENSIVE INCOME

Accumulated other comprehensive income is comprised as follows:

As at December 31, 2008	3,282
Reclassification of cumulative foreign currency translation gain	(3,282)
Gain on currency translation of the financial statements of a foreign operation during the year	4
As at December 31, 2009	4
Gain on currency translation of the financial statements of a foreign operation during the year	1
As at December 31, 2010	5

The financial statements of the Swiss entity of the Company have been translated from Swiss Francs into the reporting currency of the Company with a resulting currency translation gain of \$1 for year ended December 31, 2010 (2009: gain of \$4).

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5. ACCUMULATED OTHER COMPREHENSIVE INCOME (continued)

Consistent with the sale during 2009 of substantially all of the Company's petroleum properties located in the United States, the cumulative foreign currency translation gain of \$3,282 which originated in 2007 was reclassified. Accordingly, the amount was reflected in the loss from discontinued operations for the year ended December 31, 2009.

6. CASH AND CASH EQUIVALENTS

Cash and cash equivalents consist primarily of cash deposits held in Canadian dollars.

7. INVESTMENT IN COMPANY

On August 27, 2010, ShaMaran Ventures BV, a wholly owned subsidiary of the Company entered into a Subscription Agreement and a Shareholders Agreement with Aspect Energy International, LLC ("Aspect") to acquire 33.5% of the fully-diluted share capital of General Exploration Partners Inc ("GEP"), a wholly owned subsidiary of Aspect. GEP holds an 80% working interest in the Production Sharing Contract ("PSC") in respect of the Atrush Block Oil and Gas Exploration Area located in Kurdistan.

The total consideration exchanged for the investment in GEP was \$45.1 million comprised of cash payments totaling \$24.3 million and share consideration of \$5.0 million, representing 12.5 million shares of the Company, and an obligation to contribute the next \$15.8 million in cash required to fund GEP's oil exploration and development operations, which will be repaid on a first in first out basis from a portion of available petroleum production in the future.

Of the \$15.8 million obligation \$12,643 remained at December 31, 2010 and is reported as deferred consideration under current liabilities on the balance sheet. The Company has also reported in the Consolidated Statement of Operations and Deficit a loss from investment in the amount of \$27 which corresponds to 33.5% of the net loss reported by GEP over the period from August 27, 2010 to December 31, 2010 in the amount of \$81.

8. INVENTORIES

Inventories were comprised as follows:

	As at December 31,	
	2010	2009
Drilling equipment and consumable materials	2,656	-
	2,656	-

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9. PROPERTY PLANT AND EQUIPMENT

Property plant and equipment is comprised as follows:

	Cost	Accumulated depreciation	Net book value
As at December 31, 2009			
Petroleum properties – Kurdistan	184,953	-	184,953
Corporate PP&E	233	(6)	227
	185,186	(6)	185,180
As at December 31, 2010			
Petroleum properties – Kurdistan	149,692	-	149,692
Corporate PP&E	690	(160)	530
	150,382	(160)	150,222

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.

In August 2010 the Company executed agreements with the Kurdistan Regional Government (“KRG”) to amend the Pulkhana Block 10 and the Arbat Block PSCs, waiving the Company of its previous contractual requirement to issue 150 million common shares of the Company to the KRG. Accordingly, an adjustment was made to reduce the carrying value of petroleum properties by \$61,349, which represented the amount previously capitalized in respect of the previous contractual requirement. Refer also to note 10(b).

10. SHARE CAPITAL AND CONTRIBUTED SURPLUS

(a) Share capital and contributed surplus

The Company is authorized to issue an unlimited number of common shares with no par value.

Share capital and contributed surplus are comprised as follows:

	Number of shares	Share capital	Contributed surplus
Balance at December 31, 2008	308,756,088	250,899	3,024
Shares issued on private placement	140,000,000	96,250	-
Shares issued (acquisition)	50,000,000	31,966	-
Stock options exercised during the year	790,000	558	(210)
Stock option expense during the year	-	-	546
Balance at December 31, 2009	499,546,088	379,673	3,360
Shares issued (acquisition, see note 7)	12,500,000	5,000	-
Shares issued on private placement	111,111,106	47,813	-
Stock options exercised during the year	25,000	20	(7)
Stock options expense during the year	-	-	514
Balance at December 31, 2010	623,182,194	432,506	3,867

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(b) Shares to be issued

In August 2010 the Company executed agreements with the Kurdistan Regional Government to amend the Pulkhana Block 10 and the Arbat Block PSCs. The amendments waive the Company of its previous contractual requirement to issue 150 million common shares of the Company to the KRG, which was comprised of 100 million shares due on signing of the PSCs plus a further 50 million shares due 30 days prior to the expiry of the first exploration sub-period in the Pulkhana Block, and in exchange require the Company to contribute 20% of its profit oil share (produced oil, less royalty and cost oil) from the Pulkhana Block 10 PSC and the Arbat Block PSC as capacity building payments to the Government.

The amount previously reported as shares to be issued of \$61,349 has been reversed with a corresponding decrease to the cost of the Company's petroleum properties within property, plant and equipment. Refer also to note 9.

(c) 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. A four month hold period may be imposed by the stock exchange from the date of grant. 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 prices reflect trading values of the Company's shares at grant date.

Movement during the year in stock options issued and outstanding is as follows:

	Number of options	Weighted average exercise price (Cdn \$)
Outstanding at December 31, 2009	4,110,000	0.82
Granted	1,390,000	0.51
Exercised	(25,000)	0.48
Cancelled/forfeited	(915,000)	1.20
Outstanding at December 31, 2010	4,560,000	0.65

At December 31, 2010 there were 3,155,000 options exercisable at an average exercise price of Cdn \$0.69 per share with a weighted average remaining life of 2.13 years.

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(c) Share options (continued)

The incentive stock options issued and outstanding are as follows:

Expiry date	Number of options outstanding at December 31, 2010	Exercise price (Cdn \$)
April 24, 2011	1,210,000	0.48
January 18, 2012	300,000	1.20
March 27, 2012	150,000	2.15
September 10, 2014	875,000	0.67
September 30, 2014	710,000	0.64
January 3, 2015	600,000	0.47
March 25, 2015	100,000	0.60
May 11, 2015	75,000	0.43
August 9, 2015	75,000	0.43
September 22, 2015	315,000	0.54
October 1, 2015	125,000	0.64
October 20, 2015	25,000	0.78
	4,560,000	

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:

	As at December 31,	
	2010	2009
Expected dividend yield	0%	0%
Risk-free interest rate (weighted average)	3.21%	3.32%
Expected stock price volatility (weighted average)	86.95%	85.77%
Expected option life in years (weighted average)	4.11	3.98
Grant date fair value (weighted average)	Cdn \$0.37	Cdn \$0.48

Stock option compensation expense for the year ended December 31, 2010 was \$514 (2009: \$546).

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.

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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 are as follows:

	For the year ended December 31,	
	2010	2009
Income / (loss) from continuing operations before income tax	(77)	1,687
Corporate income tax rate	30.0%	30.0%
Computed income tax expense / (recovery)	(23)	506
Increase / (decrease) resulting from:		
Non-taxable foreign exchange gain	(664)	(1,482)
Share issuance costs charged to share capital	(204)	(1,402)
Non-deductible compensation expense	154	164
Foreign tax rate differences	182	12
Effect of change in tax rates	233	448
Change in valuation allowance	586	2,254
Effect of changes in foreign exchange rates	(200)	(446)
Other	17	(42)
Income tax expense from continuing operations	81	12

The components of the future income tax assets are as follows:

	As at December 31,	
	2010	2009
Non-capital losses	61,715	60,366
Share issue costs carried forward	1,447	2,033
Properties – tax basis over carrying value	1,279	1,160
Exploration expenses	803	764
Future income tax assets before allowance	65,244	64,323
Valuation allowance	(65,244)	(64,323)
Future income tax asset	-	-

(b) Tax losses carried forward

The Company has tax losses and costs which are available to apply to future taxable income as follows:

	For the year ended December 31,	
	2010	2009
Canadian losses from operations	10,774	7,401
Canadian exploration expenses	3,210	3,057
Canadian unamortized share issue costs	5,606	7,577
Dutch losses from operations	1,446	-
U.S. Federal losses from operations	167,807	167,188
U.S. Federal – tax basis in excess of carrying values of properties	3,654	3,315
Total	192,497	188,538

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(b) Tax losses carried forward (continued)

The Canadian losses from operations may be used to offset future Canadian taxable income and will expire over the period from 2015 to 2030. 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 2011 to 2014. The U.S. Federal losses are available to offset future taxable income in the United States through 2030.

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. The Company incurred fees for these services and associated reimbursable costs during the current year of \$185 (2009: \$214), respectively. Namdo is a private corporation owned by a shareholder of the Company. There was no amount owing to this related party at December 31, 2010 (2009: Nil).

Mile High Holdings Ltd., a private corporation associated with a shareholder of the Company, provided transportation services to the Company relating to its fundraising activities in the amount of \$152 during year ended December 31, 2010 (2009: \$385). There was \$12 owing to this related party at December 31, 2010 (2009: \$385).

During the year ended December 31, 2010, the Company incurred legal fees of \$41 (2009: \$217) with a law firm in which an officer of the Company is a partner. There was no amount owing to this related party at December 31, 2010 (2009: Nil).

The Company receives services from various subsidiary companies of Lundin Petroleum AB ("Lundin"), a shareholder of the Company. Lundin charges for the year ended December 31, 2010 were \$2,673 (2009: \$1,245). The charges were comprised of G&G and other technical service costs of \$382 (2009: \$317), reimbursement for Company travel and related expenses of \$601 (2009: \$207), office rental, administrative and building services of \$328 (2009: \$86), and charges of \$1,362 (2009: \$635) 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 through to June 30, 2010, thereafter charged at 1.5% per annum, and payable semi-annually. The amount owing to Lundin at December 31, 2010 was \$214 (2009: \$767).

Total amounts owing to related parties as at December 31, 2010 was \$226 (2009: \$1,152). 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.

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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.

Financial assets	Fair value measurement at reporting using:			
	December 31, 2010	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	58,684	58,684	-	-
Total	58,684	58,684	-	-

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.

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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, 2010, the Company had \$50,364 denominated in Canadian dollars. As of December 31, 2010, with other variables unchanged, a 1% strengthening of the U.S. dollar against the Canadian dollar would increase the net loss by \$500 due to this financial asset.

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, 2010, the Company had \$50,364 denominated in Canadian dollars. As of December 31, 2010, with other variables unchanged, a 0.25% weakening of the interest rate on Canadian funds on deposit would increase the net loss by approximately \$126 due to this financial asset.

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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 are as follows:

	As at December 31,	
	2010	2009
Current assets	61,985	64,819
Current liabilities	(20,621)	(4,916)
Working capital	41,364	59,903
Shareholders' equity	235,518	244,563

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".

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(a) Production Sharing Contracts (continued)

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, 2010, the Company had executed \$11.0 million of its minimum financial obligations through the completion of its two dimensional ("2D") seismic acquisition program in both Blocks.

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.

All modifications to the PSC's are subject to the approval of the KRG.

(b) Amendment and Novation Agreement to the Block 42 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 to acquire 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 that it has concluded its minimum commitments under the K 42 Option as at December 31, 2010.

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.

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(c) Net Profit Interest

During 2009 the Company entered into a non-legally binding heads of agreement (“HOA”) which offered a net profit interest to certain parties in the Pulkhana and Arbat PSC’s, and if granted, the K42 PSC. This non-legally binding HOA has not been formalized into a legally binding agreement.

SHAMARAN PETROLEUM CORP.

DIRECTORS	CORPORATE INFORMATION
<p>Keith C. Hill Director, Chairman Vancouver, British Columbia</p> <p>Pradeep Kabra Director, President & Chief Executive Officer Geneva, Switzerland</p> <p>Brian D. Edgar Director Vancouver, British Columbia</p> <p>Gary S. Guidry Director Calgary, Alberta</p> <p>Alexandre Schneiter Director Anieres, Switzerland</p> <p>J. Cameron Bailey Director Calgary, Alberta</p>	<p>CORPORATE OFFICE 885 West Georgia Street Suite 2101 Vancouver, British Columbia V6C 3E8 Telephone: +1-604-689-7842 Facsimile: +1-604-689-4250 Website: www.shamaranpetroleum.com</p> <p>OPERATIONS OFFICE 5 Chemin de la Pallanterie 1222 Vésenaz Switzerland Telephone: +41-22-560-8600 Facsimile: +41-22-560-8601</p> <p>BANKER HSBC Bank Canada Vancouver, British Columbia</p> <p>AUDITOR PricewaterhouseCoopers LLP London, UK</p> <p>TRANSFER AGENT Computershare Trust Company of Canada Vancouver, British Columbia</p> <p>STOCK EXCHANGE LISTING TSX Venture Exchange Trading Symbol: SNM</p> <p>INVESTOR RELATIONS Sophia Shane Vancouver, British Columbia</p>
OFFICERS	
<p>Brenden Johnstone Chief Financial Officer Geneva, Switzerland</p> <p>Kevin E. Hisko Corporate Secretary Vancouver, British Columbia</p>	