valeura energy inc.

MANAGEMENT'S DISCUSSION AND ANALYSIS

For the three months and years ended December 31, 2012 and 2011

(tabular amounts in thousands of Canadian Dollars, except share or per share amounts)

The following Management's Discussion and Analysis ("MD&A") as provided by the management of Valeura Energy Inc. ("Valeura" or the "Company") is dated as of March 13, 2013 and should be read in conjunction with Valeura's audited consolidated financial statements and related notes for the years ended December 31, 2012 and 2011. Additional information relating to Valeura is available under Valeura's profile on www.sedar.com, including Valeura's Annual Information Form year ended December 31, 2012 ("2012 AIF"). The reporting currency is the Canadian dollar (see the sections titled "Foreign Exchange" and "Currency Translation Adjustment" for discussion on Valeura's functional currencies).

Basis of Presentation

The audited consolidated financial statements have been issued under International Financial Reporting Standards ("IFRS") as at and for the years ended December 31, 2012 and 2011. The financial statements have been prepared in accordance with IFRS accounting policies and methods of computation as set forth in Note 3 of the audited consolidated financial statements.

The discussion and analysis of oil and natural gas production is presented on a working-interest, before royalty basis. For the purpose of calculating unit of production information, natural gas is converted to a barrel of oil equivalent ("boe") using six thousand cubic feet of natural gas equal to one barrel of oil. This conversion ratio of 6:1 is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. Readers are cautioned that boe as a unit of measure may be misleading, particularly if used in isolation.

The Company makes estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the revenues and expenses during the reporting period. Management reviews these estimates, including those related to accruals, reserves, environmental and decommissioning obligations and income taxes at each financial reporting period. Changes in facts and circumstances may result in revised estimates and actual results may differ from these estimates. Readers should be aware that historical results are not necessarily indicative of future performance.

Special Note Regarding Additional-GAAP Measures

This MD&A includes references to financial measures commonly used in the oil and gas industry. The terms "operating netback" (petroleum and natural gas sales less royalties, production expenses and transportation costs) and "funds flow from operations" (net loss for the period adjusted for non-cash items) are additional GAAP measures and do not have standardized meanings prescribed by GAAP and are therefore unlikely to be comparable to similar measures used by other issuer's. The closest GAAP measure to operating netback and funds flow from operations is net loss – see the reconciliation of these additional-GAAP financial measures to net loss under "Results of Operations". The Company uses these supplemental additional-GAAP measures to assist in evaluating operating performance.

Forward-looking Statements

Certain information included in this MD&A constitutes forward-looking information under applicable securities legislation. Such forward-looking information is provided for the purpose of providing information about management's current expectations and plans relating to the future. Readers are cautioned that reliance on such information may not be appropriate for other purposes, such as making investment decisions. Forward-looking information typically contains statements with words such as "anticipate", "believe", "expect", "plan", "intend", "estimate", "propose", "project", "target" or similar words suggesting future outcomes or statements regarding an outlook. Forward-looking information in this MD&A includes, but is not limited to, information with respect to: the Company's growth strategy, operational decisions and the timing thereof; and, development and exploration plans and expenditures for the Company's Turkish operations, including expenditures for the planned tight gas development in the Thrace Basin and any additional expenditures and timing associated with farm-in lands, and the funding thereof. Forward-looking information is based on a number of factors and assumptions which have been used to develop such information but which may prove to be incorrect. Although the Company believes that the expectations reflected in such forward-looking information is reasonable, undue reliance should not be placed on forward-looking information because the Company can give no assurance that such expectations will prove to be correct. In addition to other factors and assumptions which may be identified in this MD&A, assumptions have been made regarding and are implicit in, among other things: the ability of the Company to execute its strategy and close on acquisitions; the ability of the Company to obtain financing on acceptable terms; the anticipated tight gas development program in the Thrace Basin and the ability to finance future development; the ability to meet drilling deadlines and other requirements under licences and leases (including spudding deadlines under the Bostanci Licence 4985 and Karakilise License 5052); field production rates and decline rates; the ability of the Company to secure adequate product transportation; the impact of increasing competition in or near the Company's plays; the timely receipt of any required regulatory approvals, including stock exchange approvals, both domestically and internationally; continued operations of and approvals forthcoming from the General Directorate of Petroleum Affairs of the Republic of Turkey ("GDPA") in a manner consistent with past conduct; the ability of the Company to obtain qualified staff, equipment and services in a timely and cost efficient manner to develop its business; the ability of the Company to manage water production; results of future seismic programs; the Company's ability to operate the properties in a safe, efficient and effective manner; the ability to replace and expand oil and natural gas reserves through acquisition, development or exploration; the timing and costs of pipeline, storage and facility construction and expansion; future oil and natural gas prices; currency, exchange and interest rates; the state of the capital markets; the regulatory framework regarding royalties, taxes and environmental matters; the ability of the Company to successfully manage the political and economic risks inherent in pursuing oil and gas opportunities in foreign countries; and the ability of the Company to successfully market its oil and natural gas products. Readers are cautioned that the foregoing list is not exhaustive of all factors and assumptions which have been used.

Forward-looking information is based on current expectations, estimates and projections that involve a number of known and unknown risks and uncertainties which could cause actual results to differ materially from those anticipated by the Company and described in the forward-looking information. The material risk factors affecting the Company and its business are similar to those of other companies engaged in the business of exploring for and producing oil and gas, both domestically and in foreign countries. Exploration, appraisal, and development of oil and natural gas reserves are speculative activities and involve a significant degree of risk. A number of factors could cause actual results to differ materially from those anticipated by the Company including, but not limited to: risks associated with the oil and gas industry (e.g. operational risks in exploration, inherent uncertainties in interpreting geological data, and changes in plans with respect to exploration or capital expenditures, the uncertainty of estimates and projections in relation to costs and expenses, and health, safety, and environmental risks); uncertainty regarding the sustainability of initial production rates and decline rates thereafter; uncertainty regarding the ability to address technical drilling challenges and manage water production; uncertainty regarding the state of capital markets and the availability of future financings; the risk of being unable to meet drilling deadlines and the requirements under licences and leases (including Licences 4985 and 5052); the risks of disruption to operations and access to worksites, threats to security and safety of personnel and potential property damage related to political issues, terrorist attacks, insurgencies or civil unrest (particularly in the southeastern part of Turkey); the risks of increased costs and delays in timing related to protecting the safety and security of Valeura's personnel and property; the risk of commodity and BOTAS pricing and foreign exchange rate fluctuations; the uncertainty associated with negotiating with third parties in countries other than Canada; the risk of partners having different views on work programs and potential disputes among partners; the uncertainty regarding government and other approvals; potential changes in laws and regulations; risks associated with weather delays and natural disasters; and, the risk associated with international activity. See Valeura's Annual Information Form for a detailed discussion of the risk factors.

The forward-looking information contained in this MD&A is made as of the date hereof and the Company undertakes no obligation to update publicly or revise any forward-looking information, whether as a result of new information, future events or otherwise, unless required by applicable securities laws. The forward looking information contained in this MD&A is expressly qualified by this cautionary statement.

(tabular amounts in thousands of Canadian Dollars, except share or per share amounts)

Highlights and Selected Financial Information

	Three months ended		Years ended	
	December 31, 2012	December 31, 2011	**December 31, 2012**	December 31, 2011
Financial				
Petroleum and natural gas sales	**$ 5,409**	$ 7,619	**$ 24,942**	$ 16,725
Net loss	**(12,110)**	(3,406)	**(15,905)**	(15,777)
Per share, basic and diluted	**(0.21)**	(0.07)	**(0.32)**	(0.45)
Funds flow from operations[1]	**2,700**	4,085	**11,816**	2,520
Per share, basic and diluted	**$ 0.05**	$ 0.09	**$ 0.24**	$ 0.07
Production volumes				
Crude oil and NGL's (bbl/d)	**61**	56	**63**	59
Natural gas (Mcf/d)	**5,682**	10,801	**7,206**	6,192
Total (boe/d)	**1,008**	1,856	**1,264**	1,091
Sales prices				
Crude oil (per bbl)	**$ 77.98**	$ 82.64	**$ 79.75**	$ 76.42
Natural gas (per Mcf)	**9.54**	7.25	**8.77**	6.72
Total (per boe)	**58.37**	44.61	**53.93**	42.01
Capital expenditures	**$ 6,231**	$ 5,116	**$ 31,255**	$ 72,808
Net working capital surplus			**24,257**	29,419
Cash and cash equivalents			**29,031**	24,107
Weighted average shares outstanding[2]				
Basic and diluted (thousands)	**56,656**	46,406	**48,983**	34,846

Outstanding Share Data[3]

	December 31, 2012
Common shares	57,906,135
Warrants[4]	13,269,217
Stock options	3,379,000
Performance warrants	2,796,750
Diluted	77,351,102

On September 17, 2012, the Company entered into an agreement with a syndicate of underwriters to purchase, on a "bought deal" basis, 11.5 million common shares of Valeura. The public offering of common shares closed on October 10, 2012. As of the date of this MD&A, the outstanding share data has not changed.

1. Funds flow from operations is calculated as cash flow from operating activities before adjustments for decommissioning expenditures and net changes in non-cash working capital.
2. After 10:1 share consolidation effective September 15, 2011. The weighted average number of common shares outstanding is not increased for outstanding stock options and warrants when the effect is anti-dilutive.
3. After 10:1 share consolidation effective September 15, 2011.
4. The actual number of share purchase warrants outstanding is 132,692,175 which will be consolidated on a 10:1 basis only upon exercise. The number of share purchase warrants after consolidation may differ slightly due to rounding.

The Company

Valeura Energy Inc. and its subsidiaries are currently engaged in the exploration, development and production of petroleum and natural gas in Turkey and Western Canada. The Company continues to pursue a strategy of expanding internationally in Turkey and other selected countries in the region. Valeura's shares are traded on the Toronto Stock Exchange ("TSX") under the trading symbol "VLE".

Valeura has grown internationally through opportunistic acquisitions of producing assets with exploitation and exploration upside in selected countries in regions of interest which originally included the Middle East and North Africa region, the Mediterranean Basin and South America. The Company completed its first international transaction in Turkey during 2010 and has executed five other transactions since that time. The Company now holds an interest in approximately 2.0 million gross acres (0.8 million net acres) in the Thrace Basin of northwest Turkey and the Anatolian Basin of southeast Turkey. The assets in the Thrace Basin include a 40 percent interest in an established shallow gas production and marketing business and a large acreage position of approximately 1.0 million gross acres (0.5 million net acres) with exposure to a potentially significant tight gas resource play below the existing shallow gas production. The assets in the Anatolian Basin include eight exploration licences with conventional and unconventional oil potential.

Turkish Operations

Thrace Basin

Edirne Asset Acquisition

The Company closed its first acquisition in the Thrace Basin with the purchase of natural gas assets from Edirne Enerji Petrol Arama Üretim Ve Ticaret Limited Şirketi ("Edirne") on March 24, 2011 for a total cash payment of approximately $1.9 million. An affiliate of TransAtlantic Petroleum Ltd. ("TransAtlantic") is the operator of the Edirne Licence.

The Edirne Licence covers an area of 119,125 gross acres (41,694 net acres) in the Thrace Basin. Valeura acquired a 35 percent working interest in the lands and producing assets associated with the Edirne Licence. Potential exists on the Edirne Licence to carry out well workovers, compression and drilling.

The total 2012 capital program for the Edirne licence included the drilling of one successful gas well which is on production and three workovers on existing gas wells. All activities were funded by cash on hand and funds flow from operations.

TBNG-PTI Asset Acquisition

On June 8, 2011, the Company closed its second acquisition of producing natural gas assets and lands in the Thrace Basin and interests in exploration lands in the Anatolian Basin (Gaziantep area) of southeast Turkey owned by Thrace Basin Natural Gas (Turkiye) Corporation ("TBNG") and Pinnacle Turkey Inc. ("PTI") for $53.7 million (after adjustments for the period from the effective date of October 1, 2010 to June 8, 2011). This acquisition closed contemporaneously with acquisitions made by affiliates of TransAtlantic from the same vendor. All of the TBNG-PTI lands are operated by TransAtlantic.

This acquisition provided cash flow to the Company from sales of shallow gas production in the Thrace Basin, current interests in 503,633 gross acres of onshore and offshore land (172,326 net), and exposure to a potentially significant unconventional tight gas opportunity in the Thrace Basin.

The lands located in the Thrace Basin include five production leases and four exploration licences, of which one licence is entirely on land and three licences have a portion in the shallow waters (up to 200 metres water depth) of the Sea of Marmara. As part of the original acquisition, the TBNG-PTI lands included five exploration licences in the deeper waters of the Sea of Marmara (200 to 1,200 metre water depth). The Company elected, in conjunction with its joint interest partners, to relinquish these licences upon review of the farm out efforts which were unsuccessful.

Natural gas is currently produced from approximately 130 wells on the TBNG-PTI lands, all located onshore, that are completed primarily in stacked sands in the Danismen and Osmancik formations at relatively shallow depths of 500 to 1,500 metres. The gas is processed and compressed in owned facilities and is distributed in an owned pipeline network directly to commercial and end-user customers. TransAtlantic has responsibility for the marketing arrangements on behalf of the parties.

Opportunities exist on the Thrace Basin lands to continue to pursue exploration and development drilling, well workovers and wellhead compression to mitigate natural declines in existing production from conventional shallow gas reservoirs. Approximately 3,500 kilometres of legacy 2D seismic is available on the onshore lands in the Thrace Basin and an additional 413 square kilometres of 3D seismic was acquired in the second half of 2011, and fully interpreted by April 2012, to support the Company's exploration and development drilling program.

Valeura believes there is upside potential associated with applying modern technology to exploit deeper tight gas sands, particularly in the Mezardere, Teslimkoy and Kesan formations down to depths of approximately 1,800 to 3,700 metres, depending on the area. The Company has had an active program of re-entering selected existing medium-depth wells to fracture stimulate ("frac") selected sandstone units as part of a proof-of-concept exploitation program. The Company completed re-entry fracs on 24 existing wells during the period July 1, 2011 to December 31, 2012. The Company also spudded 20 wells on the TBNG-PTI lands in 2012, including 11 unconventional tight gas wells to a maximum depth of 3,755 metres. Of the 20 wells spudded in 2012, nine of these wells are currently on production, nine wells are in various stages of completion and evaluation, and two wells are dry and abandoned.

Thrace Basin Farm-ins and Other Acquisitions

On May 4, 2011, the Company completed a farm-in to earn a 100 percent working interest and operatorship of Licence 4201 owned by Marhat Marmara Boru Hatlari Ins. Muh Taahh.san.Tic.Ltd.sti. ("Marhat") (Marhat farm-in) in the Thrace Basin. The licence requires a commitment to drill two wells at a cost of approximately US$3.0 million. The Company drilled the first well, Dagdere-1, in February 2012 for a total cost of approximately US$1.4 million. The Dagdere-1 well remains suspended and after further review is not commercial to complete. For the year ended December 31, 2012, the expenditures to date of $1.6 million are charged to exploration and evaluation expense. Management has made a decision in the first quarter of 2013 to discontinue the work commitment on Licence 4201 and to relinquish the licence in advance of the next district drilling commitment in late March 2013.

On June 13, 2011, the Company completed a farm-in to earn a 50 percent working interest in licences 4094 and 4532 owned by an affiliate of TransAtlantic (TransAtlantic farm-in) in the Thrace Basin. TransAtlantic remains as the operator of these licences. The combined licences require the commitment to drill two wells and spend approximately US$3.0 million on seismic. The Company drilled the first well, Evrenbey-1, in November 2011. The Evrenbey-1 well was cased and suspended. The remaining estimated commitment is approximately US$4.5 million.

On January 16, 2012, Valeura closed the acquisition of a 24 percent non-operated working interest held by Guney Yildizi Petrol Uretim Sondaj, Muteahhitlik ve Ticaret A.S. ("GYP") in three exploration licences (3998, 3999 and 4187) in the Thrace Basin operated by Merty Energy for consideration of US$1.5 million. The Company participated in the acquisition of 186 kilometres of new 2D seismic on Licence 3999 in the third quarter of 2012 and spudded the Kavacik-1 well on this licence which was dry and abandoned. Valeura and its partners agreed to let all three licences expire under the existing arrangements over the October 2012 to January 2013 period. The Company has reapplied for Licence 3999 and 4187 with a 100 percent working interest.

Anatolian Basin

Karakilise

On November 14, 2011, the Company executed a binding letter agreement with GYP and AME which defined Valeura's working interest of 27.5 percent in the two Karakilise licences 2674 and 2677. Under the terms of the agreement, the Company agreed to fully fund the first US$1.3 million of the deepening cost of Altinakar-1 well on Licence 2674 to the primary exploration target of light oil in the Bedinan Formation. GYP is the operator of the licences. The deepening to a depth of 2,418 metres was completed in March 2012. The well was subsequently cased and produced at rates of approximately 10 to 13 barrels of oil per day ("bbl/d"). The well was frac'd in early September 2012 but it was unsuccessful in improving oil productivity on a sustained basis.

Valeura was also awarded Licence 5052 in the Karakilise area on a 100 percent interest basis in June 2012. As at December 31, 2012, the Company has 365,227 gross (189,587 net) acres of land in the Karakilise area.

The Company participated in the acquisition of 82 kilometres of new 2D seismic on Licence 2677 in the third quarter of 2012.

Gaziantep

The TBNG-PTI acquisition described above also included lands in the Gaziantep area in the Anatolian Basin. The lands include four exploration licences covering an area of 488,070 gross acres (126,898 net). In July 2012, the Company participated in re-entering a small Mardin Group heavy oil discovery at the Alibey-1 well on Licence 4607 and drilling a new horizontal sidetrack of approximately 414 metres in length within the Mardin. In December 2012, part of the horizontal section was completed near the toe of the well. The operator, TransAtlantic Petroleum, has disclosed that the initial productivity of the completed interval is approximately 150 bbl/d (gross) of heavy oil, based on swabbing results. It is expected that additional indicated porous sections in the well will also be perforated and tested in the second quarter of 2013, and the well placed on production.

Bostanci

In June 2012, Valeura was awarded Bostanci Licence 4985 on the border with Northern Iraq and Syria. The licence was part of a group of licences originally held under the AME-GYP farm-in lands. The lands expired under the previous arrangement and one of the expired licences was subsequently awarded to Valeura.

Valeura currently holds the Bostanci Licence 4985 on a 100 percent basis but under a pre-bidding arrangement, Oando Energy Resources Inc. ("Oando") has a right to a 50 percent participating interest. The transfer of a working interest to Oando requires GDPA approval. Valeura and Oando are currently working on the necessary joint venture agreements to affect this transfer and reviewing funding options to meet the licence spudding deadline of early June 2013.

The GDPA and Turkish military have approved the acquisition of a small additional 2D sesmic program of approximately 11 kilometres within a military-controlled buffer area immediately north of the border with northern Iraq. This program will complement earlier seismic acquired in the region in early 2011 and should help to better define the structural prospect which the Company believes has potential in Cretaceous, Jurassic and Triassic-aged formations down to a depth of approximately 4,300 metres.

(tabular amounts in thousands of Canadian Dollars, except share or per share amounts)

Outlook

After more than 18 months of technical evaluations, new 3D seismic acquisition, deeper drilling and an extensive proof-of-concept frac program, the Company has initiated a tight gas delineation and development program in the Tekirdag area, the first area on the TBNG-PTI lands earmarked for the transition from proof-of-concept to development. This program is expected to initially incorporate wells drilled to a depth of 1,600 to 1,800 metres through the target Teslimkoy Formation and top 200 to 300 metres of the Kesan Formation to be completed with multi-stage fracs. Ultimately, it is expected that well spacing will be reduced to approximately 40 acres per well and deeper sands in the Kesan Formation will also be exploited.

The front end of the program in the first quarter of 2013, as described above, includes several new delineation wells in early 2013 and multi-stage fracs on deep wells drilled in 2012 and early 2013 to better define the ultimate scope and design of this Tekirdag area program, which is expected to be advanced in phases and extend over a number of years.

Results of Operations

	Three months ended		Years ended	
	December 31, 2012	December 31, 2011	**December 31, 2012**	December 31, 2011
Petroleum and natural gas sales	**$ 5,409**	$ 7,619	**$ 24,942**	$ 16,725
Royalties	**(731)**	(998)	**(3,392)**	(2,114)
Production costs	**(1,073)**	(1,372)	**(4,254)**	(3,908)
Operating netback[1]	**3,605**	5,249	**17,296**	10,703
Other income	**459**	89	**780**	374
General and administrative	**(1,362)**	(2,052)	**(6,285)**	(6,593)
Transaction costs	**-**	166	**-**	(1,935)
Realized foreign exchange gain (loss)	**(2)**	(192)	**25**	(29)
Current income tax	**-**	825	**-**	
Funds flow from operations[1]	**2,700**	4,085	**11,816**	2,520
Gain on asset disposition	**-**	-	**171**	-
Non-cash expenses				
Share based compensation	**(403)**	(606)	**(1,649)**	(2,477)
Financing costs	**(138)**	(30)	**(613)**	(66)
Exploration and evaluation expense	**(12,476)**	(1,057)	**(13,606)**	(4,429)
Unrealized foreign exchange gain (loss)	**148**	(116)	**75**	(369)
Depletion and depreciation	**(1,857)**	(5,320)	**(10,459)**	(9,934)
Impairment	**(2,476)**	-	**(3,364)**	(1,610)
Deferred tax recovery (expense)	**2,392**	(362)	**1,724**	588
Net loss	**$ (12,110)**	$ (3,406)	**$ (15,905)**	$ (15,777)

[1] Non-GAAP measure – see note regarding non-GAAP measures on page 1

(tabular amounts in thousands of Canadian Dollars, except share or per share amounts)

Corporate Sales Volumes

	Three months ended		Years ended	
	December 31, 2012	December 31, 2011	**December 31, 2012**	December 31, 2011
Crude oil and NGLs (bbl/d)	**61**	56	**63**	59
Natural gas (Mcf/d)	**5,682**	10,801	**7,206**	6,192
Total (boe/d)	**1,008**	1,856	**1,264**	1,091
Turkey (boe/d)	**944**	1,771	**1,199**	974
Canada (boe/d)	**64**	85	**65**	117
Total (boe/d)	**1,008**	1,856	**1,264**	1,091

Approximately 94 percent of Valeura's total production is produced within Turkey, the majority of which is natural gas production in the Thrace Basin.

Average sales volumes of 1,008 boe/d for the three months ended December 31, 2012 were lower when compared to average sales volumes of 1,856 boe/d for the three months ended December 31, 2011 due to natural declines. Average sales volumes of 1,264 boe/d for the year ended December 31, 2012 were higher when compared to average sale volumes of 1,091 boe/d for the year ended December 31, 2011 as a result of a full years' production in 2012 from the TBNG-PTI asset acquisition in Turkey which closed on June 8, 2011.

Corporate Operating Netbacks (per boe)

	Three months ended		Years ended	
	December 31, 2012	December 31, 2011	**December 31, 2012**	December 31, 2011
Petroleum and natural gas sales	**$ 58.37**	$ 44.61	**$ 53.93**	$ 42.01
Royalties	**(7.89)**	(5.84)	**(7.33)**	(5.31)
Production costs	**(11.58)**	(8.03)	**(9.20)**	(9.82)
Operating netback	**$ 38.90**	$ 30.74	**$ 37.40**	$ 26.88

Sales Volumes and Operating Income – Turkey Operations

	Three months ended		Years ended	
	December 31, 2012	December 31, 2011	**December 31, 2012**	December 31, 2011
Natural gas (Mcf/d)	**5,541**	10,602	**7,064**	5,835
Crude oil (bbl/d)	**20**	4	**21**	1
Total (boe/d)	**944**	1,771	**1,199**	974
Operating income:				
Petroleum and natural gas sales	**$ 5,119**	$ 7,178	**$ 23,709**	$ 14,750
Royalties	**(707)**	(962)	**(3,186)**	(1,966)
Production costs	**(871)**	(1,087)	**(3,441)**	(2,617)
Operating income	**$ 3,541**	$ 5,129	**$ 17,082**	$ 10,167

(tabular amounts in thousands of Canadian Dollars, except share or per share amounts)

Operating Netbacks (per boe) – Turkey Operations

	Three months ended		Years ended	
	December 31, 2012	December 31, 2011	**December 31, 2012**	December 31, 2011
Petroleum and natural gas sales	**$ 58.96**	$ 44.05	**$ 54.07**	$ 41.50
Royalties	**(8.15)**	(5.90)	**(7.27)**	(5.53)
Production costs	**(10.04)**	(6.67)	**(7.85)**	(7.36)
Operating netback (per boe)	**$ 40.77**	$ 31.48	**$ 38.95**	$ 28.61

Pricing Information

	Three months ended		Years ended	
Average benchmark prices	**December 31, 2012**	December 31, 2011	**December 31, 2012**	December 31, 2011
Crude oil – Edmonton Light (per bbl)	**$ 83.99**	$ 97.35	**$ 86.10**	$ 95.03
Natural gas – BOTAS (per Mcf)[1]	**TL 20.12**	TL 15.19	**TL 17.94**	TL 13.71
Natural gas – BOTAS (per Mcf)	**$ 11.12**	$ 8.47	**$ 9.97**	$ 8.09
Average exchange rate (TL/CAD)	**1.8094**	1.7933	**1.7997**	1.6946
Valeura's average realized prices				
Crude oil (per bbl)	**$ 77.98**	$ 82.64	**$ 79.75**	$ 76.42
Natural gas – Turkey (per Mcf)	**$ 9.70**	$ 7.33	**$ 8.90**	$ 6.91
Natural gas – consolidated (per Mcf)	**$ 9.54**	$ 7.25	**$ 8.77**	$ 6.72

The following table shows the percentage change in Valeura's realized prices for Q4 2012 and YTD 2012 when compared with Q4 2011 and YTD 2011:

	Q4 2012	**YTD 2012**
Crude oil	-6%	4%
Natural gas	32%	31%

Natural gas prices remain much stronger in Turkey when compared to Canada. With approximately 94 percent of Valeura's current production coming from natural gas in Turkey, the Company has positioned itself to take advantage of Turkey's higher natural gas prices. Natural gas prices under sales contracts for all production in the Thrace Basin are linked to the BOTAS benchmark price in Turkish Lira. Effective April 1, 2012 and October 1, 2012 the Turkish Lira natural gas reference price increased by 20 percent and 10 percent, respectively. This has resulted in an effective Canadian dollar converted reference price of $11.12 per Mcf for Q4 2012. All natural gas sales in the Edirne field are delivered to the BOTAS pipeline and sold to a large wholesale buyer while sales on the TBNG-PTI lands are under direct sales contracts to industrial buyers in the area at prices referenced to the BOTAS benchmark price. All natural gas sales contracts in the Thrace Basin reflect a negotiated discount to the BOTAS benchmark price.

The Company's Q4 2012 average realized natural gas price in Turkey increased by 32 percent to $9.70 per Mcf from $7.33 per Mcf in the same period in 2011 due to increases in the BOTAS benchmark price effective April 1,

[1] Boru Hatlari ile Petrol Tasima Anonim Sirketi ("BOTAS") owns and operates the national crude oil pipeline grid and the national gas pipeline grid in Turkey. BOTAS regularly posts prices and its Industrial Interruptible Tariff benchmark is shown herein as a reference price. See the 2012 Annual Information Form for further discussion.

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2012 (20 percent increase) and October 1, 2012 (10 percent increase), and reduced discounts to the BOTAS benchmark price for direct sales contracts effective January 1, 2012. The strengthening of the Turkish Lira against the Canadian Dollar during Q4 2012 slightly increased the realized price in Canadian Dollars in Q4 2012 compared to the prior quarter. Current realized natural gas prices in Turkey are approximately $10 per Mcf.

Petroleum and Natural Gas Sales Revenues

	Three months ended		Years ended	
	December 31, 2012	December 31, 2011	**December 31, 2012**	December 31, 2011
Crude oil and NGLs	**$ 424**	$ 416	**$ 1,810**	$ 1,543
Natural gas	**4,985**	7,203	**23,132**	15,182
Total revenues	**$ 5,409**	$ 7,619	**$ 24,942**	$ 16,725

The composition of petroleum and natural gas sales revenues for the three months and year ended December 31, 2012 was approximately 93 percent natural gas and 7 percent crude oil and NGLs. Revenues for the three months ended December 31, 2012 decreased in comparison to the same period in 2011 due to lower volumes. The decrease in volumes was partially offset by higher natural gas prices in Turkey for 2012. Revenues increased for the year ended December 31, 2012 when compared to the same period in 2011 primarily due to the addition of natural gas production in Turkey from the TBNG-PTI asset acquisition which closed on June 8, 2011.

Royalties

	Three months ended		Years ended	
	December 31, 2012	December 31, 2011	**December 31, 2012**	December 31, 2011
Royalties	**$ 731**	$ 998	**$ 3,392**	$ 2,114
Percentage of revenue	**13.5%**	13.1%	**13.6%**	12.6%

Royalties for the three months ended December 31, 2012 decreased in comparison to the same period in 2011 as a result of lower production volumes and lower revenues. Royalties increased for the year ended December 31, 2012 when compared to the same period in 2011 primarily due to the addition of natural gas production in Turkey. Revenues in Turkey are subject to a 12.5 percent federal royalty and certain overriding royalties.

Production Costs

	Three months ended		Years ended	
	December 31, 2012	December 31, 2011	**December 31, 2012**	December 31, 2011
Production costs	**$ 1,073**	$ 1,372	**$ 4,254**	$ 3,908
$ per boe	**11.58**	8.03	**9.20**	9.82

Overall production costs were lower in the three months ended December 31, 2012 when compared to the same period in 2011 due to lower volumes. Overall production costs increased for the year ended December 31, 2012 when compared to the same period in 2011 due to the addition of production from the Thrace Basin assets in Turkey. Unit costs decreased to $9.20/boe in 2012 from $9.82/boe in 2011 as a result of the addition of lower cost natural gas operations in Turkey. For the Q4 2012 comparative to 2011, operating costs of $11.58/boe were higher than $8.03/boe in 2011 as a result of the effect of fixed costs over lower volumes.

With approximately 93 percent of Valeura's current production coming from natural gas production acquired from the TBNG-PTI and Edirne acquisitions in Turkey, the Company is benefitting from a lower cost operation. For the three months and year ended December 31, 2012, production costs in Turkey were $1.67 per Mcf ($10.04/boe) and $1.31 per Mcf ($7.85/boe) respectively.

(tabular amounts in thousands of Canadian Dollars, except share or per share amounts)

General and Administrative Expenses

	Three months ended		Years ended	
	December 31, 2012	December 31, 2011	**December 31, 2012**	December 31, 2011
General and administrative	**$ 1,394**	$ 1,923	**$ 6,433**	$ 5,609
Business development	**97**	265	**543**	1,230
Total gross general and administrative expenses	**1,491**	2,188	**6,976**	6,839
Recoveries	**(129)**	(136)	**(691)**	(246)
Total general and administrative expenses	**$ 1,362**	$ 2,052	**$ 6,285**	$ 6,593

Total general and administrative ("G&A") expenses for the three months and year ended December 31, 2012 decreased by 34 percent and 5 percent, respectively, when compared to the same periods in 2011. In 2012, engineering evaluation charges, review & audit fees, legal fees and corporate filing fees were all lower as 2012 operations were more normalized after closing the Turkish acquisition in 2011 and graduating to the TSX in Q4 2011.

Gain on asset disposition

On July 18, 2012, the Company closed a minor asset disposition and received $89,000 from a third party as payment. The gain on the sale of these assets was $71,000 including removal of decommissioning obligations of $35,000.

On April 3, 2012, the Company received $100,000 from a third party as payment for an option to farm-in on certain Saskatchewan lands prospective for helium. The entire amount received was recorded as a gain on asset disposition in Q2 2012.

Transaction Costs

In accordance with IFRS 3 – "Business Combinations", acquisition related costs or transaction costs are recognized separately from the business combination and are included as an expense in the statement of loss. For the three months and year ended December 31, 2012 transaction costs were $nil and $nil compared to $(0.2) million and $1.9 million respectively, for the same periods in 2011. Transaction costs in 2011 pertained to the Edirne and TBNG-PTI asset acquisitions.

Foreign Exchange

The Company incurred a foreign exchange gain of $146,000 and $100,000 respectively, for the three months and year ended December 31, 2012 compared to a foreign exchange loss of $308,000 and $398,000 respectively, for the three months and year ended December 31, 2011. The foreign exchange gain in 2012 is due to the strengthening of the Turkish Lira against the Canadian and United States Dollars.

The functional currency for the Company's Turkish operations is the Turkish Lira and the functional currency for the Company's Canadian operations is the Canadian Dollar. Foreign exchange gains and losses are the result of translation of accounts denominated in currencies other than the functional currencies of Valeura and its subsidiaries, and settling transactions denominated in currencies other than the functional currency of the entity.

(tabular amounts in thousands of Canadian Dollars, except share or per share amounts)

Other Income

During the three months and year ended December 31, 2012, the Company recorded other income of $459,000 and $780,000 respectively, compared to $89,000 and $374,000, for the same periods in 2011. Other income is comprised of processing fee income and interest income related to cash on hand. In 2011 other income was comprised of interest income related to cash on hand.

Income Taxes

During the three months and year ended December 31, 2012, the Company did not have any current income tax expense. Capital spending and utilization of tax pools in the fourth quarter of 2012 was sufficient to offset income earned during the quarter. The Company did not record any current income tax expense in the year ended December 31, 2011. Valeura has combined tax pools and non capital losses of $84.0 million over all its affiliated companies that can be applied to future income to reduce future income taxes.

Funds Flow from Operations

Funds flow from operations for the three months and year ended December 31, 2012 was $2.7 million and $11.8 million respectively, compared to $4.1 million and $2.5 million for the same periods in 2011. The decrease in funds flow from operations for the three months ended December 31, 2012 is the result of lower production volumes which was partially offset by increased natural gas prices in Turkey. The increase in funds flow from operations for the year ended December 31, 2012 is the result of increased production from the acquired assets in the Thrace Basin in Turkey and higher natural gas prices in Turkey.

Non-cash Expenses:

Share-based Compensation

Share-based compensation is a non-cash expense associated with the stock options and performance warrants issued to directors, officers, employees and certain other service providers of the Company.

Share-based compensation expense for the three months and year ended December 31, 2012 was $0.4 million and $1.6 million respectively, compared to $0.6 million and $2.5 million for the same periods in 2011. Performance warrants issued in 2010 attracted a higher amount of share-based compensation expense in 2011 due to accelerated amortization under IFRS.

Financing costs

	Three months ended		**Years ended**	
	December 31, 2012	December 31, 2011	**December 31, 2012**	December 31, 2011
Accretion of decommissioning obligations	**$ 138**	$ 30	**$ 613**	$ 66

Accretion of decommissioning obligations for the three months and year ended December 31, 2012 was $138,000 and $613,000 respectively, compared to $30,000 and $66,000 for the same periods in 2011. Accretion of decommissioning obligations was higher in 2012 due to the addition of new wells and facilities from the capital investment program in Turkey.

Exploration and Evaluation Expense

Exploration and evaluation ("E&E") expense consists of exploration projects that are deemed to have a lower fair value when compared to book value. E&E expense for the three months and year ended December 31, 2012 was

$12.5 million and $13.6 million respectively, compared to $1.1 million and $4.4 million for the same periods in 2011. E&E expense for 2012 includes $1.9 million of expenses for four dry and abandoned wells, $1.5 million for the expiry of three licences (3998, 3999 and 4187) which were surrendered to the GDPA, $8.6 million for the relinquishment of Licence 3734 (see below), and $1.6 million for relinquishing Licence 4201 (see below).

On September 6, 2012, an application was filed with the GDPA to carve out a production lease from the exploration Licence 3734 in the Thrace Basin. This licence was acquired as part of the TBNG-PTI lands and was in its final 3 year term as an exploration licence. On November 11, 2012, the approval of the production Lease 5122 was published and awarded to Valeura and its partners, and the remaining Licence 3734 acreage was relinquished. Upon receiving notice of the production lease award, the Company and its partners applied for an exploration licence for the relinquished Licence 3734 acreage. As at December 31, 2012 and the date of this MD&A, Valeura and its partners have not received official notification of the award of the new exploration licence despite being the only party to apply for the licence. As a result, the Company has impaired $8.6 million of capitalized costs for Licence 3734 as part of exploration and evaluation expense for the year ended December 31, 2012. Valeura, along with its partners, are confident that the award of the new exploration licence over the same lands will be made to the existing partners in 2013 and the joint venture has made provisions in the capital budget for 2013 for further drilling on these lands.

On May 4, 2011, the Company entered into a farm-in agreement to earn a 100 percent working interest in Licence 4201 ("Marhat farm-in") in the Thrace Basin. The licence required a commitment to drill two wells of which one well (Dagdere-1) was drilled in the first quarter of 2012 and upon further evaluation does not appear prospective for hydrocarbons. For the year ended December 31, 2012, the expenditures to date of $1.6 million are charged to exploration and evaluation expense. Management has made a decision in the first quarter of 2013 to discontinue the work commitment on Licence 4201 and to relinquish the licence in advance of the next district drilling commitment in late March 2013.

Depletion and Depreciation

Depletion and depreciation for the three months and year ended December 31, 2012 was $1.9 million and $10.5 million respectively, compared to $5.3 million and $9.9 million for the same periods in 2011. For the three months ended December 31, 2012 depletion and depreciation was lower when compared to the same period in 2011 due to lower total production volumes. For the year ended December 31, 2012 depletion and depreciation was higher when compared to 2011 due to the addition of production volumes from the Company's Turkish operations. Depletion is calculated on a unit-of-production basis utilizing proved plus probable reserves.

On a per unit basis, depletion and depreciation for the three months and year ended December 31, 2012 was $20.02/boe and $22.61/boe respectively, compared to $31.15/boe and $24.95/boe for the same periods in 2011. Depletion and depreciation expense for both Q4 2012 and YTD 2012 is lower on a unit-of-production basis due to the addition of proved plus probable reserves from the 2011 TBNG-PTI acquisition and reserves added by advancement of the proof-of-concept program applied to the deeper unconventional tight gas.

Impairment

Impairment for the three months and year ended December 31, 2012 was $2.5 million and $3.4 million respectively, compared to $nil and $1.6 million for the same periods in 2011. Impairment in 2012 relates to a reduction in fair value of the Canadian assets due to decreased Canadian natural gas prices in 2012 and a more pessimistic outlook for the timing of an anticipated rebound in natural gas prices. The Company has made a strategic decision to focus 100 percent of its capital in Turkey. The decline in the value of the Canadian assets is the direct result of the lack of capital invested in those assets along with the decline in commodity prices in North America.

(tabular amounts in thousands of Canadian Dollars, except share or per share amounts)

Deferred Tax

Deferred tax for the three months and year ended December 31, 2012 was a recovery of $2.4 million and $1.7 million respectively, compared to an expense of $0.4 million and a recovery of $0.6 million for the same periods in 2011. Deferred tax relates to changes in the temporary difference between the net book value and the tax basis of the assets and liabilities in the Company's Turkish operations that commenced in 2011. Although the Company is carrying a deferred tax liability, it does not expect to be cash taxable for the foreseeable future provided that capital expenditures in Turkey are not significantly reduced.

Currency Translation Adjustments

Translation of all assets and liabilities from the respective functional currencies to the reporting currency are performed using the rates prevailing at the statement of financial position date. The differences arising upon translation from the functional currency to the reporting currency are recorded as currency translation adjustments in accumulated other comprehensive income or loss ("AOCI") and are held within AOCI until a disposal or partial disposal of a subsidiary. A disposal or partial disposal will then give rise to a realized foreign exchange gain or loss which is recorded in net earnings.

Currency translation adjustments for the three months and year ended December 31, 2012 was a gain of $1.1 million and $1.8 million respectively, compared to a loss of $1.9 million and $7.6 million respectively, for the same periods in 2011 and are related to the fluctuation in value of the Turkish Lira when compared to the Canadian Dollar in the respective periods. The currency translation gain in Q4 2012 is due to the strengthening of the Turkish Lira against the Canadian dollar.

Capital Expenditures

The following summarizes the Company's capital spending:

	Three months ended		Years ended	
Turkey	**December 31, 2012**	December 31, 2011	**December 31, 2012**	December 31, 2011
Geological and geophysical	**$ 664**	$ 1,149	**$ 3,611**	$ 4,901
Land	**-**	-	**1,554**	-
Drilling and completions	**4,561**	1,631	**20,574**	7,794
Equipping	**95**	64	**478**	157
Recompletions and fractures	**901**	1,896	**4,904**	3,773
Other	**-**	4	**2**	134
Asset acquisitions	**-**	-	**-**	55,671
Turkey total	**6,221**	4,744	**31,123**	72,430
Canada total	**10**	372	**132**	378
Consolidated total	**$ 6,231**	$ 5,116	**$ 31,255**	$ 72,808

Turkey

Capital spending for 2012 was $31.3 million of which $20.6 million related to drilling and completion activities in Turkey. The Company spudded a total of 25 gross (10.125 net) wells of which 23 gross (9.59 net) wells targeted natural gas in the Thrace Basin while the remaining two gross (0.535 net) wells targeted oil in the Anatolian Basin.

Of the 23 gross natural gas wells spudded, 20 gross (8.0 net) wells were on TBNG-PTI lands, one gross (0.35 net) successful gas well was on Edirne Licence 3839, one gross (1.0 net) cased and suspended well was on Licence 4201 and one gross (0.24 net) well was dry and abandoned on Licence 3999. Of the 20 gross wells spudded on the TBNG-PTI lands nine wells have been completed and put on production; nine wells are in various stages of completion; and two wells are dry and abandoned.

Of the two gross oil wells spudded in the Anatolian Basin, one gross (0.275 net) well was on Licence 2674 (Karakilise) and one gross (0.26 net) well was on Licence 4607 (Gaziantep). The Karakilise well (Altinakar-1) is on production as an oil well and the Gaziantep well (Alibey-1) is a shut-in oil well.

A total of 32 gross (12.8 net) workovers were completed on TBNG-PTI lands and three gross (1.05 net) workovers were completed on Edirne lands. A total of 16 gross (6.4 net) re-entry fracs were completed on TBNG-PTI lands and one gross (0.275 net) re-entry frac was completed in the Anatolian Basin on Licence 2674.

Valeura drilled several key deep wells (BTD-3, Baglik-1 and Kayi-Derin-1) in 2012 that were frac'd in August 2012 (BTD-3), December 2012 (Kayi Derin-1) and January 2013 (Baglik-1) in the deeper sections of the Kesan Formation below 2,400 metres and are in various stages of clean-up and evaluation. These and several more recent drill wells (BTD-5, TDR-9, DTD-19, and TDR-14 of which BTD-5 and DTD-19 were frac'd in February 2013), are considered key catalysts in delineating the scope of the tight gas development program in the Tekirdag area. In addition, the Company drilled and frac’d the Kazanci-5 well, the first deep well in the northern part of the TBNG-PTI lands, to a total depth of 3,250 metres. The well was frac'd in late January 2013 and is in the clean-up and evaluation stage. The Company expects that the results from these deeper wells will have a significant influence on the pace of the drilling and frac program on the TBNG-PTI lands in 2013 and the associated capital budget.

Credit Facilities

On October 10, 2012, the Company opened a general credit facility in the amount of US$0.3 million with a Turkish bank for the purpose of obtaining letters of credit required by the Turkish government and certain other third parties with which Valeura conducts ongoing business. As at December 31, 2012, the Company had not drawn an amount on this credit facility. Letters of credit totaling US$0.1 million were issued in 2012 against the credit facility. The general credit facility is not secured by any of the Company’s assets, and because no amount has been drawn, no interest rate terms have been set.

On December 31, 2011, the Company had credit facilities with a Canadian chartered bank consisted of a $1.9 million revolving operating demand loan with an interest rate of bank prime plus 1.25 percent per annum and a $1.0 million development demand loan with an interest rate of bank prime plus 1.50 percent per annum. On February 22, 2012, the Company closed its Canadian credit facilities due to lack of utilization. Management continues to evaluate international bank loan facility alternatives in 2013 in conjunction with the advancement of the development of the unconventional tight gas drilling.

(tabular amounts in thousands of Canadian Dollars, except share or per share amounts)

Share Capital

Common shares	Number of Shares		Amount
Balance, December 31, 2010	19,867,713	$	46,974
Shares issued pursuant to private placement	26,538,435		80,279
Rounding due to consolidation	(13)		-
Share issuance costs	-		(5,194)
Balance, December 31, 2011	46,406,135	$	122,059
Shares issued pursuant to public offering	11,500,000		14,950
Share issuance costs	-		(1,231)
Balance, December 31, 2012	**57,906,135**	**$**	**135,778**

2011 Share Capital Transactions

On February 28, 2011, the Company completed a private placement of subscription receipts for total gross proceeds of $86.25 million. Valeura issued a total of 26,538,435 subscription receipts at a price of $3.25 per subscription receipt. The underwriters will receive a fee equal to 5 percent of the gross proceeds raised, of which 35 percent was paid at closing of the financing and the remaining amount will be paid upon satisfaction of the escrow release conditions.

Each subscription receipt represented the right to automatically receive one common share and one-half of one common share purchase warrant of the Company. Each full warrant entitles the holder thereof to acquire one common share at a price of $5.50 per common share for a period of 60 months from the closing of the offering. The Company will have the right to accelerate the expiry of the warrants to 30 days from the date of notice if the 20 day volume weighted average price of the Company's common shares on the TSX is equal to or greater than $11.00 per common share.

Effective September 15, 2011, Valeura graduated from the TSX Venture Exchange and commenced trading on the TSX. In conjunction with the TSX graduation, the Company's common shares were consolidated on a 10:1 basis upon the initiation of trading on the TSX. All the outstanding options and warrants have been adjusted accordingly to reflect the share consolidation. The actual number of share purchase warrants currently outstanding is 132,692,175 which will be consolidated on a 10:1 basis only upon exercise. The number of share purchase warrants after consolidation may differ slightly due to rounding. Each post-consolidation share purchase warrant entitles the holder to acquire one common share at a price of $5.50 per common share for a period of 60 months from the closing of the offering. The Company will have the right to accelerate the expiry of the warrants to 30 days from the date of notice if the 20 day volume weighted average price of the Company's common shares on the TSX is equal to or greater than $11.00 per common share.

2012 Financing

On October 10, 2012, the Company completed a public offering of shares for total gross proceeds of $14.95 million. Valeura issued a total of 11.5 million common shares at a price of $1.30 per share. The underwriters received a fee equal to six percent of the gross proceeds raised and total share issuance costs were $1.2 million.

(tabular amounts in thousands of Canadian Dollars, except share or per share amounts)

As at December 31, 2012 the common shares outstanding are shown below:

	December 31, 2012
Common shares	57,906,135
Share purchase warrants	13,269,217
Stock options	3,379,000
Performance warrants	2,796,750
Diluted	77,351,102

As of the date of this MD&A, Valeura has 57,906,135 common shares outstanding. In addition, Valeura has outstanding 3,379,000 options, 2,796,750 performance warrants, and 13,269,217 share purchase warrants to purchase common shares. Assuming the exercise of all options and warrants, Valeura would have 77,351,102 common shares outstanding on a diluted basis.

Liquidity, Financing and Capital Resources

	Three months ended		**Years ended**	
	December 31, 2012	December 31, 2011	**December 31, 2012**	December 31, 2011
Opening cash position	**$ 15,579**	$ 33,191	**$ 24,107**	$ 19,460
Inflow of funds				
Issuance of shares – net of share issue costs	**13,719**	(10)	**13,719**	81,056
Proceeds on asset disposition	**-**	-	**189**	-
Funds from operations	**2,700**	4,085	**11,816**	2,520
	16,419	4,075	**25,724**	83,576
Outflow of funds				
Capital expenditures	**(6,231)**	(5,116)	**(31,255)**	(72,808)
Decommissioning costs incurred	**(28)**	(2)	**(41)**	(56)
Changes in working capital and foreign exchange on cash	**3,292**	(8,041)	**10,496**	(6,065)
	(2,967)	(13,159)	**(20,800)**	(78,929)
Closing cash position	**$ 29,031**	$ 24,107	**$ 29,031**	$ 24,107

Capital Funding and Resources

As at December 31, 2012, Valeura's working capital balance was $24.3 million including a cash and cash equivalents position of $29.0 million.

The Company's cash position and funds flow from operations are the primary sources of capital for exploration and development expenditures in 2012. Valeura's opening cash position in 2012 was $24.1 million. During the year ended December 31, 2012 the Company utilized this opening cash balance, funds flow from operations of $11.8 million and a portion of the $13.7 million (net) equity financing proceeds to fund an exploration and development capital program of $31.3 million and incurred decommissioning costs of $0.04 million. The resultant cash and cash equivalents balance at December 31, 2012 is $29.0 million.

Financial Capacity

At the end of Q4 2012 the Company's working capital position was approximately $24.3 million. The combination of this working capital surplus plus estimated cash flow is expected to be sufficient to fund the Company's target capital program in 2013. The Company has considerable flexibility in how it manages its capital program given the terms of licence agreements in Turkey and the structure of its joint venture operating agreements.

Capital Management

The Company's objective is to maintain a flexible capital structure which allows it to execute its growth strategy through strategic acquisitions and expenditures on exploration and development activities while maintaining a strong financial position. The Company's capital structure includes working capital and shareholders' equity. Currently, total capital resources available include working capital and funds flow from operations.

The Company's capital expenditure includes expenditures in oil and gas activities which may or may not be successful. The Company makes adjustments to the capital structure in light of changes in economic conditions and the risk characteristics of the underlying petroleum and natural gas assets. In order to maintain or adjust the capital structure, the Company may, from time to time, issue shares, adjust its capital spending or issue debt instruments. The Company is not subject to any externally imposed capital requirements.

Valeura has not utilized bank loans or debt capital to finance capital expenditures to date. It is expected that the Company's borrowing capacity will increase with continued expansion of production and reserves in Turkey. In the future, if the Company borrows on a bank loan facility for capital expansion, the Company will monitor capital based on the ratio of net debt to annualized funds from operations or any other covenants under a potential international lending facility. This ratio represents the time period it would take to pay off the debt if no further capital expenditures were incurred and if funds from operations remained constant.

Use of Proceeds

As at the date of this MD&A, the Company has not fully utilized the proceeds from the October 10, 2012 public offering. In the short form prospectus dated October 2, 2012, the use of proceeds included a down-spacing program focusing on medium-depth tight gas development in the Tekirdag area of the Thrace Basin in Turkey with an estimated cost of $8.0 to $14.0 million. This program is proceeding at a slower pace than originally planned given the work underway on the catalyst wells in delineating the scope of the tight gas development program in the Tekirdag area as described in the Capital Expenditures section of this MD&A. However, the Company has not changed the intended use of proceeds. Valeura and its partners have access to drilling and frac services to execute the development program.

(tabular amounts in thousands of Canadian Dollars, except share or per share amounts)

Selected Quarterly Information

				Three months ended
	December 31, 2012	September 30, 2012	June 30, 2012	March 31, 2012
Total daily production (boe/d)	1,008	1,140	1,340	1,572
Average wellhead price ($/boe)	58.37	55.88	56.28	47.62
Petroleum and natural gas sales	$ 5,409	$ 5,859	$ 6,864	$ 6,810
Funds from operations	2,700	2,803	3,373	2,939
$ per share (basic and diluted)[1]	0.05	0.06	0.07	0.06
Net loss	(12,110)	(702)	(752)	(2,340)
$ per share (basic and diluted)[1]	(0.21)	(0.02)	(0.02)	(0.05)

				Three months ended
	December 31, 2011	September 30, 2011	June 30, 2011	March 31, 2011
Total daily production (boe/d)	1,856	1,635	692	156
Average wellhead price ($/boe)	44.61	38.81	43.02	40.13
Petroleum and natural gas sales	$ 7,619	$ 5,837	$ 2,707	$ 562
Funds from operations	4,085	1,983	(1,622)	(1,924)
$ per share (basic and diluted)[1]	0.09	0.04	(0.06)	(0.10)
Net loss	(3,406)	(3,749)	(4,359)	(4,262)
$ per share (basic and diluted)[1]	(0.07)	(0.08)	(0.17)	(0.21)

1. The average number of common shares outstanding is not increased for outstanding stock options and performance warrants when the effect is anti-dilutive.

Significant factors that have impacted the Company's results during the above periods include:

- Revenue is directly impacted by the Company's ability to replace existing declining production and add incremental production through its on-going capital expenditure program.
- Valeura is benefiting from higher natural gas prices and netbacks in Turkey. In Canada, the price of natural gas has been negatively impacted by an increasing supply of natural gas coming from new technology tapping into abundant supplies of tight shale gas reservoirs in North America.
- The Company acquired producing natural gas assets in the Thrace Basin in 2011 which added approximately 1,500 boe/d of production at the time. The results of operations from these assets are included in the Company's financial and operating results from the close of the acquisitions. The Company incurred significant non-recurring transactions costs totaling $1.9 million related to these acquisitions.
- With the commencement of significant drilling and production operations in Turkey in 2011, the Company has increased foreign exchange and currency translation exposure. Capital expenditures in Turkey are denominated in US Dollars and Turkish Lira and gas prices and operating expenses are denominated in Turkish Lira resulting in currency exposure on a consolidated basis. The foreign exchange gain in Q4 2012 was $0.1 million while the currency translation adjustment recorded in accumulated other comprehensive income was a gain of $1.1 million. The currency translation gain for the three months ended December 31, 2012 is the result of the strengthening of the Turkish Lira against the Canadian Dollar.
- The Company incurred an impairment charge of $3.4 million on its Canadian Grand Forks and Minor Properties CGUs and E&E expense of $13.6 million on its Turkish properties during 2012. The E&E expense consists of four dry holes drilled on the Turkish properties and the expiry of five licences which were surrendered to the GDPA.

(tabular amounts in thousands of Canadian Dollars, except share or per share amounts)

Fourth Quarter Review

During the fourth quarter, production volumes declined to 1,008 boe/d from prior quarters in 2012 as a result of delays in well completions for the key catalyst gas wells drilled in the Thrace Basin in Turkey. This resulted in funds flow from operations of $2.7 million for the quarter. Partially offsetting the drop in production was a further increase in natural gas prices in Turkey resulting in an effective gas price of $9.70 per mcf. The Company spent $6.2 million on exploration and development capital which was funded by the funds flow from operations along with the existing cash position. Net loss in the fourth quarter of $12.1 million was incurred upon recognition of $12.5 million of exploration and evaluation expense, $2.5 million of impairment expense reflecting a write down on the Canadian assets, $0.4 million of share based compensation expense and $1.9 million of depletion and depreciation expense. The exploration and evaluation expense is described above and includes $8.6 million related to relinquished Licence 3734 acreage that is currently in the application process.

Segmented Information

	Three months ended		Years ended	
	December 31, 2012	December 31, 2011	**December 31, 2012**	December 31, 2011
Petroleum and natural gas revenue				
Canada	**$ 290**	$ 441	**$ 1,233**	$ 1,975
Turkey	**5,119**	7,178	**23,709**	14,750
	5,409	7,619	**24,942**	16,725
Net loss				
Canada	**(4,235)**	(4,070)	**(10,587)**	(12,084)
Turkey	**(7,875)**	664	**(5,318)**	(3,693)
	(12,110)	(3,406)	**(15,905)**	(15,777)
Capital expenditures				
Canada	**10**	372	**132**	378
Turkey	**6,221**	4,744	**31,123**	72,430
	$ 6,231	$ 5,116	**$ 31,255**	$ 72,808
Total assets				
Canada			**25,912**	37,037
Turkey			**99,799**	83,665
			$ 125,711	$ 120,702

Commitments and Contractual Obligations

On June 13, 2011, the Company entered into a farm-in agreement to earn a 50 percent working interest in Licence 4094 and 4532 (TransAtlantic farm-in) in the Thrace Basin. The combined licences require the commitment to drill two wells and spend approximately US$3.0 million on seismic. The remaining commitment at December 31, 2012 is approximately US$4.5 million, which is comprised of one well and the seismic program.

On August 31, 2011, the Company entered into a two-year sublease agreement for office space in Calgary commencing on November 1, 2011 and expiring on October 31, 2013. The total amount committed under this sublease is approximately $425,000 which includes an estimate for operating costs over the term of the lease. The remainder of this commitment is approximately $180,000 as at December 31, 2012.

On October 26, 2012, Valeura entered into a further two-year sublease agreement for its current office space in Calgary commencing on November 1, 2013 and expiring on October 31, 2015. The total amount committed under this sublease is approximately $1.0 million, including an estimate for operating costs over the term of the lease.

(tabular amounts in thousands of Canadian Dollars, except share or per share amounts)

Selected Annual Information

			Year Ended
	December 31, 2012	December 31, 2011	December 31, 2010[1]
Petroleum and natural gas sales	$ 24,942	$ 16,725	$ 3,235
Cash provided by operations	9,837	300	(2,978)
Funds from operations	11,816	2,520	(2,779)
$ per share (basic and diluted)	0.24	0.07	(0.18)
Net loss	(15,905)	(15,776)	(11,424)
$ per share (basic and diluted)	$ (0.32)	$ (0.45)	$ (0.72)
Daily production (boe/d)	1,264	1,091	234
Sales price ($/boe)	$ 53.93	$ 42.01	$ 37.83
Total assets	125,711	120,702	38,167
Total long term liabilities	16,298	15,750	595
Net working capital (deficiency)	$ 24,257	$ 29,419	$ 19,697

1. The 2010 comparatives have been adjusted to conform to IFRS.

- The increase in petroleum and natural gas sales over the three-year period is due to the acquisition of the TBNG-PTI assets in 2011.
- Funds flow from operations in 2012 of $11.8 million was a significant improvement over the funds flow from operations for the prior years due to the acquisition of production and related funds flow from operations in Turkey.
- The net loss in 2012 was similar to prior years; increased funds flow from the acquisition of production and subsequent drilling operations in Turkey in 2012 were offset by the increased exploration and evaluation expense.
- Total assets have increased over the three-year period as a result of the acquisition of petroleum and natural gas assets in Turkey in addition to the follow up exploration and development expenditures.
- The increase in total long term liabilities over the three-year period primarily relates to deferred taxes and decommissioning obligations associated with the acquisition of assets in Turkey in 2011.
- The decrease in net working capital at year-end 2012 compared to year-end 2011 was the result of continued capital spending in Turkey which was partially offset by increased funds flow from operations and funds raised from the public offering of shares in 2012.

New Accounting Pronouncements and Critical Accounting Policies

Use of estimates and judgments

The preparation of consolidated financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the year in which the estimates are revised and in any future years affected.

Critical judgments in applying accounting policies:

The following are the critical judgments that management has made in the process of applying the Company's accounting policies and that have the most significant effect on the amounts recognized in the consolidated financial statements:

- Valeura's assets are aggregated into cash-generating units for the purpose of calculating impairment. Cash generating units ("CGU" or "CGUs") are based on an assessment of the unit's ability to generate independent cash inflows. The determination of these CGUs was based on management's judgment in regards to shared infrastructure, geographical proximity, petroleum type and similar exposure to market risk and materiality.
- Judgments are required to assess when impairment indicators exist and impairment testing is required. In determining the recoverable amount of assets, in the absence of quoted market prices, impairment tests are based on estimates of reserves, production rates, future oil and natural gas prices, future costs, discount rates, market value of land and other relevant assumptions.
- The application of the Company's accounting policy for exploration and evaluation assets requires management to make certain judgments as to future events and circumstances as to whether economic quantities of reserves have been found.
- Judgments are made by management to determine the likelihood of whether deferred income tax assets at the end of the reporting period will be realized from future taxable earnings.

Key sources of estimation uncertainty:

The following are key estimates and their assumptions made by management affecting the measurement of balances and transactions in the consolidated financial statements:

- Estimation of recoverable quantities of proven and probable reserves include estimates and assumptions regarding future commodity prices, exchange rates, discount rates and production and transportation costs for future cash flows as well as the interpretation of complex geological and geophysical models and data. Changes in reported reserves can affect the impairment of assets, the decommissioning obligations, the economic feasibility of exploration and evaluation assets and the amounts reported for depletion, depreciation and amortization of property, plant and equipment. These reserve estimates are verified by third party professional engineers, who work with information provided by the Company to establish reserve determinations in accordance with National Instrument 51-101.
- The Company estimates the decommissioning obligations for oil and natural gas wells and their associated production facilities and pipelines. In most instances, removal of assets and remediation occurs many years into the future. Amounts recorded for the decommissioning obligations and related accretion expense require assumptions regarding removal date, future environmental legislation, the extent of reclamation activities required, the engineering methodology for estimating cost, inflation estimates, future removal technologies in determining the removal cost, and the estimate of the liability specific discount rates to determine the present value of these cash flows.

- In a business combination, management makes estimates of the fair value of assets acquired and liabilities assumed which includes assessing the value of oil and gas properties based upon the estimation of recoverable quantities of proven and probable reserves being acquired.
- The Company's estimate of share-based compensation is dependent upon estimates of historic volatility and forfeiture rates.
- The deferred tax liability is based on estimates as to the timing of the reversal of temporary differences, substantively enacted tax rates and the likelihood of assets being realized.

Recent accounting standards and interpretations issued but not yet effective

The International Accounting Standards Board ("IASB") released the following new standards which are effective for fiscal years beginning January 1, 2013 with earlier adoption permitted:

- IFRS 10 – "Consolidated Financial Statements" builds on existing principles and standards and identifies the concept of control as the determining factor in whether an entity should be included in the consolidated financial statements of the parent company.
- IFRS 11 – "Joint Arrangements" establishes the principles for financial reporting by entities when they have an interest in jointly controlled operations.
- IFRS 12 – "Disclosure of Interest in Other Entities" provides the disclosure requirements for interests held in other entities including joint arrangements, associates, special purpose entities and other off balance sheet entities.
- IFRS 13 – "Fair Value Measurement" defines fair value and requires disclosure about fair value measurements.

The Company is currently assessing the impact, if any, that the adoption of these standards will have on its financial statements, and currently plans to adopt the above IFRS accounting standards effective January 1, 2013.

Disclosure Controls and Procedures and Internal Controls over Financial Reporting

The Company's President and Chief Executive Officer and Chief Financial Officer have designed, or caused to be designed under their supervision, disclosure controls and procedures ("DC&P") for Valeura. DC&P, as defined in National Instrument 52-109, *Certification of Disclosure in Issuers' Annual and Interim Filings*, are designed to provide reasonable assurance that information required to be disclosed in reports filed with, or submitted to, securities regulatory authorities is recorded, processed, summarized and reported within the time periods specified under Canadian securities law and include controls and procedures designed to ensure that information required to be so disclosed is accumulated and communicated to management, including the CEO and CFO, as appropriate, to allow timely decisions regarding required disclosure. The President and Chief Executive Officer and Chief Financial Officer of Valeura evaluated the effectiveness of the design and operation of the Company's DC&P. Based on that evaluation, the officers concluded that Valeura's DC&P were effective as at December 31, 2012.

Internal control over financial reporting ("ICFR"), as defined in National Instrument 52-109, includes those policies and procedures that: (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect transactions and dispositions of assets of the Company; (ii) are designed to provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles and that receipts and expenditures of the Company are being made in accordance with authorizations of management and Directors of the Company; and (iii) are designed to provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company's assets that could have a material effect on the consolidated financial statements.

The President and Chief Executive Officer and Chief Financial Officer are responsible for establishing and maintaining ICFR for Valeura. They have, as at the financial year ended December 31, 2012, designed ICFR, or caused it to be designed under their supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS. Under the supervision of the President and Chief Executive Officer and Chief Financial Officer, Valeura conducted an evaluation of the effectiveness of the Company's ICFR as at December 31, 2012 and concluded that as of December 31, 2012, Valeura maintained effective ICFR.

It should be noted that a control system, including the Company's disclosure and internal controls and procedures, no matter how well conceived can provide only reasonable, but not absolute assurance that the objectives of the control system will be met and it should not be expected that the disclosure and internal controls and procedures will prevent all errors or fraud.

There were no changes to Valeura's ICFR during the year ended December 31, 2012 that materially affected, or are reasonably likely to materially affect, the Company's ICFR.

Off Balance Sheet Arrangements

The Company had no off balance sheet arrangements outstanding as at December 31, 2012 other than those previously disclosed under commitments.

Financial Instruments

Financial instruments of the Company include cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities. The carrying values of the financial instruments approximate their fair values due to their relatively short periods to maturity.

Business Risks and Uncertainties

There are a number of risk factors that the Company faces as participants in the Canadian and international oil and gas industries, which are inherently risky. Certain key risk factors are discussed below:

Foreign Operations

The Company pursues operations outside of Canada. As such, the Company's operations will be subject to a number of risks over which it has no control. These risks may include risks related to economic, social or political instability or change, terrorism, hyperinflation, currency non-convertibility or instability and changes of laws affecting foreign ownership, interpretation or renegotiation of existing contracts, government participation, taxation, working conditions, rates of exchange, exchange control, exploration licensing, petroleum and export licensing and export duties as well as government control over domestic oil and gas pricing. Problems may also arise due to the quality or failure of locally obtained equipment or technical support, which could result in failure to achieve expected target dates for exploration operations or result in a requirement for greater expenditure. In addition, the Company is a non-operator on the majority of its properties in Turkey and may not always be able to reach agreement with its partners, which could negatively impact costs and timing.

The Company will operate in such a manner as to minimize and mitigate its exposure to these risks. However, there can be no assurance that the Company will be successful in protecting itself from the impact of all of these risks.

Prices, Markets and Marketing

The marketability and price of oil and natural gas that may be acquired or discovered by the Company in Turkey or Canada will be affected by numerous factors beyond its control. The Company's ability to market its natural gas may depend upon its ability to acquire space on pipelines that deliver natural gas to commercial markets. The Company may also be affected by deliverability uncertainties related to the proximity of its reserves to pipelines and processing facilities, and related to operational problems with such pipelines and facilities as well as extensive government regulation relating to price, taxes, royalties, land tenure, allowable production, the export of oil and natural gas and many other aspects of the oil and natural gas business. The Company's revenues, profitability, future growth and the carrying value of its oil and gas properties, provided such properties yield production, are substantially dependent on prevailing prices of oil and gas.

The Company's ability to borrow and to obtain additional capital on attractive terms is also substantially dependent upon oil and gas prices. Prices for oil and gas are subject to large fluctuations in response to relatively minor changes in the supply of and demand for oil and gas, market uncertainty and a variety of additional factors beyond the control of the Company. These factors include economic conditions in the United States and Canada, the actions of the Organization of Petroleum Exporting Countries ("OPEC"), governmental regulation, political stability in the Middle East and elsewhere, the foreign supply of oil and gas, the price of foreign imports and the availability of alternative fuel sources. Any substantial and extended decline in the price of oil and gas would have an adverse effect on the Company's carrying value of its proved reserves, borrowing capacity, revenues, profitability and cash flows from operations. The exchange rates between the Canadian and US Dollar and Canadian Dollar and Turkish Lira also affects the profitability of the Company.

Variations in Foreign Exchange Rates and Interest Rates

World oil and gas prices are quoted in United States dollars and the price received by Canadian producers is therefore affected by the Canadian/United States dollar exchange rate, which will fluctuate over time. In recent years, the Canadian dollar has increased materially in value against the United States dollar although the Canadian dollar has recently decreased from such levels. Material increases in the value of the Canadian dollar will negatively impact the Company's production revenues. Future Canadian/United States and Canadian/Turkish Lira exchange rates could accordingly impact the future value of the Company's reserves as determined by independent evaluators. The Company's functional currency in its subsidiary operations in Turkey is the Turkish Lira. The revenue stream will be translated into Turkish Lira from US Dollars for crude oil, is based in Turkish Lira for natural gas, and the majority of costs will be incurred in US Dollars and Turkish Lira. Increases in the value of the Turkish Lira could result in increases in the cost of operations. Decreases in the value of the Turkish Lira could result in decreases in revenue. To the extent that the Company engages in risk management activities related to foreign exchange rates, there is a credit risk associated with counterparties with which the Company may contract. Valeura continues to assess its exposure to all foreign currencies. The Company is in the process of specifically assessing its exposure to the Turkish Lira and any possibilities that may exist mitigating such exposure.

An increase in interest rates could result in a significant increase in the amount the Company may be required to pay to service debt.

Volatility of Commodity Prices

Prices for oil and natural gas fluctuate in response to changes in the supply of and demand for petroleum and natural gas, market uncertainty and a variety of additional factors that are largely beyond the Company's control. Oil prices are determined by international supply and demand. Factors which affect oil prices include the actions of OPEC, world economic conditions, government regulation, political stability throughout the world, the availability of alternative fuel sources and weather conditions. World oil prices are quoted in United States dollars and the price received by the Company is affected by the Canadian/US dollar exchange rate, which will fluctuate over time. Natural gas prices in Canada and internationally are affected by supply and demand, weather conditions and by prices of alternative sources of energy. Turkish natural gas prices are quoted in Turkish Lira and the price received by the Company is affected by the Canadian Dollar/Turkish Lira exchange rate, which fluctuates over time. Material increases in the value of the Canadian dollar may negatively impact production revenues. Such increases may also negatively impact the future value of reserves as determined by independent evaluators. In recent years, the Canadian Dollar has increased materially in value against the United States dollar. In recent months, the Canadian Dollar has appreciated in value against the Turkish Lira.

The impact on the oil and gas industry, in general, from commodity price volatility is significant. During periods of high prices, producers generate sufficient cash flows to conduct active exploration programs without external capital. Increased commodity prices frequently translate into very busy periods for service suppliers triggering premium costs for their services. Purchasing land and properties similarly increases in cost during these periods. During low commodity price periods, acquisition costs drop, as do internally generated funds to spend on exploration and development activities. With decreased demand, the prices charged by the various service suppliers also decline. This volatility causes significant variation in net production revenue for the Company from period to period. In an environment of low prices, certain wells or other projects may become uneconomic and the Company may elect not to produce from certain wells, leading to a reduction in development opportunities and the volume and value of reserves.

Volatile oil and gas prices make it difficult to estimate the acquisition value of producing properties and often cause disruption in the market for oil and gas producing properties, as buyers and sellers have difficulty agreeing on such value.

Capital Requirements

The impact on capital markets caused by investor uncertainty in the global economy has a significant impact on the Company's business model. The Company anticipates making substantial capital expenditures for the acquisition, exploration, development and production of oil and natural gas reserves in the future. There can be no assurance that debt or equity financing will be available or that cash generated by operations will be sufficient to make these expenditures. If debt or equity financing is available, it may not be on terms acceptable to the Company. Failure to obtain such financing on a timely basis could cause the Company to reduce capital spending which would result in reduced production and the potential loss of exploration licences due to a failure to meet drilling deadlines.

Third Party Credit Risk

The Company must successfully market its oil and natural gas to prospective buyers. The Company may be exposed to third party credit risk through its contractual arrangements with its current or future marketers of its oil and natural gas production. In the event such entities fail to meet their contractual obligations to the Company, such failures may have a material impact on the Company's business, financial condition, results of operations and prospects. In addition, poor credit conditions in the industry and of joint venture partners may impact a joint venture partner's willingness to participate in the Company's ongoing capital program, potentially delaying the program and the results of such program unless sole risk provisions are available under the joint venture agreements.

Exploration, Development and Production

The long-term commercial success of the Company will depend on its ability to find, acquire, develop and commercially produce oil and natural gas reserves. No assurance can be given that the Company will be able to locate satisfactory properties for acquisition or participation. Moreover, if such acquisition or participations are identified, the Company may determine that current markets, terms of acquisition and participation or pricing conditions make such acquisitions or participations uneconomic.

Future oil and gas exploration may involve unprofitable efforts, not only from dry wells, but from wells that are productive but do not produce sufficient net revenues to return a profit after drilling, operating and other costs. Completion of a well does not assure a profit on the investment or recovery of drilling, completion and operating costs. In addition, drilling hazards or environmental damage could greatly increase the cost of operations, and various field operating conditions may adversely affect the production from successful wells. These conditions include delays in obtaining governmental approvals or consents, shut-ins of wells resulting from extreme weather conditions, insufficient storage or transportation capacity or other geological and mechanical conditions. While diligent well supervision and effective maintenance operations can contribute to maximizing production rates over time, production delays and declines from normal field operating conditions cannot be eliminated and can be expected to adversely affect revenue and cash flow levels to varying degrees.

In addition, operations are subject to the risks of exploration, development and production of oil and natural gas properties, including encountering unexpected formations or pressures, premature declines of reservoirs, the invasion of water into producing formations, blow-outs, sour gas releases, fires and spills. Losses resulting from the occurrence of any of these risks could have a materially adverse effect on future results of operations, liquidity and financial condition.

The Company attempts to control operating risks by maintaining a disciplined approach to implementation of its exploration and development programs. Exploration risks are managed by hiring experienced technical professionals and by concentrating the exploration activity on specific core regions that have multi-zone potential where the Company has experience and expertise. The Company is not always able to control these risks when it is a non-operator.

Uncertainty of Reserve Estimates

The process of estimating oil and gas reserves is complex and involves a significant number of assumptions in evaluating available geological, geophysical, engineering and economic data; therefore, reserves estimates are inherently uncertain. To estimate the economically recoverable oil and natural gas reserves and related future net cash flows, many factors and assumptions are incorporated such as expected reservoir characteristics based on geological, geophysical and engineering assessments, future production rates based on historical performance and expected future operating and investment activities, future oil and gas prices and quality differentials, future development and operating costs and assumed effects of regulation by government agencies.

Properties will, over a period of time, actually deliver oil and natural gas in quantities different than originally estimated due to changes in reservoir performance. The timing of future capital expenditures is subject to uncertainty. Projected future commodity prices and the operating and capital cost structure are subject to significant management judgment and currently, highly volatile. Actions by Canadian provincial governments and foreign governments to alter their respective royalty and tax regimes may have a significant and unpredictable impact.

Environment, Health and Safety

All phases of the oil and natural gas business present environmental risks and hazards and are subject to environmental regulation pursuant to a variety of federal, provincial and local laws and regulations. In Canada and other international jurisdictions, environmental legislation provides for, among other things, restrictions and prohibitions on spills, releases or emissions of various substances produced in association with oil and natural gas operations. The legislation also requires that wells and facility sites be operated, maintained, abandoned and reclaimed to the satisfaction of applicable regulatory authorities. Compliance with such legislation can require significant expenditures and a breach of applicable environmental legislation may result in the imposition of fines and penalties, some of which may be material.

Environmental legislation is evolving in a manner expected to result in stricter standards and enforcement, larger fines and liability and potentially increased capital expenditures and operating costs. The discharge of oil, natural gas or other pollutants into the air, soil or water may give rise to liabilities to governments and third parties and may require the Company to incur costs to remedy such discharge. There are potential risks to the environment inherent in the business activities of the Company.

Management of Growth

The Company may be subject to growth-related risks including capacity constraints and pressure on its internal systems and controls. The ability of the Company to manage growth effectively will require it to continue to implement and improve its operational and financial systems and to expand, train and manage its employee base. The potential inability of the Company to deal with this growth could have a material adverse impact on its business, operations and prospects.

Insurance

The Company's involvement in the exploration for and development of oil and natural gas properties may result in the Company becoming subject to liability for pollution, blow outs, leaks of sour natural gas, property damage, personal injury or other hazards. Although the Company maintains insurance in accordance with industry standards to address certain of these risks, such insurance has limitations on liability and may not be sufficient to cover the full extent of such liabilities. In addition, such risks are not, in all circumstances, insurable or, in certain circumstances, the Company may elect not to obtain insurance to deal with specific risks due to the high premiums associated with such insurance or other reasons. The payment of any uninsured liabilities would reduce the funds available to the Company. The occurrence of a significant event that the Company is not fully insured against, or the insolvency of the insurer of such event, may have a material adverse effect on the Company's business, financial condition, results of operations and prospects.