



Consolidated Financial Statements

December 31, 2010 and 2009

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Management's Report

Management is responsible for the preparation of the consolidated financial statements and the consistent presentation of all other financial information that is publicly disclosed. The consolidated financial statements have been prepared in accordance with the accounting policies detailed in the notes to the consolidated financial statements and in accordance with Canadian generally accepted accounting policies and include estimates and assumptions based on management's best judgement. Management maintains a system of internal controls to provide reasonable assurance that assets are safeguarded and that relevant and reliable financial information is produced in a timely manner. Independent auditors appointed by the shareholders have examined the consolidated financial statements. Their report is presented on the next page. The Audit Committee, consisting of independent members of the Board of Directors, have reviewed the consolidated financial statements with management and the independent auditors. The Board of Directors has approved the consolidated financial statements on the recommendation of the Audit Committee.

(signed) *Brian H. Dau*

(signed) *M. Darlene Wong*

Brian H. Dau
President & Chief Executive Officer

M. Darlene Wong
Vice President, Finance,
Chief Financial Officer & Secretary

March 25, 2011

Independent Auditors' Report

To the Shareholders of Anderson Energy Ltd.

We have audited the accompanying consolidated financial statements of Anderson Energy Ltd., which comprise the consolidated balance sheets as at December 31, 2010 and 2009, the consolidated statements of operations, comprehensive loss and deficit, and cash flows for the years then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Anderson Energy Ltd. as at December 31, 2010 and 2009, and of its consolidated results of operations and its consolidated cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

(signed) *KPMG LLP*

Chartered Accountants

Calgary, Canada
March 25, 2011

ANDERSON ENERGY LTD.

Consolidated Balance Sheets

DECEMBER 31, 2010 AND 2009

(Stated in thousands of dollars)

2010

2009

ASSETS

Current assets:

Cash and cash equivalents	\$	4,024	\$	1
Accounts receivable and accruals <i>(note 11)</i>		20,998		22,990
Prepaid expenses and deposits		3,052		3,778
Future income tax asset <i>(note 7)</i>		508		-
		<u>28,582</u>		<u>26,769</u>
Property, plant and equipment <i>(note 3)</i>		<u>506,533</u>		<u>470,400</u>
	\$	<u>535,115</u>	\$	<u>497,169</u>

LIABILITIES AND SHAREHOLDERS' EQUITY

Current liabilities:

Accounts payable and accruals	\$	46,862	\$	36,889
Unrealized loss on derivative contracts <i>(note 11)</i>		<u>1,918</u>		<u>-</u>
		48,780		36,889
Bank loans <i>(note 4)</i>		52,719		62,404
Convertible debentures <i>(note 5)</i>		43,460		-
Asset retirement obligations <i>(note 6)</i>		36,320		33,879
Future income taxes <i>(note 7)</i>		<u>20,045</u>		<u>31,278</u>
		201,324		164,450
Shareholders' equity:				
Share capital <i>(note 8)</i>		422,038		391,637
Equity component of convertible debentures <i>(note 5)</i>		4,242		-
Contributed surplus <i>(note 8)</i>		8,164		6,104
Deficit		<u>(100,653)</u>		<u>(65,022)</u>
		333,791		332,719
Commitments <i>(note 13)</i>				
Subsequent event <i>(note 14)</i>				
	\$	<u>535,115</u>	\$	<u>497,169</u>

See accompanying notes to the consolidated financial statements.

On behalf of the Board:

(signed) *J.C. Anderson*

Director

(signed) *Brian H. Dau*

Director

ANDERSON ENERGY LTD.
Consolidated Statements of Operations, Comprehensive Loss and Deficit

YEARS ENDED DECEMBER 31, 2010 AND 2009

(Stated in thousands of dollars, except per share amounts)

	2010	2009
REVENUES		
Oil and gas sales	\$ 86,457	\$ 76,993
Royalties	(9,011)	(8,253)
Realized loss on derivative contracts	(131)	-
Unrealized loss on derivative contracts <i>(note 11)</i>	(1,918)	-
Interest income	<u>96</u>	<u>155</u>
	75,493	68,895
EXPENSES		
Operating	29,148	26,906
General and administrative	7,733	6,998
Stock-based compensation	1,175	1,092
Interest and other financing charges	3,352	3,733
Depletion, depreciation and accretion	<u>81,265</u>	<u>80,940</u>
	<u>122,673</u>	<u>119,669</u>
Net loss before taxes	(47,180)	(50,774)
Future income tax reduction <i>(note 7)</i>	<u>(11,549)</u>	<u>(14,316)</u>
Net loss and comprehensive loss for the year	(35,631)	(36,458)
Deficit, beginning of year	<u>(65,022)</u>	<u>(28,564)</u>
Deficit, end of year	<u>\$ (100,653)</u>	<u>\$ (65,022)</u>
Net loss per share <i>(note 8)</i>		
Basic	\$ (0.21)	\$ (0.29)
Diluted	<u>\$ (0.21)</u>	<u>\$ (0.29)</u>

See accompanying notes to the consolidated financial statements.

ANDERSON ENERGY LTD.

Consolidated Statements of Cash Flows

YEARS ENDED DECEMBER 31, 2010 AND 2009

(Stated in thousands of dollars)

	2010	2009
CASH PROVIDED BY (USED IN)		
OPERATIONS		
Net loss for the year	\$ (35,631)	\$ (36,458)
Items not involving cash:		
Depletion, depreciation and accretion	81,265	80,940
Future income tax reduction	(11,549)	(14,316)
Unrealized loss on derivative contracts <i>(note 11)</i>	1,918	-
Stock-based compensation	1,175	1,092
Accretion on convertible debentures <i>(note 5)</i>	2	-
Asset retirement expenditures	(1,549)	(1,482)
Changes in non-cash working capital <i>(note 10)</i>	<u>5,365</u>	<u>(5,956)</u>
	40,996	23,820
FINANCING		
Decrease in bank loans	(9,685)	(22,910)
Issue of common shares, net of issue costs	29,859	56,538
Issue of convertible debentures, net of issue costs	47,700	-
Changes in non-cash working capital <i>(note 10)</i>	<u>384</u>	<u>115</u>
	68,258	33,743
INVESTMENTS		
Additions to property, plant and equipment	(114,380)	(33,612)
Proceeds on disposition of properties	2,207	54
Changes in non-cash working capital <i>(note 10)</i>	<u>6,942</u>	<u>(24,005)</u>
	<u>(105,231)</u>	<u>(57,563)</u>
Increase in cash	4,023	-
Cash, beginning of year	<u>1</u>	<u>1</u>
Cash and cash equivalents, end of year	\$ <u>4,024</u>	\$ <u>1</u>
Cash in bank	374	1
Short-term investments	<u>3,650</u>	-
Cash and cash equivalents	\$ <u>4,024</u>	\$ <u>1</u>

See note 10 for supplemental cash flow information.

See accompanying notes to the consolidated financial statements.

ANDERSON ENERGY LTD.

Notes to the Consolidated Financial Statements

YEARS ENDED DECEMBER 31, 2010 AND 2009
(Tabular amounts in thousands of dollars, unless otherwise stated)

Anderson Energy Ltd. ("Anderson Energy" or the "Company") was incorporated under the laws of the province of Alberta on January 30, 2002. Anderson Energy is engaged in the acquisition, exploration and development of oil and gas properties in western Canada.

1. SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of presentation. These consolidated financial statements include the accounts of Anderson Energy Ltd. and its wholly owned subsidiaries and a partnership and have been prepared by management in accordance with accounting principles generally accepted in Canada. All inter-entity transactions and balances have been eliminated. Management is required to 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 amount of revenue and expenses during the reported period. Actual results could differ from these estimates. Specifically, the amounts recorded for depletion and depreciation of oil and gas properties and the accretion of asset retirement obligations are based on estimates. The ceiling test is based on estimates of reserves, production rates, oil and gas prices, future costs and other relevant assumptions. The amounts for stock-based compensation are based on estimates of risk-free rates, expected lives, forfeitures and volatility. Future income taxes are based on estimates as to the timing of the reversal of temporary differences and tax rates currently substantively enacted. The fair value of derivative contracts are based on the discounted value of the market for future commodity prices, interest rates and the exchange rate between United States and Canadian dollars. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future periods could be significant.

(b) Cash and cash equivalents. Cash is defined as cash in the bank, less outstanding cheques. Cash equivalents consist of term deposits with original maturity dates of less than 30 days.

(c) Property, plant and equipment. The Company follows the full cost method of accounting for oil and gas properties. Under this method, all costs related to the exploration for and development of oil and gas reserves are capitalized. Capitalized costs include lease acquisitions, geological and geophysical costs, lease rentals on non-producing properties, costs of drilling productive and non-productive wells, plant and production equipment costs, asset retirement costs and that portion of general and administrative expenses directly attributable to exploration and development activities. Proceeds received from disposals of oil and gas properties and equipment are credited against capitalized costs unless the disposal would alter the rate of depletion and depreciation by more than 20%, in which case a gain or loss on disposal is recorded.

1. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

Oil and gas capitalized costs are depleted and depreciated using the unit of production method based on total proved reserves before royalties. Natural gas sales and reserves are converted to equivalent units of crude oil using their relative energy content. The costs of acquiring and evaluating unproved properties are initially excluded from depletion calculations until it is determined whether or not proved reserves are attributable to the property or impairment occurs. Office equipment and furniture are being depreciated over their useful lives using the declining balance method at rates between 20% and 30% per annum.

A detailed impairment calculation is performed when events or circumstances indicate a potential impairment of the carrying amount of oil and gas properties may have occurred, and at least annually in the fourth quarter. An impairment loss is recognized when the carrying amount of a cost centre is not recoverable and exceeds its fair value. The carrying amount is assessed to be recoverable when the sum of the undiscounted cash flows expected from proved reserves plus the cost of unproved properties, net of impairments, exceeds the carrying amount of the cost centre. When the carrying amount is assessed not to be recoverable, an impairment loss is recognized to the extent that the carrying amount of the cost centre exceeds the sum of the discounted cash flows from proved and probable reserves plus the cost of unproved properties, net of impairments, of the cost centre. The cash flows are estimated using expected future product prices and costs and are discounted using a risk-free interest rate.

(d) Asset retirement obligations. The Company records the fair value of asset retirement obligations as a liability in the period in which it incurs a legal obligation to restore an oil and gas property, typically when a well is drilled, equipment is put in place or in the event of an acquisition. The fair value is discounted using the Company's credit adjusted, risk-free rate with the associated asset retirement costs capitalized as part of the carrying amount of property, plant and equipment and depleted and depreciated using the unit of production method based on total proved reserves before royalties. Subsequent to the initial measurement of the obligations, the obligations are increased at the end of each period to reflect the passage of time resulting in an accretion charge to earnings. The obligations are also adjusted for changes in the estimated future cash flows underlying the obligation. Actual costs incurred upon settlement of the retirement obligation are charged against the obligation to the extent of the liability recorded.

(e) Income taxes. The Company follows the asset and liability method of accounting for income taxes. Under this method, income tax assets and liabilities are recognized for the estimated tax consequences attributable to differences between the amounts reported in the financial statements and their respective tax bases, using income tax rates that are substantively enacted and expected to apply in the periods when the temporary differences are expected to reverse. The effect of a change in rates on future income tax assets and liabilities is recognized in the period that the change occurs.

(f) Flow-through shares. The resource expenditure deductions for income tax purposes related to exploratory and development activities funded by flow-through share arrangements are renounced to investors in accordance with income tax legislation. An estimate of the additional tax liability to be incurred and included in the future tax provision is recognized and charged to share capital at the time the resource expenditure deductions for income tax purposes are renounced to investors.

1. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

(g) Stock-based compensation plans. The Company accounts for stock options granted to employees and directors using the fair value method of accounting for stock-based compensation plans. Under this method, the Company recognizes compensation expense, with a corresponding increase to contributed surplus, based on the fair value of the options over the vesting period of the grant. The Company uses a Black-Scholes option pricing model to determine the fair value of options at the date of grant. When exercised, the consideration paid together with the amount previously recognized in contributed surplus is recorded as an increase to share capital.

(h) Revenue recognition. Revenue from the sale of oil and gas is recognized when title passes from the Company to the purchaser.

(i) Financial instruments. A financial instrument is any contract that gives rise to a financial asset to one entity and a financial liability or equity instrument to another entity. Upon initial recognition, all financial instruments, including all derivatives, are recognized on the balance sheet at fair value. Subsequent measurement is then based on the financial instruments being classified into one of five categories: held for trading, held to maturity, loans and receivables, available for sale and other liabilities. The Company has designated its cash and cash equivalents as held for trading which is measured at fair value. Accounts receivable are classified as loans and receivables which are measured at amortized cost. Accounts payable and accrued liabilities, bank loans and the liability component of convertible debentures are classified as other liabilities which are measured at amortized cost determined using the effective interest rate.

The Company is exposed to market risks resulting from fluctuations in commodity prices, foreign exchange rates and interest rates in the normal course of operations. A variety of derivative instruments may be used by the Company to reduce its exposure to fluctuations in commodity prices, foreign exchange rates, and interest rates. The Company does not use these derivative instruments for trading or speculative purposes. The Company considers all of these transactions to be economic hedges, however, the Company's contracts do not qualify or have not been designated as hedges for accounting purposes. As a result, derivative contracts are classified as held for trading and are recorded on the balance sheet at fair value, with changes in the fair value recognized in earnings, unless specific hedge criteria are met. If specific hedge criteria are met, changes in the fair value are initially recognized in other comprehensive income, and are subsequently reclassified to earnings in the same period in which the revenues associated with the hedged transactions are recognized. The fair values of these derivative instruments are based on an estimate of the amounts that would have been received or paid to settle these instruments prior to maturity given future market prices and other relevant factors.

The Company has elected to account for its physical delivery sales contracts for the purpose of receipt or delivery of non-financial items in accordance with its expected purchase, sale or usage requirements as executory contracts on an accrual basis rather than as non-financial derivatives.

1. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

The Company measures and recognizes embedded derivatives separately from the host contracts when the economic characteristics and risks of the embedded derivative are not closely related to those of the host contract, when it meets the definition of a derivative and when the entire contract is not measured at fair value. Embedded derivatives are recorded at fair value.

The Company nets all transaction costs incurred, in relation to the acquisition of a financial asset or liability, against the related financial asset or liability. Convertible debentures are recorded net of issue costs and bank loans are presented net of deferred interest payments, with interest recognized in earnings on an effective interest basis.

The Company applies trade-date accounting for the recognition of a purchase or sale of cash equivalents and derivative contracts.

(j) Convertible debentures. The Company's convertible debentures are financial liabilities consisting of a liability with an embedded conversion feature. As such, the debentures are segregated between liabilities and equity based on the residual value method, where the liability is first measured using a discount rate without the conversion feature and the remaining amount is allocated to equity. Therefore, the debenture liabilities are presented at less than their maturity values. The liability and equity components are further reduced for issuance costs initially incurred. The difference between the discounted liability component and the maturity value is accreted by the "effective interest" method over the debenture term and expensed accordingly. As debentures are converted to shares, an appropriate portion of the liability and equity components are transferred to share capital.

(k) Interests in joint operations. A substantial portion of the Company's oil and gas exploration and development activities are conducted jointly with others, and accordingly, the consolidated financial statements reflect only the Company's proportionate interest in such activities.

(l) Per share amounts. Basic per share amounts are calculated using the weighted average number of common shares outstanding during the period. Diluted per share amounts reflect the potential dilution that could occur if securities or other contracts to issue common shares were exercised or converted to common shares. The treasury stock method is used to determine the dilutive effect of stock options and other dilutive instruments. Under the treasury stock method, only options for which the exercise price is less than the market value impact the dilution calculations.

(m) Comparative figures. Certain comparative figures have been reclassified to conform to the current year's presentation.

2. FUTURE ACCOUNTING PRONOUNCEMENTS

Convergence with International Financial Reporting Standards ("IFRS"). In January 2006, the Canadian Accounting Standards Board ("AcSB") announced its decision to replace Canadian GAAP with IFRS. On February 13, 2008, the AcSB confirmed January 1, 2011 as the mandatory changeover date to IFRS for all Canadian publicly accountable enterprises. As a result, Anderson Energy will prepare its financial statements under IFRS for the interim periods and fiscal year ends beginning in 2011.

3. PROPERTY, PLANT AND EQUIPMENT

	<i>2010</i>	<i>2009</i>
Cost	\$ 838,405	\$ 723,549
Less accumulated depletion and depreciation	<u>(331,872)</u>	<u>(253,149)</u>
Net book value	<u>\$ 506,533</u>	<u>\$ 470,400</u>

At December 31, 2010, unproved property costs of \$5.0 million (December 31, 2009 – \$6.2 million) have been excluded from the full cost pool for depletion and depreciation calculations. Future development costs of proved, undeveloped reserves of \$137.0 million (December 31, 2009 – \$197.6 million) have been included in the depletion and depreciation calculation.

For the year ended December 31, 2010, \$5.2 million (December 31, 2009 – \$4.6 million) of general and administrative costs including \$0.9 million (December 31, 2009 – \$1.0 million) of stock-based compensation costs were capitalized. The future tax liability of \$0.3 million (December 31, 2009 – \$0.3 million) associated with the capitalized stock-based compensation has also been capitalized. Capitalized general and administrative costs consist of salaries and associated office rent of staff involved in capital activities.

No impairment was recognized under the ceiling test at December 31, 2010. The future commodity prices used in the ceiling test were based on commodity price forecasts of the Company's independent reserves engineers adjusted for differentials specific to the Company's reserves. Factors used in the ceiling test calculation are as follows:

	<i>AECO Gas Price (\$Cdn/Mcf)</i>	<i>WTI Cushing (\$US/bbl)</i>	<i>Exchange rate (US\$/Cdn)</i>
2011	4.16	88.00	0.98
2012	4.74	89.00	0.98
2013	5.31	90.00	0.98
2014	5.77	92.00	0.98
2015	6.22	95.17	0.98
2016	6.53	97.55	0.98
2017	6.76	100.26	0.98
2018	6.90	102.74	0.98
2019	7.06	105.45	0.98
2020	7.21	107.56	0.98
Thereafter 2%			

After 2020, only inflationary growth of 2% was considered. Natural gas liquids prices were tied to crude oil prices based on historical trends and analysis. Exchange rates were expected to remain constant beyond 2020.

4. BANK LOANS

At December 31, 2010, total bank facilities were \$125 million consisting of an \$80 million extendible revolving term credit facility, a \$10 million working capital credit facility and a \$35 million supplemental credit facility, with a syndicate of Canadian banks. The extendible revolving term credit facility and working capital credit facility have a revolving period ending on July 12, 2011, extendible at the option of the lenders. If not extended, these facilities cease to revolve and all outstanding advances thereunder become repayable one year from the term date of July 12, 2011. The supplemental facility is also available on a revolving basis and is scheduled to expire on July 1, 2011, with any outstanding amounts due in full at that time.

4. **BANK LOANS** *(Continued)*

At December 31, 2010 there were no amounts drawn under the supplemental facility. The average effective interest rate on advances in 2010 was 4.9% (December 31, 2009 – 4.2%). The Company had \$133,500 in letters of credit outstanding at December 31, 2010, which reduced the amount of credit available to the Company.

Advances under the facilities can be drawn in either Canadian or U.S. funds and bear interest at the bank's prime lending rate, bankers' acceptance or LIBOR loan rates plus applicable margins. The margins vary depending on the borrowing option used and the Company's financial ratios. At December 31, 2010 there were no advances in U.S. funds.

Loans are secured by a floating charge debenture over all assets and guarantees by material subsidiaries. Draws over \$30 million under the supplemental facility will be subject to the consent of the bank syndicate at the time of the drawdown.

The available lending limits of the facilities are reviewed semi-annually and are based on the bank syndicate's interpretations of the Company's reserves and future commodity prices. There can be no assurance that the amount of the available facilities or the applicable margins will not be adjusted at the next scheduled review on or before July 12, 2011.

5. **CONVERTIBLE DEBENTURES**

On December 31, 2010, the Company issued \$50 million of convertible unsecured subordinated debentures (the "Debentures") on a bought deal basis. The Debentures have a face value of \$1,000, bear interest at the rate of 7.5% per annum payable semi-annually in arrears on the last day of January and July of each year commencing on July 31, 2011 and mature on January 31, 2016 (the "Maturity Date"). The Debentures are convertible at the holder's option at a conversion price of \$1.55 per common share (the "Conversion Price"), subject to adjustment in certain events. The Debentures are not redeemable by the Corporation before January 31, 2014. On and after January 31, 2014 and prior to the Maturity Date, the Debentures are redeemable at the Corporation's option, in whole or in part, at a price equal to their principal amount plus accrued and unpaid interest if the weighted average trading price of the common shares on the Toronto Stock Exchange for the 20 consecutive trading days preceding the date on which the notice of redemption is given is not less than 125% of the Conversion Price. The Debentures are listed and posted for trading on the TSX under the symbol "AXL.DB".

As the Debentures are convertible into common shares, the liability and equity components are presented separately. The initial carrying amount of the financial liability is determined by discounting the stream of future payments of interest and principal. Using the residual method, the carrying amount of the conversion feature is the difference between the principal amount and the carrying value of the financial liability. The Debentures, net of the equity component and issue costs are accreted using the effective interest rate method over the term of the Debentures such that the carrying amount of the financial liability will equal the principal balance at maturity.

5. CONVERTIBLE DEBENTURES *(Continued)*

There were no convertible debentures outstanding at December 31, 2009. The following table indicates the convertible debenture activities for the year ended December 31, 2010:

	<i>Face Value</i>	<i>Debt Component</i>	<i>Equity Component</i>
Balance, December 31, 2009	\$ -	\$ -	\$ -
Issued pursuant to prospectus ⁽¹⁾	50,000	45,553	4,447
Issue costs	(2,300)	(2,095)	(205)
Accretion expense	-	2	-
Balance, December 31, 2010	<u>\$ 47,700</u>	<u>\$ 43,460</u>	<u>\$ 4,242</u>

⁽¹⁾ Includes 1,000 Debentures issued to directors for total gross proceeds of \$1.0 million.

6. ASSET RETIREMENT OBLIGATIONS

The Company estimates the total undiscounted cash flows required to settle its asset retirement obligations is approximately \$73.7 million (December 31, 2009 – \$70.1 million), including expected inflation of 2% (December 31, 2009 – 2%) per annum. The majority of the costs will be incurred between 2011 and 2030. A credit adjusted risk-free rate of 8% to 10% (December 31, 2009 – 8% to 10%) was used to calculate the fair value of the asset retirement obligations. A reconciliation of the asset retirement obligations is provided below:

	<i>2010</i>	<i>2009</i>
Balance, beginning of year	\$ 33,879	\$ 30,820
Liabilities incurred	758	1,544
Liabilities settled	(1,549)	(1,482)
Change in estimate	690	666
Accretion expense	2,542	2,331
Balance, end of year	<u>\$ 36,320</u>	<u>\$ 33,879</u>

7. TAXES

The temporary differences that gave rise to the Company's future income tax liabilities (assets) at December 31, 2010 and 2009 were as follows:

	<i>2010</i>	<i>2009</i>
Future income tax liabilities (assets):		
Property, plant and equipment	\$ 46,073	\$ 50,210
Non-capital losses	(18,080)	(9,289)
Asset retirement obligations	(9,080)	(8,470)
Share issue costs	(2,229)	(1,985)
Current income deferred	2,853	812
Balance, end of year	<u>\$ 19,537</u>	<u>\$ 31,278</u>
Future income tax asset	\$ (508)	\$ -
Future income tax liability	<u>20,045</u>	<u>31,278</u>
	<u>\$ 19,537</u>	<u>\$ 31,278</u>

7. TAXES *(Continued)*

The provision for income taxes differs from the result that would have been obtained by applying the combined federal and provincial tax rates to the loss before income taxes. The difference results from the following items:

	2010		2009
Loss before taxes	\$ (47,180)	\$	(50,774)
Combined federal and provincial tax rates	28.0%		29.0%
Expected future income tax reduction	(13,210)		(14,724)
Increase in income taxes resulting from:			
Changes in expected future tax rates	1,339		108
Non-deductible stock-based compensation and other	322		300
Future income tax reduction	\$ (11,549)	\$	(14,316)

At December 31, 2010, the Company has loss carryforwards of \$72 million that will expire between 2025 and 2030. The Company expects to be able to fully utilize these losses.

8. SHARE CAPITAL AND CONTRIBUTED SURPLUS

Authorized share capital. The Company is authorized to issue an unlimited number of common and preferred shares. The preferred shares may be issued in one or more series.

Issued share capital.

	Number of Common Shares		Amount
Balance at December 31, 2008	87,300,401	\$	334,176
Issued pursuant to prospectus ⁽¹⁾	63,200,000		60,040
Share issue costs	-		(3,502)
Tax effect of share issue costs	-		923
Balance at December 31, 2009	150,500,401	\$	391,637
Issued pursuant to prospectus ⁽²⁾	21,900,000		31,755
Share issue costs	-		(1,963)
Tax effect of share issue costs	-		507
Stock options exercised	84,900		67
Transferred from contributed surplus on stock option exercise	-		35
Balance at December 31, 2010	172,485,301	\$	422,038

(1) Includes 4,992,034 common shares issued to management and directors and 3,377,966 common shares issued to family of management and directors for total gross proceeds of \$8.0 million.

(2) Includes 352,466 common shares issued to directors for total gross proceeds of \$0.5 million.

Stock options. The Company has an employee stock option plan under which employees, directors and consultants are eligible to receive grants. The exercise price of stock options equals the weighted average trading price of the Company's shares for the five trading days prior to the date of the grant. Options have terms of either five or ten years and vest equally over a three year period starting on the first anniversary date of the grant. Changes in the number of options outstanding during the years ended December 31, 2010 and December 31, 2009 are as follows:

8. SHARE CAPITAL AND CONTRIBUTED SURPLUS (Continued)

	<i>Number of options</i>		<i>Weighted average exercise price</i>
Balance at December 31, 2008	7,594,856	\$	4.37
Granted	3,316,200		0.80
Expirations	(252,300)		6.47
Forfeitures	(400,000)		3.01
Balance at December 31, 2009	10,258,756	\$	3.22
Granted	3,950,250		1.06
Exercised	(84,900)		0.79
Expirations	(1,430,124)		5.78
Forfeitures	(687,750)		1.44
Balance at December 31, 2010	12,006,232	\$	2.32
Exercisable at December 31, 2010	6,111,399	\$	3.53

<i>Range of exercise prices</i>	<i>Options outstanding</i>			<i>Options exercisable</i>	
	<i>Number of options</i>	<i>Weighted average exercise price</i>	<i>Weighted average remaining life (years)</i>	<i>Number of options</i>	<i>Weighted average exercise price</i>
\$0.79 to \$0.99	2,706,900	\$ 0.79	3.6	902,300	\$ 0.79
\$1.00 to \$1.50	3,831,750	1.06	4.6	29,400	1.09
\$2.26 to \$3.35	727,950	2.68	2.7	489,300	2.68
\$3.36 to \$5.00	4,354,732	4.00	1.5	4,308,499	4.00
\$5.01 to \$7.50	320,100	5.67	0.3	317,100	5.68
\$7.51 to \$9.01	64,800	7.69	0.1	64,800	7.69
Total at December 31, 2010	12,006,232	\$ 2.32	3.0	6,111,399	\$ 3.53

The fair value of the options issued during the year ended December 31, 2010 was \$0.55 per option (December 31, 2009 – \$0.42 per option). The weighted average assumptions used in arriving at the values were: a risk-free interest rate of 2.3% (December 31, 2009 – 2.4%), expected option life of five years (December 31, 2009 – five years), expected volatility of 58% (December 31, 2009 – 60%) and a dividend yield of 0% (December 31, 2009 – 0%).

Per share amounts. During the year ended December 31, 2010 there were 170,298,490 weighted average shares outstanding (December 31, 2009 – 125,047,250). On a diluted basis, there were 170,298,490 weighted average shares outstanding (December 31, 2009 – 125,047,250) after giving effect to dilutive stock options and dilutive convertible debentures. At December 31, 2010, there were 12,006,232 options (December 31, 2009 – 10,258,756) and 32,258,065 common shares reserved for convertible debentures (December 31, 2009 – Nil) that were anti-dilutive.

Contributed surplus

	<i>Amount</i>
Balance at December 31, 2008	\$ 4,000
Stock-based compensation	2,104
Balance at December 31, 2009	\$ 6,104
Stock-based compensation	2,095
Transferred from contributed surplus on stock option exercise	(35)
Balance at December 31, 2010	\$ 8,164

9. MANAGEMENT OF CAPITAL STRUCTURE

Anderson Energy's capital management policy is to maintain a strong, but flexible capital structure that optimizes the cost of capital and maintains investor, creditor and market confidence while sustaining the future development of the business.

The Company manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of the underlying petroleum and natural gas assets. The Company's capital structure includes shareholders' equity of \$333.8 million, bank loans of \$52.7 million, convertible debentures with a face value of \$50.0 million and the working capital deficiency of \$18.8 million, excluding the unrealized loss on derivative contract and future income tax asset. In order to maintain or adjust the capital structure, the Company may from time to time issue shares, seek additional debt financing and adjust its capital spending to manage current and projected debt levels.

Consistent with other companies in the oil and gas sector, Anderson Energy monitors capital based on the ratio of total debt to funds from operations. This ratio is calculated by dividing total debt at the end of the period (comprised of the working capital deficiency, the liability component of convertible debentures and outstanding bank loans) by the annualized current quarter funds from operations (cash flow from operating activities before changes in non-cash working capital and asset retirement expenditures). This ratio may increase at certain times as a result of acquisitions, the timing of capital expenditures and market conditions. In order to facilitate the management of this ratio, the Company prepares annual capital expenditure budgets, which are updated as necessary depending on varying factors including current and forecast crude oil and natural gas prices, capital deployment and general industry conditions. The annual and updated budgets are approved by the Board of Directors.

	<i>2010</i>		<i>2009</i>
Bank loans	\$ 52,719	\$	62,404
Current liabilities, excluding unrealized loss on derivative contracts	46,862		36,889
Current assets, excluding future income tax asset	(28,074)		(26,769)
Net debt before convertible debentures	\$ 71,507	\$	72,524
Convertible debentures (liability component)	43,460		-
Total net debt	\$ 114,967	\$	72,524
Cash from operating activities in quarter	\$ 10,721	\$	5,361
Changes in non-cash working capital	(1,324)		3,246
Asset retirement expenditures	118		544
Funds from operations in quarter	\$ 9,515	\$	9,151
Annualized current quarter funds from operations	\$ 38,060	\$	36,604
Net debt before convertible debentures to funds from operations	1.9		2.0
Total net debt to funds from operations	3.0		2.0

At December 31, 2010, the Company's total net debt to annualized funds from operations was 3.0 and the Company's net debt before convertible debentures to annualized funds from operations was 1.9. At December 31, 2009, the Company's total debt to annualized funds from operations was 2.0. The increase in the total net debt to funds from operations ratio in the fourth quarter of 2010 is due to \$26.5 million in capital expenditures and lower natural gas prices in the quarter as well as the issuance of 50,000 convertible debentures on December 31, 2010. Net debt before convertible debentures to annualized funds from operation in 2010 was relatively consistent with 2009. New production resulting from the

9. MANAGEMENT OF CAPITAL STRUCTURE *(Continued)*

capital expenditures is not yet reflected in the reported funds from operations. As this new crude oil production is brought on stream at higher expected operating margins, the debt to funds from operations ratio is expected to decrease.

The Company's share capital is not subject to external restrictions, however, its credit facilities are petroleum and natural gas reserves based (see note 4). Anderson Energy has not paid or declared any dividends since the date of incorporation and does not contemplate doing so in the foreseeable future.

10. SUPPLEMENTAL CASH FLOW INFORMATION

	<i>2010</i>	<i>2009</i>
Change in non-cash working capital:		
Accounts receivable and accruals	\$ 1,992	\$ 5,970
Prepaid expenses and deposits	726	(1,086)
Accounts payable and accruals	9,973	(34,730)
<u>Change in non-cash working capital</u>	<u>\$ 12,691</u>	<u>\$ (29,846)</u>
Relating to:		
Operating activities	\$ 5,365	\$ (5,956)
Financing activities	384	115
Investing activities	6,942	(24,005)
<u>Change in non-cash working capital</u>	<u>\$ 12,691</u>	<u>\$ (29,846)</u>

The following cash payments were made (received):

	<i>2010</i>	<i>2009</i>
Interest paid	\$ 2,256	\$ 2,835
<u>Interest received</u>	<u>(90)</u>	<u>(155)</u>

11. FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT

The Company's financial instruments include cash and cash equivalents, accounts receivable and accruals, deposits, accounts payable and accruals, bank loans, convertible debentures and forward price contracts.

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

The Company has exposure to credit risk, liquidity risk and market risk as a result of its use of financial instruments. This note presents information about the Company's exposure to each of the above risks and the Company's objectives, policies and processes for measuring and managing these risks. Further quantitative disclosures are included throughout these financial statements.

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

11. FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT *(Continued)*

Fair value of financial asset and financial liabilities. Financial instruments measured at fair value on the balance sheet require classification into one of the following levels of fair value hierarchy:

- Level 1 – observable inputs such as quoted prices in active markets;
- Level 2 – inputs, other than the quoted market prices in active markets, which are observable, either directly and/or indirectly; and
- Level 3 – unobservable inputs for the asset or liability in which little or no market data exists, therefore requiring an entity to develop its own assumptions.

Cash and cash equivalents as shown in the consolidated balance sheet as at December 31, 2010 and 2009, is measured using level 1. The commodity contracts are classified as level 2 within the fair value hierarchy. The Company does not have any financial instruments that are measured using level 3 inputs.

During the years ended December 31, 2010 and 2009, there were no transfers between level 1, level 2 and level 3 classified assets and liabilities.

Cash and cash equivalents. The fair value of cash and cash equivalents approximates its carrying value due to its short-term nature.

Accounts receivable and accruals, accounts payable and accruals. The carrying amount of accounts receivable and accruals and accounts payable and accruals approximate their fair values due to the short-term nature of the instruments.

Bank loans. The fair value of the Company's variable-rate bank loans approximates its carrying value, as it is at a floating market rate of interest.

Convertible debentures. The liability component has been classified as other liabilities and measured at amortized cost. The convertible debentures have a fixed term and interest rate (note 5) resulting in fair values that will vary over time as market conditions change. The fair value of the liability component of convertible debentures was determined based on a discounted cash flow model assuming no future conversions and continuation of current interest and principal payments as well as taking into consideration the current public trading activity of such debentures. The Company applied a discount rate of 10% considering current available market information, assumed credit adjustments and term to maturity.

Forward crude oil price swap. The Company may manage the risk associated with changes in commodity prices by entering into derivatives, which are recorded at fair value as derivative assets and liabilities with gains and losses recognized through earnings. As the fair value of the contracts varies with commodity prices, they give rise to financial assets and liabilities. The fair values of the derivatives are determined by a Level 2 valuation model, where pricing inputs other than quoted prices in an active market are used. These pricing inputs include quoted forward prices for commodities, foreign exchange rates, volatility and risk-free rate discounting, all of which can be observed or corroborated in the marketplace. The actual gains and losses realized on eventual cash settlement can vary materially due to subsequent fluctuations in commodity prices and foreign exchange rates as compared to the valuation assumptions.

11. FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT *(Continued)*

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. A substantial portion of the Company's accounts receivable are with natural gas and liquids marketers and joint venture partners in the oil and gas industry and are subject to normal industry credit risks. Purchasers of the Company's natural gas and liquids are subject to credit review to minimize the risk of non-payment. As at December 31, 2010, the maximum credit exposure is the carrying amount of the accounts receivable and accruals of \$21.0 million (December 31, 2009 – \$23.0 million). As at December 31, 2010, the Company's receivables consisted of \$11.4 million (December 31, 2009 – \$14.4 million) from joint venture partners and other trade receivables and \$9.6 million (December 31, 2009 – \$8.6 million) of revenue accruals and other receivables from petroleum and natural gas marketers.

Receivables from petroleum and natural gas marketers are typically collected on the 25th day of the month following production. The Company's policy to mitigate credit risk associated with these balances is to establish marketing relationships with large purchasers. The Company historically has not experienced any significant collection issues with its petroleum and natural gas marketers. Of the \$9.6 million of revenue accruals and receivables from petroleum and natural gas marketers, \$8.5 million was received on or about January 25, 2011. The balance is expected to be received in subsequent months through joint venture billings from partners.

Joint venture receivables are typically collected within one to three 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. However, the receivables are from participants in the petroleum and natural gas sector, and collection is dependent on typical industry factors such as commodity price fluctuations, escalating costs and the risk of unsuccessful drilling. Further risks exist with joint venture partners, as disagreements occasionally arise that increase the potential for non-collection. For properties that are operated by Anderson Energy, production can be withheld from joint venture partners who are in default of amounts owing. In addition, the Company often has offsetting amounts payable to joint venture partners from which it can net receivable balances. At December 31, 2010, the largest amount owing from one partner is \$0.8 million.

The Company is from time to time exposed to credit risk associated with possible non-performance by counterparties to derivative financial instrument contracts. The Company believes these risks to be minimal as the counterparties are major financial institutions.

The Company's allowance for doubtful accounts as at December 31, 2010 is \$1.0 million (December 31, 2009 – \$1.6 million). This allowance was mostly created in prior years and is associated with prior corporate acquisitions and potential joint venture billing disputes. The Company wrote-off \$0.6 million in receivables during the year ended December 31, 2010 (December 31, 2009 – \$Nil). The Company would only choose to write-off a receivable balance (as opposed to providing an allowance) after all reasonable avenues of collection had been exhausted.

11. FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT *(Continued)*

As at December 31, the Company considers its receivables to be aged as follows

Aging	2010		2009	
Not past due	\$	18,960	\$	22,402
Past due by less than 120 days		1,706		537
Past due by more than 120 days		332		51
Total	\$	20,998	\$	22,990

These amounts are before offsetting amounts owing to joint venture partners that are included in accounts payable and accrued liabilities.

Liquidity risk. Liquidity risk is the risk that the Company will incur difficulties meeting its financial obligations as they are due. The Company's approach to managing liquidity is to ensure, as far as possible, that it will have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions without incurring unacceptable losses or risking harm to the Company's reputation.

The Company prepares annual capital expenditure budgets, which are regularly monitored and updated as considered necessary. The Company uses authorizations for expenditures on both operated and non-operated projects to further manage capital expenditures. To facilitate the capital expenditure program, the Company has revolving reserves based credit facilities, as outlined in note 4, which are reviewed semi-annually by the lenders. The Company monitors its total debt position monthly. The Company also attempts to match its payment cycle with collection of petroleum and natural gas revenues on the 25th of each month. The Company anticipates it will have adequate liquidity to fund its financial liabilities through its future cash flows.

The following are the contractual maturities of financial liabilities and associated interest payments as at December 31, 2010:

Financial Liabilities	2011	2012	2013	2014	2015	2016
Accounts payable and accruals	\$ 46,862	\$ -	\$ -	\$ -	\$ -	\$ -
Bank loans – principal	-	52,719	-	-	-	-
Convertible debentures – interest	2,198	3,750	3,750	3,750	3,750	1,875
Convertible debentures – principal	-	-	-	-	-	50,000
Total	\$ 49,060	\$ 56,469	\$ 3,750	\$ 3,750	\$ 3,750	\$ 51,875

Please refer to note 13 for additional details on commitments.

Market risk. Market risk consists of currency risk, commodity price risk and interest rate risk. The objective of market risk management is to manage and control market risk exposures within acceptable limits, while maximizing returns.

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

11. FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT *(Continued)*

Currency risk. Foreign currency exchange rate risk is the risk that the fair value or future cash flows will fluctuate as a result of changes in foreign exchange rates. Substantially all of the Company's petroleum and natural gas sales are denominated in Canadian dollars, however, the underlying market prices in Canada for petroleum and natural gas are impacted by changes in the exchange rate between the Canadian and United States dollar. The Company had no outstanding forward exchange rate contracts in place at December 31, 2010.

Commodity price risk. Commodity price risk is the risk that the fair value or future cash flows will fluctuate as a result of changes in commodity prices. Commodity prices for petroleum and natural gas are impacted by world economic events that dictate the levels of supply and demand as well as the relationship between the Canadian and United States dollar, as outlined above. The Company may mitigate commodity price risk through the use of financial derivatives and physical delivery fixed price sales contracts. All such contracts require approval of the Board of Directors.

There were no derivative contracts for the year ended December 31, 2009. As at December 31, 2010, Anderson had a fixed price contract for 1,000 barrels per day of crude oil for calendar 2011 at a NYMEX crude oil price of Canadian \$88.45 per barrel.

The unrealized loss on derivative contracts of \$1.9 million for the year ended December 31, 2010 has been included on the balance sheet as a current liability with changes in the fair value included in unrealized loss on derivative contracts on the consolidated statements of operations. As at December 31, 2010, if the future strip prices for crude oil were \$1 per barrel higher or lower with all other variables held constant, the earnings of the year would have been \$0.4 million lower for the year. An equal and opposite impact would have occurred had future strip prices for crude oil been lower by the same amount.

In October 2010, the Company entered into fixed price swaps for 1,000 barrels per day of crude oil for December 2010 at a NYMEX crude oil price of Canadian \$85.70 per barrel. The Company realized a loss of \$0.1 million in relation to this contract in the year ended December 31, 2010, which is included in the realized loss on derivative contract on the consolidated statements of operations.

In March 2011, the Company entered into a fixed price contract for 250 barrels per day of crude oil for calendar 2012 at a NYMEX crude oil price of Canadian \$103.20 per barrel.

In December 2009, the Company entered into physical sales contracts to sell 20,000 GJ per day of natural gas for each of January, February and March 2010 at an average AECO price of \$5.41 per GJ. The Company realized a gain of \$1.3 million in relation to these physical sales contracts in the year ended December 31, 2010, which is included in oil and gas sales.

Interest rate risk. Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. The Company is exposed to interest rate fluctuations on its bank debt which bears interest at a floating rate. For the year ended December 31, 2010, if interest rates had been 1% lower with all other variables held constant, earnings for the year would have been \$0.3 million (December 31, 2009 – \$0.5 million) higher, due to lower interest expense. An equal and opposite impact would have occurred had interest rates been higher by the same amounts.

The Company had no interest rate swap or financial contracts in place at December 31, 2009.

12. RELATED PARTY TRANSACTIONS

On December 31, 2010, the Company issued 1,000 convertible debentures to directors at a price of \$1,000 per convertible debenture for total gross proceeds of \$1.0 million as part of a \$50.0 million bought share offering of convertible debentures.

In February 2010, the Company issued 352,466 common shares to directors at a price of \$1.45 per share for total gross proceeds of \$0.5 million as part of a \$27.9 million bought share offering of common shares.

In May 2009, the Company issued 4,992,034 common shares to management and directors and 3,377,966 common shares to family of management and directors of the Company at a price of \$0.95 per share for total gross proceeds of \$8.0 million as part of a \$60.0 million bought share offering of common shares.

13. COMMITMENTS

The Company has entered into an agreement to lease office space until November 30, 2012. Future minimum lease payments are expected to be \$1.8 million in 2011 and \$1.6 million in 2012.

On December 2, 2010, the Company entered into a facilities construction and operation agreement pursuant to which it is committed to ship a minimum volume of gross crude oil through new facilities and pipelines being constructed in one of its core areas. The total financial commitment is \$2.6 million to be incurred over a minimum of five years. The contract contains a minimum volume requirement per year for the first five years following completion of construction which is expected to be in the second quarter of 2011. In the event that the volume shipped is less than the minimum volume, the Company will be subject to a fee per cubic metre of oil on the difference between actual volumes shipped and the minimum volume required. Conversely, if the Company exceeds the minimum volume requirement in a single year, the excess is carried forward as a credit to the minimum volume requirement in the subsequent year. If no volumes were shipped, a minimum of \$0.26 million would be payable each year. After the total contracted volumes have been shipped, the contract will automatically renew for one year periods unless terminated.

The Company entered into firm service transportation agreements for approximately 29 million cubic feet per day of gas sales in central Alberta for various terms expiring in one to ten years. Based on rate schedules announced to date, the payments in each of the next five years and thereafter are estimated as follows:

	<i>Committed volume (MMcfd)</i>		<i>Committed amount</i>
2011	29	\$	1,633
2012	19	\$	1,337
2013	8	\$	825
2014	4	\$	674
2015	4	\$	606
Thereafter	12	\$	442

13. COMMITMENTS *(Continued)*

On January 29, 2009, the Company executed a farm-in agreement with a large international oil and gas company (the "Farmor") on lands near its existing core operations. Under the farm-in agreement, the Company has access to 388 gross (205 net) sections of land. During the commitment phase of the transaction, the Company is committed to drill, complete and equip 200 wells to earn an interest in up to 120 sections. The Company is obligated to complete the drilling of the wells on or before March 31, 2012. The Company's equipping obligation is up to, but does not include, multi-well gathering systems downstream of field compression and/or gas plants. The Company has an option to continue the farm-in transaction until March 1, 2013 by committing to drill a minimum of 100 additional wells under similar terms as in the commitment phase to earn a minimum of 50 sections of land. Following the commitment and/or option phases, the parties to the agreement can then jointly develop the lands on denser drilling spacing under terms of an operating agreement.

The Company commenced drilling in the fourth quarter of 2009 and currently estimates that the average working interest of the 200 well capital commitment will be approximately 80% to 85%, based on partner participation identified to date. As of December 31, 2010, the Company has drilled 126 wells under the farm-in agreement and plans to defer the drilling of the remaining 74 wells until 2012. The Company earns its interest in each well as the well is put on production. A \$550,000 penalty is payable for each well not drilled under the commitment as of March 31, 2012, subject to certain reductions due to unavoidable events beyond the Company's control and rights of first refusal. The Company estimates that its minimum commitment to drill the remaining 74 wells is \$10 million.

14. SUBSEQUENT EVENT

On February 9, 2011, the Company disposed of properties for gross proceeds of \$5.1 million.