

## ARCAN RESOURCES LTD.

### MANAGEMENT'S DISCUSSION AND ANALYSIS

#### Basis of Presentation

Arcan Resources Ltd. ("**Arcan**" or the "**Corporation**") is engaged in the exploration for, and the development and production of, petroleum and natural gas in Western Canada. Arcan was incorporated on October 9, 2003 and conducted operations as a private Corporation until January 1, 2007, maintaining a June 30 year-end. On January 1, 2007 Arcan amalgamated with Desco Energy Ltd. with the amalgamated entity's year-end established as December 31. The amalgamation resulted in Arcan becoming a public Corporation and a reporting issuer, with its shares trading on the TSX Venture Exchange under the symbol 'ARN' on January 9, 2007.

This Management's Discussion and Analysis ("**MD&A**") is an explanation, through the eyes of management, of how Arcan performed during the periods covered by the unaudited interim financial statements of Arcan filed concurrently with this MD&A, and of Arcan's financial condition and future prospects. This MD&A is for the three and six month periods ended June 30, 2010 as compared to the three and six month periods ended June 30, 2009. The MD&A complements and supplements the financial statements of Arcan. For a full understanding of the financial position and results of operations of the Corporation, the MD&A should be read in conjunction with the unaudited interim financial statements for the three and six month periods ended June 30, 2010 and 2009 together with the notes thereto as well as the audited financial statements for the year ended December 31, 2009 and 2008, together with the notes related thereto and other documents filed on SEDAR, including historical financial statements, the information circular dated April 22, 2010 relating to the Corporation's annual general and special meeting that was held on May 25, 2010 and the Corporation's annual information form dated April 22, 2010 for the year ended December 31, 2009. These documents are available at [www.sedar.com](http://www.sedar.com) under the Corporation's SEDAR profile.

The unaudited financial statements to which this MD&A relates have been prepared in accordance with Canadian Generally Accepted Accounting Principles ("**GAAP**"). In this MD&A, unless otherwise indicated, all monetary amounts disclosed herein are in Canadian dollars and all references to "\$" are to Canadian dollars.

Arcan's management is responsible for the integrity of the information contained in this report and for the consistency between the MD&A and the unaudited interim financial statements. In the preparation of these statements, estimates are necessary. Management believes these estimates have been based on careful judgments and have been properly presented. The unaudited interim financial statements have been prepared using policies and procedures established by management and fairly reflect Arcan's financial position, results of operations and funds from operations.

Arcan's board of directors and audit committee have reviewed and approved the unaudited interim financial statements and MD&A for the three and six month periods ended June 30, 2010. This MD&A is dated August 19, 2010.

Readers are advised to read the legal advisories at the end of this MD&A.

#### Non-GAAP Measurements

Readers are cautioned that this MD&A contains the term "funds from operations", which should not be considered an alternative to, or more meaningful than, "cash provided by operating activities" or "net earnings" as determined in accordance with GAAP as an indicator of Arcan's performance. Arcan also presents "funds from operations per share", whereby funds from operations are divided by the basic and diluted weighted average number of common shares outstanding to determine per share amounts. Operating and corporate netbacks are also presented. "Operating netbacks" represent Arcan's revenue,

less royalties and operating expenses, and "corporate netbacks" represent Arcan's operating netback, less realized economic hedging losses, general and administrative ("**G&A**") and interest expense, in order to determine the amount of funds generated by production. Operating and corporate netbacks have been presented on a per barrel of oil equivalent ("**boe**") basis, as well.

The measures referenced above do not have any standardized meaning prescribed by GAAP and therefore are unlikely to be comparable to similar measures presented by other companies. Management believes that funds from operations and operating and corporate netbacks are useful supplemental measures as they provide an indication of the ability of Arcan to fund future growth through capital investment and/or repay debt. These measures have been described and presented in this MD&A in order to provide shareholders and potential investors with additional information regarding Arcan's liquidity and its ability to generate funds to finance its operations. Arcan's method of calculating funds from operations may differ from that of other companies, and, accordingly, may not be comparable.

Arcan determines funds from operations as cash flow from operating activities before changes in non-cash working capital as follows:

<b>Funds from Operations</b>				
	Three Months Ended		Six Months Ended	
(\$000's)	<b>June 30, 2010</b>	June 30, 2009	<b>June 30, 2010</b>	June 30, 2009
Cash flow from operating activities (per GAAP)	<b>3,669</b>	2,102	<b>6,217</b>	3,463
Change in non-cash working capital	<b>832</b>	578	<b>1,111</b>	1,183
Funds from operations	<b>4,501</b>	2,680	<b>7,328</b>	4,646

### **Second Quarter 2010 Highlights**

- Record production of 1,943 boe per day for the three months ended June 30, 2010, up 28% from the 1,523 boe per day for the three months ended June 30, 2009 and up 32% from the 1,468 boe per day for the three months ended March 31, 2010. Production as at August 19, 2010 exceeds 3,000 boe per day with eight of 12 horizontal wells on production.
- Operating netbacks rose to \$36.31 per boe (revenue of \$62.52 per boe and operating cost of \$12.12 per boe) for the three months ended June 30, 2010 up 16% from \$31.31 per boe for the three months ended June 30, 2009 and 13% from \$32.18 per boe for the three months ended March 31, 2010.
- Funds from operations increased 68% to \$4.5 million (\$0.06 per diluted share) for the three months ended June 30, 2010 up from \$2.7 million (\$0.07 per diluted share) in the three months ended June 30, 2009 and 59% up from \$2.8 million for the three months ended March 31, 2010.
- The Corporation focused on the Swan Hills Beaverhill Lake, drilling seven (5.7 net) new horizontal wells in the three months ended June 30, 2010. As at August 19, 2010 Arcan has drilled a total of 12 (10.1 net) horizontal wells in the Swan Hills Beaverhill Lake reef.
- The Corporation completed and released details on its second, third and fourth horizontal multi-stage fractured light oil wells which each tested in excess of 500 boe per day.
- Subsequent to the end of the second quarter Arcan has tested two additional wells. These are Arcan's seventh well (15-29) 08-32-68-8W5 ("**8-32**") which tested at approximately 300 boe per day and eighth well (15-29) 09-30-68-8W5 ("**9-30**") which tested at approximately 600 boe per day.
- Arcan is currently testing the ninth well (2-17) 13-17-68-8W5 ("**13-17**") and tenth well (2-17) 6-09-68-8W5 ("**6-09**") and estimates it will be fracturing the eleventh and twelfth wells shortly.

- Arcan syndicated and increased its credit facility from \$50 million to \$70 million.
- As at August 19, 2010, Arcan has entered into financial oil contracts for a total production of 1,000 barrels per day for fiscal 2011 through collars with a \$70 floor and a \$100 ceiling.

Financial and Operating Summary	Three Months Ended		Six Months Ended	
	June 30, 2010	June 30, 2009	June 30, 2010	June 30, 2009
<b>Financials</b> (\$000s except per share amounts)				
Oil and NGL sales	10,380	6,178	18,333	11,107
Natural gas sales	676	1,031	1,714	1,833
Total petroleum and natural gas revenue	11,056	7,209	20,048	12,940
Cash flow from operating activities	3,669	2,102	6,217	3,463
Funds from operations <sup>1</sup>	4,501	2,680	7,328	4,646
Per share basic <sup>1</sup>	0.06	0.07	0.12	0.12
Per share diluted <sup>1</sup>	0.06	0.07	0.12	0.12
Net loss	(992)	(1,314)	(1,796)	(2,605)
Per share basic	(0.01)	(0.03)	(0.03)	(0.07)
Per share diluted	(0.01)	(0.03)	(0.03)	(0.07)
Capital expenditures – cash	21,240	229	92,075	3,406
Total assets	244,234	145,729	244,234	145,729
Total liabilities	85,989	59,716	85,989	59,716
Shareholders' equity	158,245	86,012	158,245	86,012
Bank loan	33,903	39,627	33,903	39,627
Net debt and working capital	57,263	40,414	57,263	40,414
<b>Operating</b>				
Production:				
Crude oil (bbls per day)	1,674	1,061	1,410	1,085
Natural gas (Mcf per day)	1,613	2,772	1,782	2,112
Total (boe per day) (6:1)	1,943	1,523	1,707	1,437
Average realized price:				
Crude oil (\$ per bbl)	68.13	63.98	71.84	56.55
Natural gas (\$ per Mcf)	4.60	4.09	5.32	4.80
Combined average (incl. processing revenue) (\$ per boe)	62.52	52.01	64.89	49.75
<b>Netback (\$ per boe)</b>				
Petroleum and natural gas sales	62.52	52.01	64.89	49.75
Royalties	14.09	9.20	15.68	9.81
Operating and transportation expenses	12.12	11.50	14.67	11.32
Operating netback	36.31	31.31	34.54	28.62
Realized economic hedging losses – cash	-	1.60	-	0.85
G&A expenses – cash	8.72	6.92	8.34	7.01
Interest expense – net	2.09	2.86	2.43	2.57
Corporate netback	25.50	19.93	23.77	18.19
<b>Common Shares</b> (000s)				
Shares outstanding, end of period	75,173	37,869	75,173	37,869
Weighted average shares <sup>2</sup> - basic	75,029	37,829	61,748	37,829
- diluted	75,029	37,829	61,748	37,829

**Notes:**

- (1) The reader is referred to the section – "Non-GAAP Measurements" in this MD&A.
- (2) In computing the net loss per diluted share in the respective periods, nil shares were added to the weighted average number of shares outstanding because they were anti-dilutive.

## Overview

Arcan's production increased throughout the second quarter 2010 as new wells were tested and brought on-stream. As at August 19, 2010, production exceeds 3,000 boe per day with eight of the 12 new horizontal wells on production. As at August 19, 2010, Arcan continues to anticipate average production over 2,500 boe per day for the year ended December 31, 2010 with an estimated exit production for this period of 3,500 to 4,000 boe per day. During the second quarter 2010 and into the third quarter Arcan experienced rain delays, however, additional new horizontal wells have now been tied in and Arcan expects to receive the impact of production gains in the balance of the third quarter 2010 and through the fourth quarter 2010. Arcan anticipates it will have all 12 of the currently drilled horizontal wells on production and tied in by the end of the third quarter 2010, maximizing production into the year ended December 31, 2010. In spite of weather delays, for the three months ended June 30, 2010 Arcan did experience a 32% production increase to 1,943 boe per day, a 13% increase in operating netbacks to \$36.31 per boe and a 59% increase in funds from operations from \$2.8 million to \$4.5 million over the three months ended March 31, 2010, relating mainly to operations in the Swan Hills area. Arcan anticipates further growth through the third quarter and into the fourth quarter 2010.

Arcan's activities in the Swan Hills Beaverhill Lake formation commenced in September 2005 and developed with vertical well technology until December 9, 2009 when Arcan spudded its first multi-stage fracture horizontal well in the Swan Hills Beaverhill Lake formation at 9-29. This well was tied into Arcan's operated production facility on February 23, 2010 and has produced an average of 406 boe per day over the last six months and as at August 19, 2010 continues to produce at approximately 300 boe per day. This well is performing better than expected and is in the centre of Arcan's implemented waterflood area. The 9-29 is Arcan's longest producing horizontal well and it has already produced over 50,000 boe to date and Arcan's second longest producer (10-27-34-67W5) has produced over 25,000 boe to date.

Arcan also completed an acquisition (the "**Acquisition**") on March 31, 2010 at a cost of \$52.8 million for 81 net sections of offsetting and contiguous lands. The Acquisition provides Arcan with over 140 net sections of land on this play. As at August 19, 2010 Arcan has drilled 12 (10.1 net) horizontal wells. Details regarding the first six wells have been previously released, wells seven and eight have recently been tested, as at August 19, 2010 wells nine and ten have commenced testing and wells eleven and twelve are expected to be fractured with testing operations completed in the third quarter 2010.

Arcan is not currently drilling any wells. After the execution of its planned drilling program Arcan has temporarily suspended drilling operations to allow completions, cash flow and well results to catch up to the drilling activity. Arcan is planning its next drilling phase and anticipates that it may drill up to 30 horizontal wells in 2011. Specifically, at this point Arcan has 20 wells ready to spud, has surveyed 30 more and is in the process of surveying a further 40 additional well locations. These efforts are expected to set up a significant drilling inventory for the remainder of the year and well into 2011. Arcan's development of 12 horizontal wells in two quarters was a significant operational success and speaks to the repeatability of the play. Each of these wells has a single 800 to 1,500 metre horizontal leg and was or will be completed using 7 to 14 multi-stage acid fractures.

To organize and implement the next step in Arcan's growth strategy, Arcan is working with its independent reserves evaluators to update the original oil in place and reserves in the Deer Mountain Unit #2 (the "**Unit**"). Arcan's published December 31, 2009 net asset value, banking facilities and reserves do not include the results of the Corporation's horizontal multi-stage fractured wells and only include 22 cents of value attributed to land and seismic values. Reserves are booked to only eight net sections of land on the Swan Hills reef out of the 140 net sections of land which Arcan controls.

Going forward, field-wide development is envisioned at three to four horizontal wells plus one vertical water injection well per section. Water injection is critical and is the key to significantly enhancing oil recovery. Offsetting production in the 24 surrounding townships over the past 50+ years of the Swan Hills Beaverhill Lake formation development has already established a recovery of approximately 40% of the original oil in place through water injection. Arcan hopes to successfully boost recovery factors further by combining waterflood applications with the new horizontal multi-stage technology. Based on various

recovery factors, economic models indicate that up to six horizontal wells per section could be supported, providing Arcan with potential production growth avenues further down the road.

As at June 30, 2010, Arcan had 13 full-time office employees and 5 full-time field employees.

## **Overview of Arcan's Core Areas**

### *Swan Hills - The Complex*

The Swan Hills complex is located in north-central Alberta, approximately 200 kilometres northwest of Edmonton. The main portion of the Swan Hills complex was discovered and developed through vertical drilling in the 1950's and 1960's. The reef complex is over 80 kilometres long covering over 24 townships of land and is recognized as having a very large accumulation of 40° API light sweet oil-in-place. The main portion of the reef has undergone extensive waterflood operations and recovered over 40% of the oil-in-place. As announced by the Alberta Government, the reef is now to be developed under CO<sub>2</sub> flood as part of its \$2 billion carbon capture and storage fund, through the Swan Hills Synfuels project. Because the Swan Hills pools hold such large volumes of original-oil-in-place, each percentage point increase in the overall recovery factor represents significant incremental production and reserves at a relatively low geological risk.

### *Swan Hills - The Land*

Arcan's land base extends over 15 miles (24 kilometres) north/south along the Swan Hills reef trend with over 50 sections of Arcan's land base have already been proven productive through vertical well control. Arcan's working interest in the Unit is currently 81%. The Unit commenced production in 1964. Unitization occurred in 1984 and the Unit has only just started primary recovery. The Unit is comprised of just over nine sections of land and is situated at the northernmost tip of Arcan's 160 (150 net) section land base which is immediately adjacent and to the south of its existing infrastructure in the Unit – making Arcan the largest undeveloped land holder on the Swan Hills Beaverhill Lake oil play. Through an understanding of the old well bores drilled into the Beaverhill Lake formation, Arcan mapped a continuous reef structure extending from the Unit through its 100% working interest lands to other producing wells to the south. Historically, the Unit wells were drilled vertically and supported by an injection well to establish long life producing injection/production pods. The application of the horizontal multi-stage fracture has significantly enhanced the production profile and pool economics. Recognizing the potential long-term viability of this asset, Arcan built a new 4,000 barrel per day battery as well as a 5,000 pounds per square inch water injection system covering the Unit.

### *Swan Hills - The Reserves*

As Arcan has drilled its horizontal multi-stage fracture wells after year-end, none of the related impact is reflected in the proved producing year-end reserve report. Furthermore, newly announced royalty regime changes are also not reflected in the December 31, 2009 year-end reserve report. Arcan estimates that additional horizontal wells could add up to \$12 million per well to Arcan's net present value and could increase Arcan's reserves after undertaking a large scale development program on its Swan Hills reef play.

To date, the Unit which covers 9.5 sections of land, has recovered approximately 3.9 million boe ("MMboe"). This amount represents approximately 10% of the original oil-in-place estimate of GLJ Petroleum Consultants Ltd. of approximately 39 MMboe or approximately four MMboe per section. Offsetting units with over 40 years of production history have proven over six MMboe of oil-in-place per section and have recovered more than 35% of their estimated original oil-in-place, and are believed capable of 45% ultimate recovery under vertical well development and waterflood. Arcan estimates oil-in-place of four to ten MMboe per section and up to a 40% recovery under waterflood. Utilizing three to six horizontal wells per section for development could translate into upwards of 600,000 boe of

recoverable reserves per well. Vertical wells drilled intermittently across the land base combined with geological mapping increases Arcan's confidence in its development program.

#### *Swan Hills - The Drilling*

Arcan has completed the drilling of 12 (10.1 net) wells. All of these wells were drilled to a vertical depth of 2,450 metres into the Beaverhill Lake carbonate reservoir with one single horizontal leg per well. Each of these wells are then completed using 7 to 14 separate, 40 to 60 cubic metre 28% hydrochloric acid fracture stimulation treatments.

Arcan recently completed and tested its well number seven 8-32 at over 300 (250 net) boe per day and well number eight 9-30 at approximately 600 (480 net) boe per day. The 8-32 well was drilled with only 840 metres of horizontal leg and completed using only a 7 stage fracture. This well was drilled to accomplish more efficient drainage on untapped acreage as well as allowing Arcan to replace three vertical producers (which required replacement of bottomhole submersible pumps), with one more prolific horizontal producer, achieving a rate which was anticipated by Arcan's current reservoir modeling. The 8-32 well was drilled near Arcan's most prolific vertical wells in the north half of Section 32 which to date has the highest recovery factor and vertical well density in the Unit.

As at August 19, 2010, nine wells have been drilled with approximately 1,000 metre legs and three wells (well number eight 9-30, well number nine 13-17 and well number ten 6-09) have been drilled with approximately 1,500 metre legs. Arcan will continue to evaluate and adjust drilling, length, and completion technologies. Adjustments include recognizing that a 1,000 metre leg attracts a 5% royalty for the first 80,000 barrels and a 1,500 metre leg has a 5% royalty for the first 90,000 barrels, translating into approximately \$500,000 in incremental royalty savings for an additional few days of drilling and a few additional fractures.

Arcan has fractured and commenced testing well number nine 13-17 and well number ten 6-09 (100% working interest) and expects to release those details once they become available. Arcan anticipates it will fracture well number eleven 11-17 and well number twelve 2-30 shortly. Arcan has drilled a total of 10 horizontal wells within the Unit lands and anticipates it could drill a total of 20 wells on those lands. Arcan has now drilled and completed two horizontal wells on its 140 net sections of undeveloped lands which extend over 25 kilometres to the south of the Unit.

Eleven of the 12 wells currently drilled are in the area where Arcan already has existing operated pipelines, roads, water injection and facilities in place to accommodate 4,000 barrels per day with expected room for expansion to 8,000 barrels per day. The horizontal drilling and multi-stage fracture completion capital along with associated equipment and tie-in costs is expected to be approximately \$4.7 million per well, before royalty incentives of approximately \$0.7 million per well. Arcan anticipates that it will develop the land base utilizing three to four horizontal producing wells per section plus one or two injectors. Arcan has received approval to inject over fracture pressure in several wells within the Unit allowing voidage replacement to be maintained.

Arcan's internal economic analysis shows a 10 to 12 month payout and an estimated one year cumulative production number of 70,000 to 100,000 boe and potential ultimate recovery of 400,000 to 600,000 boe per well resulting in a rate of return of 125% to 200% per well. Results and economic analysis indicate an estimated average production rate over that first year to be approximately 200 to 300 boe per day. This estimated production rate at the end of the first year is anticipated to have an arrested decline in subsequent years due to the reservoir pressure maintenance from the existing or anticipated waterflood activities. These estimates are based upon the current horizontal production data, over 30 years of vertical well production and waterflood history from the Unit and as well as adjacent Swan Hills Beaverhill Lake production which historically has shown very low production declines over a 30 to 40 year reserve life index.

Well ID#	Well	Surface Location (R8-W5)	Spud Date	Well Test Date	Days on Production	Initial Test Rate (boepd)	Average From Inception (boepd) <sup>(1)</sup>	Current Production (boepd) <sup>(1)</sup>
1	09-29	12-29-68	Dec 2009	Feb. 23, 2010	133	600	406	300
2	10-27	05-34-67	Feb 2010	May 9, 2010	86	700	300	185
3	01-17	10-17-68	Mar 2010	June 14, 2010	43	500	254	380
4	08-30	10-29-68	Mar 2010	June 22, 2010	28	550	301	370
5	05-28	10-29-68	Apr 2010	July 8, 2010	35	500	350	300
6	06-20	10-17-68	Apr 2010	July 8, 2010	24	600	387	440
7	08-32	15-29-68	Mar 2010	Aug. 8, 2010	6	300	291	280
8	09-30	15-29-68	Apr 2010	Aug. 8, 2010	20	600	293	330
9	13-17	02-17-68	May 2010	Testing	-	-	-	-
10	06-09	02-17-68	June 2010	Testing	-	-	-	-
11	11-17	12-20-68	June 2010	Drilled	-	-	-	-
12	02-30	12-20-68	July 2010	Drilled	-	-	-	-

**Note:**

(1) Production calculations are computed as production divided by hours producing, days are computed as hours on production divided by 24. The volumes are presented on a gross interest basis. Arcan owns a 100% interest in wells number 2 and 10 and an 81% interest in the remaining wells.

**Hamburg, Alberta**

Arcan discovered the Hamburg GG oil pool in February 2006, and is the operator and owns a 50.25% working interest in the pool. These wells are prolific, producing 41° API sweet oil. Arcan enhanced its water injection in the pool in March of 2010 by converting a third well to an injector and adding a free water knock-out. Production from this pool will remain limited until the pool has been re-pressured through water injection. Arcan currently has two to four infill development opportunities to drill in the Hamburg GG pool and will evaluate this program as economic conditions warrant with longer-term plans for additional exploration tests that have been selected based on 3D seismic.

**McLeod, Alberta**

McLeod is a multi-zone liquids rich gas prone area and Arcan has interests in five (3.9 net) natural gas wells in this area. These wells are producing approximately 400 thousand cubic feet ("Mcf") per day net, or approximately 70 boe per day, which continues to decline normally. Arcan has reduced capital allocations to this area for a number of years as natural gas prices have remained weak compared to oil. Arcan will continue to evaluate opportunities for growth in the area.

**Summary of Quarterly Operating and Financial Results for the Eight Most Recent Quarters**

Fiscal quarter ended	2010		2009				2008	
	June	March	Dec.	Sept.	June	March	Dec.	Sept.
<b>Operating</b>								
Oil and NGLs (barrels per day)	1,674	1,142	1,001	913	1,061	1,110	1,102	1,087
Price (\$/bbl)	68.13	77.35	73.80	70.18	63.98	49.36	63.55	118.63
Natural gas (Mcf per day)	1,613	1,951	2,105	2,166	2,772	1,444	2,199	2,144
Price (\$/Mcf)	4.60	5.91	5.20	3.27	4.09	6.17	8.19	9.26
Barrels of oil equivalent (boe per day)	1,943	1,468	1,352	1,274	1,523	1,350	1,468	1,444
<b>Financial (\$000's, except per share amounts)</b>								
<b>Revenues</b>								
Petroleum and natural gas	11,056	8,992	7,804	6,546	7,209	5,731	8,099	13,690
Royalties	(2,491)	(2,352)	(2,554)	(2,010)	(1,275)	(1,277)	(1,881)	(3,681)
Interest and other income	-	3	1	-	2	1	(220)	207
Realized loss on commodity contracts	-	-	(737)	(481)	(222)	-	-	-
Unrealized gain (loss) on commodity contracts	-	-	531	1,228	(1,115)	(644)	-	-
Net revenues	8,565	6,643	5,045	5,283	4,599	3,810	5,998	10,216
<b>Expenses</b>								
Operating	2,143	2,388	2,672	2,465	1,593	1,352	2,416	2,482
General and administrative	1,542	1,034	788	1,063	959	863	1,086	672
Stock-based compensation	1,124	438	391	166	193	193	337	159
Interest	370	382	380	494	398	272	291	311
Accretion	194	108	103	104	105	101	99	88
Depletion and depreciation	4,139	3,219	2,795	2,680	3,098	2,720	3,036	3,553
Total expenses	9,512	7,569	7,130	6,972	6,346	5,501	7,265	7,265
Income (loss) before income taxes	(947)	(926)	(2,085)	(1,689)	(1,747)	(1,690)	(1,269)	2,951
Future income tax expense (reduction)	44	(122)	(354)	(281)	(433)	(400)	(495)	806
Net income (loss)	(991)	(804)	(1,730)	(1,408)	(1,314)	(1,290)	(772)	2,145
Net income (loss) per share- basic	(0.01)	(0.02)	(0.04)	(0.04)	(0.03)	(0.03)	(0.02)	0.06
Net income (loss) per share- diluted	(0.01)	(0.02)	(0.04)	(0.04)	(0.03)	(0.03)	(0.02)	0.05
Funds from operations	4,501	2,826	667	32	2,680	1,966	1,987	6,747
Per share – basic and diluted	0.06	0.06	0.02	0.00	0.07	0.05	0.05	0.18
Cash flow from (used in) operating activities (per GAAP)	3,669	2,548	(371)	1,235	2,102	1,361	4,590	7,150
<b>Operating Netbacks (\$/boe)</b>								
Petroleum and natural gas revenues	62.52	68.07	62.74	55.85	52.01	47.16	59.95	103.03
Royalties	14.09	17.81	20.53	17.15	9.20	10.51	13.93	27.71
Operating and transportation expenses	12.12	18.08	21.48	21.03	11.50	11.12	17.88	18.68
Operating Netbacks	36.31	32.18	20.73	17.67	31.31	25.53	28.15	56.64
<b>Total assets (\$000's)</b>	<b>244,234</b>	<b>227,067</b>	<b>151,251</b>	<b>146,130</b>	<b>145,729</b>	<b>150,398</b>	<b>149,724</b>	<b>143,006</b>
<b>Capital expended (\$000's)</b>	<b>21,240</b>	<b>70,835</b>	<b>4,979</b>	<b>3,111</b>	<b>229</b>	<b>3,177</b>	<b>9,980</b>	<b>11,323</b>
<b>Debt and working capital (\$000's)</b>	<b>(57,263)</b>	<b>(40,908)</b>	<b>(34,779)</b>	<b>(42,622)</b>	<b>(40,414)</b>	<b>(42,073)</b>	<b>(40,406)</b>	<b>(32,412)</b>
<b>Shares (000's)</b>	<b>75,173</b>	<b>74,928</b>	<b>47,940</b>	<b>37,869</b>	<b>37,869</b>	<b>37,869</b>	<b>37,869</b>	<b>37,869</b>

## Results of Operations

Arcan invested \$21.3 million of capital in the second quarter of 2010, primarily in the Swan Hills horizontal drilling program.

### Drilling

	Drilling		Success rate (%) (gross)	Working interest (%)
	Gross	Net		
Q1 / 2010	4	2.8	75	70
Q2 / 2010	7	5.7	100	81

In the second quarter of 2010, Arcan drilled seven gross (5.7 net) wells. All of these seven wells were horizontal oil wells drilled in the Swan Hills Beaverhill Lake reef play.

Production						
	Three Months Ended			Six Months Ended		
	June 30, 2010	June 30, 2009	Change (%)	June 30, 2010	June 30, 2009	Change (%)
Oil and NGL (bbls per day)	1,674	1,061	58	1,410	1,085	30
Natural gas (Mcf per day)	1,613	2,772	(42)	1,782	2,112	(16)
Total (boe per day)	1,943	1,523	28	1,707	1,437	19
Oil as a % of total volumes	86	70	-	83	76	-

Arcan's average production rate for the second quarter of 2010 was 1,943 boe per day, a 28% increase from the second quarter of 2009 average of 1,523 boe per day and a 32% increase over the first quarter 2009 average of 1,468 boe per day. Oil production increases in the three and six month periods ended June 30, 2010 more than offset natural gas declines, as compared to the three and six month periods ended June 30, 2009. Arcan's average production rate for the first half of 2010 was 1,707 boe per day, a 19% increase from the first half of 2009 average of 1,437 boe per day. Production was higher in the 2010 periods over the 2009 periods due to volumes acquired in the Acquisition and production from the new horizontal wells more than offsetting vertical well shut-ins in the Swan Hills area. Volumes of approximately 400 boe per day acquired in the Acquisition were included commencing April 1, 2010.

Arcan's capital expenditures continue to be focused towards its Swan Hills Beaverhill Lake light oil reef as oil prices have remained stable and elevated compared to natural gas prices. Year to date capital expenditures continue to be focused towards Arcan's oil properties as oil prices have continued to remain stable and elevated as compared to natural gas prices. Arcan expects the majority of its efforts for the remainder of 2010 will be directed to expanding the Swan Hills light oil production base and water injection. Arcan's oil and natural gas liquids ("**NGLs**") weighting was 86% for the second quarter of 2010, and it is estimated to be 80 to 90% light oil in the last half of 2010 as the new horizontal oil wells and the Acquisition expand Arcan's oil production rates. Arcan estimates the average production rate for the third quarter of 2010 to be 2,500 to 2,800 boe per day.

### Netbacks

The Corporation considers corporate netbacks to be an indication of ability to produce oil and natural gas profitably to earn a return on capital invested and is one of Arcan's three sources of funding (the others being raising debt and equity). Commodity price increases of 20% and volume increases of 28% were the main factors causing the 63% gain in corporate netbacks for the second quarter of 2010 over the second quarter of 2009. While Arcan expects commodity price fluctuations over the upcoming year, overall oil price levels are expected to remain relatively stable at \$70 to \$90 per barrel, royalty rates are

expected to decrease as royalty rate reductions by the Province of Alberta become effective January 1, 2011 and due to the new well incentive program that provides for a five percent royalty cap on up to 100,000 barrels of production per well. Operating costs are also expected to be reduced to the \$8 to \$12 per boe range based on higher volumes covering fixed costs and economies of scale. Arcan estimates that at a \$70 oil price less the five percent royalty of \$4 and a \$12 operating cost the new horizontal wells are contributing \$54 per barrel to netbacks. These factors, as well as Arcan's growing oil production, are expected to increase the netbacks received by Arcan for the balance of 2010.

<b>Netbacks</b>						
	Three Months Ended			Six Months Ended		
<b>\$ thousands</b>	<b>June 30, 2010</b>	June 30, 2009	Change (%)	<b>June 30, 2010</b>	June 30, 2009	Change (%)
Revenue	<b>11,056</b>	7,209	53	<b>20,048</b>	12,940	55
Royalties	<b>2,491</b>	1,275	95	<b>4,844</b>	2,552	90
Operating expenses	<b>2,143</b>	1,593	35	<b>4,531</b>	2,945	54
<b>Operating netbacks</b>	<b>6,422</b>	4,341	48	<b>10,673</b>	7,443	43
Realized economic hedging loss	-	222	-	-	222	-
G&A - cash	<b>1,542</b>	959	61	<b>2,577</b>	1,822	41
Interest expenses - net	<b>370</b>	396	(7)	<b>749</b>	669	12
<b>Corporate netbacks</b>	<b>4,510</b>	2,764	63	<b>7,347</b>	4,730	55
<b>Netbacks - \$ per boe</b>						
Revenue	<b>62.52</b>	52.01	20	<b>64.89</b>	49.75	30
Royalties	<b>14.09</b>	9.20	53	<b>15.68</b>	9.81	60
Operating expenses	<b>12.12</b>	11.50	5	<b>14.67</b>	11.32	30
<b>Operating netbacks</b>	<b>36.31</b>	31.31	16	<b>34.54</b>	28.62	21
Realized economic hedging loss	-	1.60	-	-	0.85	-
G&A - cash	<b>8.72</b>	6.92	26	<b>8.34</b>	7.01	19
Interest expenses	<b>2.09</b>	2.86	(27)	<b>2.43</b>	2.57	(5)
<b>Corporate netbacks</b>	<b>25.50</b>	19.93	28	<b>23.77</b>	18.19	31

Arcan's operating netback, defined as sales revenue, less royalties and operating expenses, was \$6.4 million in the second quarter of 2010, a 48% percent increase from \$4.3 million recorded in the second quarter of 2009 and a 51% increase over the \$4.3 million in the first quarter ended March 31, 2010 mainly due to increases in volumes. Arcan's operating netback on a per boe basis was \$36.31 in the second quarter of 2010, a 16% percent increase from \$31.31 per boe recorded in the second quarter of 2009. The increase in operating netback was due to a 20% increase in price that more than offset increases in royalties and operating costs on a per boe basis in the second quarter of 2010 as compared to the same period in 2009. Arcan's operating netback on a per boe basis was 13% percent higher than the \$32.18 per boe recorded in the first quarter of 2010. The increase in operating netback over the first quarter of 2010 was due a 33% reduction in operating costs and a 21% reduction in royalties only partially offset by an eight percent decrease in price.

Arcan's operating netback for the first half of 2010 was \$10.7 million, a 43% percent increase from \$7.4 million recorded in the first half of 2009 mainly due to increases in prices and volumes. Arcan's operating netback on a per boe basis was \$34.54 in the first half of 2010, a 21% percent increase from \$28.62 per boe recorded in the first half of 2009. The increase in operating netback was due to a 30% increase in price combined with a 19% increase in volumes in the first half of 2010 as compared to the same period in 2009. The impact of price increases has been moderated by the rising Canadian dollar versus the decreasing U.S. dollar in 2010. The move to oil weighting has significantly increased Arcan's exposure to price upside in oil both in 2010 and in 2009. The net effect to Arcan was higher netbacks from oil than would have been achieved through natural gas as natural gas prices continue to wane below \$30 per boe.

Operating netbacks from oil were \$37.59 per boe and natural gas were \$14.82 per boe in the second quarter of 2010 versus \$35.57 per boe for oil and \$14.63 per boe for natural gas in the second quarter of

2009. Operating netbacks from oil were \$35.75 per boe and natural gas were \$19.26 per boe in the first half of 2010 versus \$31.21 per boe for oil and \$6.72 per boe for natural gas in the first half of 2009. Operating netbacks from oil were \$33.26 per boe and natural gas were \$22.69 per boe during the first quarter ended March 31, 2010. Arcan's oil netbacks were stronger than natural gas netbacks for all periods mainly due to commodity pricing.

Arcan's corporate netback, defined as operating netback, less realized economic hedging gains and losses, G&A and interest (income less expense), was \$4.5 million in the second quarter of 2010 compared to \$2.8 million in the second quarter of 2009. The large increase from 2009 related mainly to commodity prices and volume increases. On a per boe basis, the corporate netback was \$25.50 per boe in the second quarter of 2010 compared to \$19.93 per boe in the second quarter of 2009 and \$21.48 per boe in the first quarter of 2010. Changes in netbacks and the components thereof are detailed by category in the above table.

Operation details by area for the three months ended June 30, 2010 and 2009 are as follows:

<b>Operating Netbacks by Area</b>						
Area	Three months ended June 30, 2010			Three months ended June 30, 2009		
	Hamburg	Swan Hills	McLeod	Hamburg	Swan Hills	McLeod
Daily Production (boe)	<b>537</b>	<b>1,316</b>	<b>90</b>	805	627	88
Revenue (\$ per boe)	<b>59.24</b>	<b>66.05</b>	<b>31.56</b>	45.32	63.98	30.06
Royalties (\$ per boe)	<b>20.43</b>	<b>12.13</b>	<b>4.96</b>	5.03	15.49	(8.72)
Operating Costs (\$ per boe)	<b>10.59</b>	<b>11.77</b>	<b>11.77</b>	7.45	9.42	53.40
Operating Netbacks (\$ per boe)	<b>28.23</b>	<b>41.41</b>	<b>14.82</b>	32.84	39.07	(14.63)

Arcan has mainly focused on its oil properties from early in 2008 through into 2010 as netbacks from its oil properties continue to outpace natural gas netbacks. On a year to date basis, production from Hamburg is 595 boe per day, McLeod is 103 boe per day and the Swan Hills is 1,008 boe per day, reducing (15%) and increasing 3% and 59%, respectively over the same period in 2009.

## Revenues

Arcan posted higher production revenues for the quarter ended June 30, 2010 versus the same quarter in 2009. The 28% increase in production volumes and 20% increase in price resulted in an increase in revenue of 53% to \$11.1 million in the second quarter of 2010 from the \$7.2 million recorded in the second quarter of 2009 and was up from the \$9.0 million in the first quarter of 2010. Year to date 2010 production revenues were higher versus the same period in 2009. The 19% increase in production volumes and 30% increase in price resulted in increased revenue of 55% to \$20.0 million in the first half of 2010 from the \$12.9 million recorded in the first half of 2009.

<b>Revenue and Realized Prices</b>						
	Three Months Ended			Six Months Ended		
(\$000's)	<b>June 30, 2010</b>	June 30, 2009	Change (%)	<b>June 30, 2010</b>	June 30, 2009	Change (%)
Oil and NGL	<b>10,380</b>	6,178	68	<b>18,333</b>	11,107	65
Natural gas	<b>676</b>	1,031	(35)	<b>1,714</b>	1,833	(6)
Total petroleum and natural gas revenue	<b>11,056</b>	7,209	53	<b>20,048</b>	12,940	55
<b>\$ per boe</b>						
Oil and NGL (per boe)	<b>68.13</b>	63.98	6	<b>71.84</b>	56.55	27
Natural gas (per Mcf)	<b>4.60</b>	4.09	13	<b>5.32</b>	4.80	11
Total petroleum and natural gas revenue (per boe)	<b>62.52</b>	52.01	20	<b>64.89</b>	49.75	30
<b>Benchmarks</b>						
WTI (U.S.\$ per bbl)	<b>77.88</b>	59.69	30	<b>78.36</b>	51.57	52
Edmonton Light Sweet (\$Cdn. per bbl)	<b>75.12</b>	66.11	14	<b>77.78</b>	58.25	34
Alberta Plant Gate (per Mcf)	<b>3.77</b>	3.30	14	<b>4.28</b>	4.05	6
Cdn\$ per U.S.\$	<b>.9725</b>	.8579	13	<b>.9671</b>	.8312	16

### Commodity Prices

In the second quarter of 2010, Arcan realized average revenue per boe of \$62.52 as compared to \$52.01 per boe recorded in the second quarter of 2009 and \$68.07 per boe in the first quarter of 2010. Arcan realized an average of \$68.13 per barrel of oil and NGL in the second quarter of 2010, an increase of 6% from the \$63.98 per barrel realized in the second quarter of 2009 but down from the \$77.35 per barrel received in the first quarter of 2010. Arcan does truck the oil emulsion from each new well to a third party facility while the well is cleaning up, receiving a lower price through this clean-up period as the oil is mixed with drilling contaminants. After drilling contaminants have been produced and trucked away, Arcan ties in the well and processes the clean oil through its own facility, receiving higher pricing. This lower pricing period from the new wells is blended into the quarterly pricing Arcan received compared to an average Edmonton Light Sweet price of \$75.12 per barrel in the second quarter of 2010. Oil and NGL prices received by the Corporation moved consistent with benchmark prices for the relative periods. The Corporation realized an average natural gas price of \$4.60 per Mcf in the second quarter of 2010, a 13% increase from the \$4.09 per Mcf averaged in the second quarter of 2009 and a decrease from the \$5.91 per Mcf received in the first quarter of 2010. This is consistent with the price changes at the Alberta Plant gate for the same periods.

In the first half of 2010, Arcan realized average revenue per boe of \$64.89 compared to \$49.75 per boe recorded in the first half of 2009. Arcan realized an average of \$71.84 per barrel of oil and NGL in the first half of 2010, an increase of 27% from the \$56.55 per barrel realized in the first half of 2009. This compares to an average Edmonton Light Sweet price of \$77.78 per barrel in the first half of 2010. Oil and NGL prices received by the Corporation moved consistent with benchmark prices for the relative periods. The Corporation realized an average natural gas price of \$5.32 per Mcf in the first half of 2010, an 11% increase from the \$4.80 per Mcf averaged in the first half of 2009. This is consistent with the price changes at the Alberta Plant gate for the same periods.

Arcan continues to receive a premium for its heat content on natural gas. Arcan anticipates oil prices will remain above U.S.\$60.00 WTI and that gas prices may remain soft through the fall of 2010 at current levels, and recover to the \$5.00 to \$7.00 per Mcf over the winter period. The strength in commodity prices has been mitigated somewhat by the strength in the Canadian dollar in 2010 as US WTI moved up 30% from the second quarter of 2009 to the second quarter of 2010, whereas Edmonton oil only gained 14% with the balance due to the dollar gaining 13% over that same period. Based on anticipated production volumes Arcan expects to post higher revenues for the balance of 2010 over the first half if WTI pricing exceeds \$70.00 per barrel based on anticipated production volumes for the balance of 2010. Pricing is expected to average approximately the same in the second half of 2010 as the first half, based on current market conditions.

All of Arcan's production for 2010 has been sold on the spot market. Arcan had no hedged volumes during the quarter ended June 30, 2010. In July of 2010, the Corporation entered into two costless collar financial oil contracts. The contracts are each for 500 barrels per day of oil with a floor price of \$70.00 per barrel Canadian and a ceiling price of \$100.05 and \$100.30 per barrel Canadian, respectively. Both contracts are for the period from January 1, 2011 to December 31, 2011. For the period from April 1, 2009 to December 31, 2009 Arcan had an economic hedge of 500 barrels per day of oil at a fixed price of \$64.40 per barrel.

## Royalties

Royalty expense in the second quarter of 2010 was \$2.5 million or 23% of revenue, compared to \$1.3 million or 18% of revenue in the second quarter of 2009, and was \$2.4 million or 26% of revenue in the first quarter of 2010. Royalty expense in the first half of 2010 was \$4.8 million or 24% of revenue, compared to \$2.6 million or 20% of revenue in the first half of 2009. Royalty rates fluctuate both based on the price of oil and gas and based on well production levels. On January 1, 2009 the Province of Alberta implemented the New Royalty Framework ("NRF") which increased Arcan's royalties to a maximum of 50% of revenue. On May 27, 2010 the Province of Alberta reduced the maximum royalty for oil to 40% of revenue effective January 1, 2011. As part of these modifications a new well incentive program was implemented allowing for 5% royalties on up to 100,000 barrels of production per well, or over \$2 million in royalty reductions per well.

Royalties have increased on a percentage of revenue, gross dollar and on a per boe basis over the second quarter of 2009 and first half of 2009 relative periods due mainly to the higher royalty rates applicable under the NRF for higher production volumes and prices. Royalties are higher on a dollar basis over the first quarter of 2010 due to higher volumes but are slightly lower on a percentage of revenue basis as the new horizontal oil wells only have a 5% royalty rate. Arcan anticipates royalties will be blended lower on a percentage of revenue basis as more new horizontal wells are on production and after January 1, 2011 when rates on older wells are reduced.

The impact of royalties enacted by December 31, 2009 has been factored into Arcan's reserves estimates and credit facilities and such calculations do not include the significant royalty reductions enacted May 27, 2010. Based on fluctuating commodity prices, production rates, drilling profiles and fluctuating modifications to the NRF it is challenging to predict future royalty rates. Accordingly, Arcan anticipates its royalty rates for 2010 to be 20% to 30% depending on production volumes, prices and possible future royalty changes.

As part of the change in royalties in the past few years the Province of Alberta implemented a drilling credit whereby drilling new wells can create royalty credits that are recorded as a reduction to capital costs and are capped at 50% of royalties paid. Depending on production volumes and commodity prices, Arcan anticipates that it will be in a position to drill 12 to 18 horizontal wells so as to maximize its drilling credits of approximately \$10 million by the end of the first quarter of 2011.

<b>Royalties</b>						
	Three Months Ended			Six Months Ended		
	<b>June 30, 2010</b>	June 30, 2009	Change (%)	<b>June 30, 2010</b>	June 30, 2009	Change (%)
Total (\$000s)	<b>2,491</b>	1,275	95	<b>4,844</b>	2,552	90
% of revenue	<b>23</b>	18	28	<b>24</b>	20	20
Per boe (\$)	<b>14.09</b>	9.20	53	<b>15.68</b>	9.81	60

## Operating Expenses (including transportation)

Operating expenses in the second quarter of 2010 decreased to \$12.12 per boe from the first quarter of 2010 of \$18.08 per boe but were higher than the \$11.50 per boe recorded in the second quarter of 2009. Operating costs have decreased from the first quarter on a per boe basis as winter operations are normally relatively more expensive than warmer weather operations. Total operating expenses in the

second quarter of 2010 were \$2.1 million, up 35% from \$1.6 million in the second quarter of 2009 and down from the \$2.4 million in the first quarter of 2010. Higher costs, primarily in the first quarter, more than offset higher production volumes in the first half of 2010 resulting in an increase in per boe operating costs of 30% to \$14.67 per boe of production from the \$11.32 per boe recorded in the first half of 2009. Total operating expenses in the first half of 2010 were \$4.5 million, up 54% from \$2.9 million in the first half of 2009 mainly as a result of elevated costs in the last few quarters of Arcan from the preparation of the Swan Hills property for the multi-stage horizontal drilling activity and related water injection, as well as water handling costs in the first quarter at Hamburg.

Arcan's operating expenses have increased since 2006 due to the Corporation's move toward oil-weighted production. Arcan's continued transition towards oil-weighted production from horizontal wells, including costs to operate the enhanced recovery, is anticipated to result in \$8 to \$12 per boe average operating costs per unit of production. Arcan expects that per boe operating expenses will decrease in the second half of 2010 as production volumes increase. Cost reductions are also anticipated as a result of the new free water knock out in Hamburg and in the prolific nature of the Swan Hills horizontal wells.

<b>Operating Expenses (including transportation)</b>						
	Three Months Ended			Six Months Ended		
	<b>June 30, 2010</b>	June 30, 2009	Change (%)	<b>June 30, 2010</b>	June 30, 2009	Change (%)
Total (\$000s)	<b>2,143</b>	1,593	35	<b>4,531</b>	2,945	54
Per boe (\$)	<b>12.12</b>	11.50	5	<b>14.67</b>	11.32	30

#### **Realized and Unrealized Loss on Commodity Contracts and Financial Instruments**

Periodically Arcan utilizes economic hedges to protect a portion of its cash flows. In July of 2010, the Corporation entered into two costless collar financial oil contracts. The contracts are each for 500 barrels per day of oil with a floor price of \$70.00 per barrel Canadian and a ceiling price of \$100.05 and \$100.30 per barrel Canadian, respectively. Both contracts are for the period from January 1, 2011 to December 31, 2011. As the contracts were entered into after the second quarter no realized loss or unrealized gain or loss was recorded for the quarter ended June 30, 2010. Arcan anticipates that these contracts will be marked-to-market at the end of each quarter with realized or unrealized gain or losses, if any, recorded in the statement of operations for each reporting period. Arcan had no production hedged in 2010 prior to July 2010.

In March 2009, Arcan entered into a fixed price oil swap contract to receive \$64.40 per barrel in exchange for Canadian dollar WTI on oil production of 500 barrels per day for the period from April 1, 2009 to December 31, 2009. The realized loss was \$0.2 million and the unrealized loss on commodity contracts was \$1.8 million at June 30, 2009. In 2009 Arcan had marked-to-market the fixed price swap and recorded gains and losses to the statement of operations for each reporting period. Arcan had a total realized loss of \$1.4 million in 2009 related to this hedge. No amounts have been realized in 2010.

<b>Realized and Unrealized Losses on Commodity Contracts</b>						
	Three Months Ended			Six Months Ended		
	<b>June 30, 2010</b>	June 30, 2009	Change (%)	<b>June 30, 2010</b>	June 30, 2009	Change (%)
Realized loss (\$000's)	-	222	-	-	222	-
Per boe (\$)	-	1.60	-	-	0.85	-
Unrealized loss (\$000's)	-	1,115	-	-	1,759	-
Per boe (\$)	-	8.04	-	-	6.76	-

#### **Cash General and Administrative ("Cash G&A")**

Cash G&A expenses for the second quarter of 2010 increased on a per boe basis to \$8.72 per boe from \$6.92 per boe in the second quarter of 2009 and increased from \$7.83 per boe in the first quarter of 2010.

The change year over year for the second quarter periods, on a per boe basis, resulted from a 61% cost increase offset somewhat by a large increase in recoveries associated with higher capital expenditure activities. Total Cash G&A expenses for the second quarter of 2010, net of recoveries of \$0.2 million, were \$1.5 million, compared to \$1.0 million in the second quarter of 2009 after recoveries of \$0.1 million. In the first quarter of 2010, Cash G&A was \$1.0 million net of recoveries of \$0.2 million. Arcan had 18 full-time employees as at June 30, 2010 as compared to 22 as at June 30, 2009. Cash G&A expenses for the first half of 2010 increased on a per boe basis to \$8.34 per boe from \$7.01 per boe in the first half of 2009. Cash G&A totalled \$2.6 million in the first half of 2010 versus the \$1.8 million for the first half of 2009. The change year over year for the periods, was largely the result of a \$0.3 million charge from a third party firm in the first quarter Arcan had hired to determine potential avenues of debt financing for the Acquisition should the equity issuance prove unsuccessful. Also, Arcan paid \$0.5 million in bank fees with respect to the new \$70 million syndicated credit facility. Cash G&A expense per boe is forecast to be elevated in the third quarter of 2010 to accommodate the \$0.8 million in total bonuses paid out during the quarter, offset somewhat on a boe basis based on higher anticipated volumes.

Total Cash G&A for three months ended June 30, 2010 of \$1.5 million was mainly comprised of wages of \$0.5 million, bank fees of \$0.5 million, legal fees of \$0.1 million and rent of \$0.1 million.

Arcan does not capitalize any Cash G&A expenses. In its role as operator of its oil and natural gas properties, the standard industry operating agreements provide for the charging of certain administrative costs to its joint venture capital expenditure programs and well operations. Arcan expects Cash G&A costs to grow marginally as Arcan continues to increase activity levels; however, per boe numbers should decline as production volumes increase.

<b>G&amp;A Expenses</b>						
	Three Months Ended			Six Months Ended		
	<b>June 30, 2010</b>	June 30, 2009	Change (%)	<b>June 30, 2010</b>	June 30, 2009	Change (%)
Total (\$000s boe)	<b>1,542</b>	959	61	<b>2,577</b>	1,822	41
Per boe (\$)	<b>8.72</b>	6.92	26	<b>8.34</b>	7.01	19

### Interest Expense

Interest expense in the second quarter of 2010 was \$0.4 million or \$2.09 per boe as compared to \$0.4 million or \$2.87 per boe in the second quarter of 2009 and \$2.87 per boe in the first quarter of 2010. Interest expense in the first half of 2009 was \$0.7 million or \$2.44 per boe as compared to \$0.7 million or \$2.58 per boe in the first half of 2009. The reduction on interest expense was due to the decrease in bank debt levels from \$39.6 million at June 30, 2009 to \$33.9 million at June 30, 2010 and reduced interest rates. Arcan's management has increased debt and working capital deficit levels based on operational success. Arcan forecasts that the debt to annualized second quarter 2010 cash flow ratio of 3.2 to one will be elevated in the third quarter due to drilling capital. Arcan estimates that interest expense will increase as higher debt levels are maintained and interest rates increase. Arcan had an effective interest rate of 4.75% on its debt facility at June 30, 2010 and 2009.

Based on Arcan's assets, the Corporation's Credit Facility was increased from \$50 million to \$70 million in May 2010. Subsequent to the end of the second quarter of 2010, Arcan has continued to increase its draws on its Credit Facility and expects to carry bank debt as required as part of routine operations on an ongoing basis.

<b>Interest Expense, Net</b>						
	Three Months Ended			Six Months Ended		
	<b>June 30, 2010</b>	June 30, 2009	Change (%)	<b>June 30, 2010</b>	June 30, 2009	Change (%)
Total (\$000s)	<b>370</b>	398	(7)	<b>749</b>	670	12
Per boe (\$)	<b>2.09</b>	2.87	(27)	<b>2.44</b>	2.58	(5)

## Funds from Operations

Funds from operations increased by 68% in the second quarter of 2010 to \$4.5 million from \$2.7 million in the second quarter of 2009, mainly due to volume and commodity price increases, and were up from \$2.8 million in the first quarter of 2010, mainly on volume increases. On a diluted per share basis, funds from operations decreased to \$0.06 in the second quarter of 2010 from \$0.07 in the same period of 2009. Funds from operations increased by 58% in the first half of 2010 to \$7.3 million from \$4.6 million in the first half of 2009, mainly due to volume and commodity price increases. On a diluted per share basis, funds from operations were consistent at \$0.12 in the first half of 2010 and in the first half of 2009.

Arcan's method of calculating funds from operations may differ from that of other companies, and, accordingly, may not be comparable. Arcan determines funds from operations as cash flow from operating activities before changes in non-cash working capital as follows:

Funds from Operations						
(\$000's except per share and per boe)	Three Months Ended			Six Months Ended		
	June 30, 2010	June 30, 2009	Change (%)	June 30, 2010	June 30, 2009	Change (%)
Cash flow from operating activities (per GAAP)	3,669	2,102	75	6,217	3,463	80
Change in non-cash working capital	832	578	44	1,111	1,183	(6)
Funds from operations	4,501	2,680	68	7,328	4,646	58
Per share (\$)	0.06	0.07	(14)	0.12	0.12	-
Per share – diluted (\$)	0.06	0.07	(14)	0.12	0.12	-
Per boe (\$ Corporate netbacks less reclamation costs)	25.46	19.33	32	23.72	17.86	33

Funds from operations per share is calculated using the weighted average basic and diluted shares used in calculating earnings per share.

## Stock-Based Compensation

Arcan recorded stock-based compensation expense of \$1.1 million in the second quarter of 2010 or \$6.36 per boe, calculated using the Black-Scholes option-pricing model. There was a significant increase in expense over the second quarter of 2009 and the first quarter of 2010 as Arcan granted 2.9 million options on April 1, 2010 at an exercise price of \$4.20 per share and had not granted any options in the second quarter of 2009 or first quarter of 2010. These newly granted options have vesting terms with one-third of the options vesting on each of the first three anniversary dates and expire after five years. These options had a calculated value of \$3.06 per share based on the Black-Scholes option-pricing model. Changes to the various periods are as a result of inputs for calculations, varied amounts of option grants as well as relative numbers of options vesting during the periods. The elevated stock-based compensation expense related to these new options will be recorded quarterly over the next three years.

Stock-based compensation expense is a non-cash expense, which represents the estimated fair value of performance and other stock options granted to employees as a motivational incentive. Arcan expects stock-based compensation expense to increase as new options are issued, but decrease on a per unit basis as volumes increase. No stock-based compensation is capitalized.

Stock-Based Compensation Expense						
	Three Months Ended			Six Months Ended		
	June 30, 2010	June 30, 2009	Change (%)	June 30, 2010	June 30, 2009	Change (%)
Total (\$000's)	1,124	193	482	1,562	386	305
Per boe (\$)	6.36	1.39	356	5.06	1.48	241

## Depletion, Depreciation and Accretion ("DD&A")

Depletion and depreciation are calculated based upon capital expenditures, production rates and reserves. Arcan recorded \$4.1 million or \$23.41 per boe in depletion and depreciation expense in the second quarter of 2010 based on production volumes of 176,838 boe. The 5% increase in depletion expense per boe as compared to the second quarter of 2009 is primarily the result of the Acquisition and estimated reserves recognized in 2010. Depletion per boe was down slightly over the first quarter of 2010, where Arcan recorded \$25.18 per boe. Arcan recorded \$7.4 million or \$23.82 per boe in depletion and depreciation expense in the first half of 2010 based on production volumes of 308,924 boe. The 6% increase in depletion expense per boe in the first half of 2010 as compared to the first half of 2009 is primarily the result of the Acquisition and changes in reserves estimated in 2010. The Corporation plans to decrease the depletion per boe amount in future years by adding reserves through an effective exploration and development program.

The Corporation excluded from its depletion and depreciation calculation costs associated with undeveloped land and seismic of \$23.3 million and included future development costs of \$27.6 million.

Arcan uses the asset retirement obligation method to record the present value of estimated clean-up and restoration costs for all of its facilities, including well sites and pipelines. The liability amount is decreased each reporting period due to the passage of time and the amount of accretion is charged to earnings in the period. Arcan recorded \$1.10 per boe of accretion expense in the second quarter of 2010, an increase from \$0.76 per boe in the second quarter of 2009 as a result of higher accumulating obligations in 2010 compared to 2009. Arcan recorded \$0.98 per boe of accretion expense in the first half of 2010, an increase from \$0.79 per boe in the first half of 2009 as a result of higher accumulating obligations in 2010 compared to 2009. The estimated clean-up costs related to the properties in the Acquisition accounted for the majority of the change to the asset retirement obligation of \$10.1 million at June 30, 2010 from \$5.4 million at December 31, 2009.

<b>Depletion, Depreciation and Accretion Expense</b>						
	Three Months Ended			Six Months Ended		
(\$000's except per boe)	<b>June 30, 2010</b>	June 30, 2009	Change (%)	<b>June 30, 2010</b>	June 30, 2009	Change (%)
Depletion and depreciation	<b>4,139</b>	3,098	34	<b>7,357</b>	5,818	26
Per boe (\$)	<b>23.41</b>	22.35	5	<b>23.82</b>	22.37	6

## Income and Other Taxes

A future tax expense of approximately \$0.1 million has been recognized in the financial statements for the second quarter of 2010, which relates to the Corporation experiencing a pre-tax loss of \$1.0 million for the quarter which included non-deductible stock based compensation of \$1.1 million. This differs from the second quarter of 2009 comparative period when pre-tax loss of \$1.7 million was recorded. A future tax reduction of approximately \$0.1 million has been recognized in the financial statements for the first half of 2010, which relates to the Corporation experiencing a pre-tax loss of \$1.9 million for the first half of 2010. In the first half of 2009 comparative period a pre-tax loss of approximately \$3.4 million was recognized and a future tax reduction of \$0.8 million was recorded. The Corporation also recorded a first quarter 2010 future tax asset of \$1.1 million on the tax effect of the share issue costs and a future tax liability of \$0.4 million on the tax effect of the flow-through shares issued in 2009. The provision for income taxes differs from the amount obtained by applying the combined federal and provincial income tax rate for 2010, which was 28.0% to pre-tax income due to non-deductible stock-based compensation and future tax rate differences.

As at June 30, 2010 the Corporation has approximately \$0.8 million in flow-through obligations outstanding.

Arcan has not paid any cash taxes since inception and estimates it has approximately \$200 million in tax pools. With capital spending in 2010 and reduced commodity prices, Arcan does not expect to be in a taxable position until 2012 at the earliest. However, Arcan is not able to forecast future possible changes in federal and provincial tax regimes.

<b>Tax Expense (Reduction)</b>						
	Three Months Ended			Six Months Ended		
	<b>June 30, 2010</b>	June 30, 2009	Change (%)	<b>June 30, 2010</b>	June 30, 2009	Change (%)
Total (\$000's)	<b>44</b>	(433)	(110)	<b>(78)</b>	(833)	(91)
Per boe (\$)	<b>0.25</b>	(3.13)	(108)	<b>(0.25)</b>	(3.20)	(92)

### Net Income (Loss)

The net loss for the second quarter of 2010 was \$1.0 million or \$0.01 per basic and diluted share, down from the \$1.3 million net loss in the second quarter of 2009. The net loss for the first half of 2010 was \$1.8 million or \$0.03 per basic and diluted share, down from the \$2.6 million net loss in the first half of 2009. The improvement in operating netbacks was the primary contributor to these changes.

<b>Net Income (Loss)</b>						
	Three Months Ended			Six Months Ended		
(\$000's except per boe)	<b>June 30, 2010</b>	June 30, 2009	Change (%)	<b>June 30, 2010</b>	<b>June 30, 2009</b>	Change (%)
Total	<b>(992)</b>	(1,314)	25	<b>(1,796)</b>	<b>(2,604)</b>	31
Per share - basic	<b>(0.01)</b>	(0.03)	67	<b>(0.03)</b>	<b>(0.07)</b>	58
- diluted	<b>(0.01)</b>	(0.03)	67	<b>(0.03)</b>	<b>(0.07)</b>	58
Per boe (\$)	<b>(5.61)</b>	(9.48)	41	<b>(5.81)</b>	<b>(10.01)</b>	42

### Capital Expenditures

The second quarter of 2010 was focused mainly in the Swan Hills area. Capital expenditures for the second quarter of 2010 were \$21.3 million. This was up materially from the \$0.2 million spent in the second quarter of 2009. The capital program consisted of drilling seven (5.7 net) horizontal wells in the Swan Hills Beaverhill lake reef play. Year to date in 2010 capital expenditures were \$92.1 million which included the \$52.8 million spent in respect of the Acquisition.

### Capital Expenditure Summary

(\$ millions)	<b>Q2 2010</b>	Q1 2010	<b>YTD June 30, 2010</b>
Land and seismic	<b>0.5</b>	4.3	<b>4.8</b>
Acquisitions	<b>1.0</b>	52.8	<b>53.8</b>
Drilling and intangibles	<b>16.2</b>	9.0	<b>25.2</b>
Facilities and equipment	<b>3.6</b>	4.7	<b>8.3</b>
<b>Total Capital – cash expended</b>	<b>21.3</b>	70.8	<b>92.1</b>

Property, plant and equipment on the balance sheet in the financial statements increased to \$229.5 million at June 30, 2010 from \$140.3 million at the end of 2009. This change reflects the increased capital expended of \$96.5 million (including \$4.4 million of asset retirement obligations) reduced by DD&A expense of \$7.4 million.

### Liquidity and Capital Resources

Arcan incurred \$21.3 million on capital expenditures during the second quarter ended June 30, 2010 and generated \$4.5 million in funds from operations, up significantly from \$0.2 million in capital expenditures and the \$2.7 million in funds from operations generated during the second quarter ended June 30, 2009. Arcan expended \$92.1 million on the Acquisition and capital during the first half ended June 30, 2010 and generated \$7.3 million in funds from operations in the first half of 2010, up significantly from \$3.4 million in

capital expenditures and the \$4.6 million in funds from operations generated during the first half ended June 30, 2009.

At June 30, 2010 Arcan had borrowed \$33.9 million from its credit facility and had a working capital deficit including bank debt of \$57.3 million as at June 30, 2010. With its current asset base Arcan estimates that it has the ability to generate short-term and long-term cash flow to meet obligations as they become due. Arcan increased bank debt and working capital deficit levels from the \$34.8 million at December 31, 2009 through increased capital expenditures while the Acquisition was partially offset by the issuance of equity. Arcan's second quarter 2010 annualized funds from operations to net debt was 3.2 to one. The ratio is expected to decrease to under 3:1 by the end of 2010.

In May 2010 Arcan entered into an agreement for a \$70 million syndicated credit facility (the "**Credit Facility**"). The Credit Facility consists of a \$60 million syndicated revolving credit facility and a \$10 million revolving operating facility. The Credit Facility is syndicated between two banks and replaced Arcan's \$50 million credit facilities. The Credit Facility has a revolving period of 364 days from the closing date, extendible annually. If not extended, the Credit Facility will automatically convert to a one year non-revolving term loan. This Credit Facility has been reflected in the Balance Sheet in the quarter, now classifying the bank loan as long term, out of current liabilities. The Credit Facility is secured by a charge on all of Arcan's assets. The Credit Facility includes customary positive and negative covenants by Arcan in favour of the lenders.

On March 24, 2010 Arcan issued 26 million subscription receipts at \$2.50 per subscription receipt for gross proceeds of \$65.0 million. Each subscription receipt entitled the holder to receive, without payment of additional consideration, one common share of Arcan on the exercise or deemed exercise of the subscription receipt. All of the subscription receipts were exercised on March 31, 2010. The proceeds of this equity deal were primarily used to fund the Acquisition (at a cost of \$52.8 million) with the balance applied to Arcan's capital program.

Arcan was previously engaged in a substantial capital expenditure program to develop its one natural gas and two core oil properties. Arcan anticipates that future capital requirements will be funded through a combination of internal cash flow, debt and/or equity financing.

Arcan estimates that it will have capital expended in excess of cash flow in the second half of 2010 and Arcan expects to be in a net debt position of \$35 to \$70 million throughout 2010. Arcan estimates that after completing eight wells by the end of the third quarter of 2010, Arcan will be able to drill approximately one additional horizontal well per month inside of its existing cash flow base and will evaluate expanding its drilling activities based on expanding its credit facilities and reserves going into the fourth quarter. Arcan estimates that as of August 19, 2010 it is near the maximum \$70 million available to it under its Credit Facility. The Credit Facility will be reviewed after an updated reserve report is completed.

Arcan expects its capital expenditure program to be significantly higher in 2010 than in 2009 and anticipates the expenditures to be financed through its Credit Facility and available funds from operations. Additional equity may be available later in 2010 if the condition of the equity markets permit; however, the Corporation does not forecast requiring this cash inflow to complete its capital program. The capital program can be curtailed with no fixed commitments to ensure management of net debt levels.

Arcan would need to engage in a substantial capital expenditure program to develop its core oil and natural gas properties to their full potential. Arcan anticipates that future capital requirements will be funded through a combination of internal cash flow, debt and equity financing. There is no assurance that debt or equity financing will be available on terms acceptable to the Corporation to meet its capital requirements. To support its cash flow, Arcan purchased two costless collar financial oil contracts. The contracts are each for 500 barrels per day of oil with a floor price of \$70.00 per barrel Canadian and a ceiling price of \$100.05 and \$100.30 per barrel Canadian, respectively. Both contracts are for the period from January 1, 2011 to December 31, 2011.

The components of Arcan's working capital deficiency are as follows:

(\$ 000's)	Quarter Ended June 2010	Quarter Ended June 2009	Quarter Ended December 2009
Current assets	14,783	8,184	10,947
Less:			
Accounts payable and accrued liabilities	38,143	7,212	17,140
Bank loan	33,903	39,627	28,586
Fair value of commodity contracts	-	1,759	-
Working capital (deficiency)	<b>(57,263)</b>	(40,414)	(34,779)

The change in current assets and accounts payable reflect the higher activity levels incurred since the end of 2009. The change to the classification of the bank loan to long term in the first quarter of 2010 from current liabilities on the balance sheet in the financial statements reflects the change in nature of the Credit Facility from the previous revolving loan. The increase in working capital deficiency from year end reflects the increased capital expenditures and the Acquisition partially offset by the issuance of equity.

### Related Party Transactions

In conjunction with the equity issuance by way of short form prospectus during the three months ended March 31, 2010, certain officers and directors acquired 68,000 common shares at \$2.50 per share.

In conjunction with the equity issuance by way of short form prospectus during the year ended December 31, 2009, certain officers and directors acquired 340,000 common shares at \$1.25 per share.

A share purchase loan of \$100,000 (2009 - \$100,000) is due from an officer of Arcan for the purchase of 40,000 common shares at a price of \$2.50 per common share. This loan is repayable, with interest calculated at the "Prescribed Rate" as determined by the Canada Revenue Agency, currently 1%, on or before April 3, 2012. This loan is secured by the underlying common shares.

### Contractual Obligations

The Corporation has previously entered into, or is involved in, farm-in and/or farm-out agreements in the normal course of its business in 2010. As of the date of this MD&A, Arcan has no farm-in and/or farm-out commitments.

Arcan has the following commitments:

- (a) Future minimum lease payments relating to operating lease commitments are:

	\$
2010	119,250
2011	244,125
2012	249,750
2013	249,750
2014	249,750
2015 and thereafter	374,625

- (b) As a requirement of a sublease for office premises, Arcan had provided a letter of guarantee in favour of the lessor for a three year period on a declining basis. The remaining amount is:

	\$
March 2010 to February 2011	60,000

## Off-Balance Sheet Obligations

There were no off-balance sheet obligations at June 30, 2010.

## Outstanding Share Data

Arcan's issued and outstanding share capital consists of the following:

	August 19, 2010	Quarter Ended June 30, 2010	Year Ended December 2009
Common shares	75,270,904	75,172,904	47,940,060
Warrants	200,500	248,500	586,631
Performance options	-	-	750,000
Stock options	7,303,167	7,313,167	4,671,166

Significant variations in share data and shareholders' equity from the year end of 2009 include the 26 million common shares issued as part of the Acquisition, the exercise of 750,000 performance options and the 2.9 million options granted on April 1, 2010.

Other than the 750,000 performance options exercised by officers of the Corporation and the subsequent sale of 250,000 shares by one of those officers, none of the officers or directors of Arcan at June 30, 2010 exercised any stock options or sold any shares of Arcan during the year to date ended June 30, 2010, the year ended December 31, 2009 or during the period ended the date hereof.

## Outlook

The repeatable application of the horizontal multi-stage acid fracture wells to the Swan Hills Beaverhill Lake formation is changing Arcan's asset base. The Acquisition and drilling, combined with water injection are expected to generate significantly increased production, recoveries, reserves and net asset value. With investments in infrastructure already in place, Arcan now looks to continue to use its deep development inventory to increase net asset value per share through horizontal multi-stage acid fracture wells in the Swan Hills Beaverhill Lake formation. Arcan's first round of drilling focused on its Deer Mountain Unit #2 lands. Arcan's plans for 2010 and 2011 include:

- increasing productive capacity at the battery and expanding its existing water injection scheme, expansion of drilling horizontal multi-stage fracture wells in the Swan Hills Beaverhill Lake formation on its 140 net sections of land outside of the Deer Mountain Unit #2 lands, building a road and pipeline system to connect production from the southern lands to existing infrastructure and tying in flared gas;
- continuing development and water injection in the Hamburg GG pool; and
- ongoing review of opportunities in the McLeod area.

Arcan plans to continue developing strategies to best exploit its land base over the long term. In the short term, Arcan intends to complete and commence production on the 12 horizontal wells drilled to date in the Swan Hills Beaverhill Lake area, as well as drill additional horizontal wells using its existing debt and cash flow capabilities by the end of the year ended December 31, 2010. Management believes that the Corporation's strengths include over \$200 million of tax pools, a strong slate of directors, experienced staff, excess productive capacity for tie in, recently initiated and growing waterfloods, new drilling plans and significant growth potential.

## Business Risks

Arcan is engaged in the business of exploration, development, production and acquisition of crude oil and natural gas. This business has many risks that even a combination of knowledge, experience and careful

evaluation may not be able to overcome. These risks may cause Arcan's actual performance and financial results in future periods to differ materially from any estimates or projections of future performance or results expressed or implied by forward-looking information in this MD&A.

Arcan's principal business risks are related to finding and developing economic hydrocarbon reserves efficiently and its ability to fund the capital expenditure program. Without the ongoing addition of new oil and natural gas reserves, any existing reserves Arcan has, and the production therefrom, will decline over time as the existing reserves are produced. A future increase in Arcan's reserves will depend not only on its ability to explore and develop any properties it has, but also on its ability to acquire suitable producing properties or prospects. No assurance can be given that further commercial quantities of oil and natural gas will be discovered or acquired by Arcan.

In addition to the risks outlined above with respect to commodity prices, financial risks associated with the petroleum industry include fluctuations in interest rates, and currency exchange rates. Arcan may use hedging instruments to manage these risks at the direction and under the supervision of the Board of Directors. Operational risks include competition, environmental factors, reservoir performance uncertainties, a complex regulatory and taxation environment and safety concerns.

The supply of service and production equipment at competitive prices is critical to the ability to add reserves at a competitive cost and produce the reserves in an economic and timely fashion. In periods of increased activity, these services and supplies can become difficult to obtain. Arcan attempts to mitigate this risk by developing strong long-term relationships with suppliers and contractors, and by maintaining an appropriate inventory of production equipment.

Arcan's longest producing Swan Hills horizontal well has been on since February 23, 2010. This limited time frame for data creates risks for unexpected production profiles. Arcan has confidence that it can, due to production history through vertical well control, mitigate some of this operational risk.

Arcan attempts to manage its business risks. Arcan has an experienced, talented, and highly motivated staff of oil and natural gas professionals. Arcan also operates almost all of its properties. This enables Arcan to control the timing, direction and costs related to exploration and development opportunities. Arcan's geological focus is on areas in which the prospects are well understood by management. Technological tools are regularly used to reduce risk and increase the probability of success. Arcan closely follows all government regulations and has an up-to-date emergency response plan that has been communicated to field operations by management. Arcan also carries insurance coverage to attempt to minimize potential losses.

### **Application of Critical Accounting Estimates**

For a full understanding of the Corporation's critical accounting estimates the MD&A should be read in conjunction with the audited financial statements for the years ended December 31, 2009 and 2008, together with the notes related thereto and the MD&A for the years ended December 31, 2009 and 2008.

### **Future Accounting Policies**

#### *International Financial Reporting Standards*

Effective January 1, 2011, Canadian public companies are required to adopt International Financial Reporting Standards ("**IFRS**"). In the time leading up to the conversion date, some existing Canadian standards will change to converge with IFRS. Arcan's financial statements up to and including the December 31, 2010 financial statements will continue to be reported in accordance with GAAP as it exists on each reporting date. Financial statements for the quarter ended March 31, 2011, including comparative amounts, will be prepared on an IFRS basis.

A transition plan is in place to convert the financial statements to IFRS. Training has been provided to key employees and the Corporation continues to assess the effect of the transition on information systems, internal controls over financial reporting and disclosure controls and procedures. Systems and controls are being updated as IFRS accounting processes are implemented. Analysis and quantification of differences between IFRS and Arcan's current accounting policies is continuing. Some accounting policies may change on adoption of IFRS even though Arcan's current accounting policies are acceptable under IFRS. Changes in accounting policy may materially impact the financial statements.

In the first half of 2010, no changes were made to the Corporation's IFRS transition plan. Arcan began its conversion to IFRS during the second quarter and is continuing work on the project in the third quarter of 2010.

There are several significant accounting policy changes anticipated on adoption of IFRS. Changes in IFRS prior to adoption may result in other accounting policy changes which could significantly impact the financial statements. Numerous accounting policy changes will be made under IFRS, with the most significant changes expected to include accounting for petroleum and natural gas ("**P&NG**"), assets and equipment accounting for business combinations and accounting for future taxes.

#### *Petroleum and Natural Gas Assets*

IFRS standards require that a Corporation choose to report their P&NG assets either at the amount which would have been recorded had the Corporation always followed current IFRS standards or at fair value on the date of adoption of IFRS. Alternatively, IFRS standards allow for a conversion exemption whereby companies can choose to record opening petroleum and natural gas properties at a deemed cost equal to historic cost as calculated under GAAP. Arcan currently intends to elect to record P&NG assets at historic cost as calculated under GAAP on January 1, 2010.

Under GAAP, all P&NG assets are accounted for under the full cost accounting guideline. Under IFRS, P&NG assets will be divided into exploration and evaluation properties ("**E&E assets**") and petroleum and natural gas properties and equipment ("**development assets**"). E&E assets will initially be capitalized and accumulated pending determination of technical feasibility and economic viability. E&E assets will not be depreciated and will be carried at cost less any accumulated impairment losses. Development assets will be measured at cost less accumulated depletion and depreciation and any accumulated impairment losses.

Both E&E assets and development assets will be assessed to determine whether impairment losses exist under IFRS as at January 1, 2010. These impairment tests will differ from the current GAAP full cost ceiling test in several significant ways. Assets (including goodwill) will be allocated to Cash Generating Units ("**CGUs**") and a separate impairment test will be completed for each CGU identified. Under current GAAP the ceiling test is a two step test. The carrying value of assets is first compared to the undiscounted future cash flows. If the carrying value of the assets exceeds the undiscounted future cash flows, then the second step of the test is required whereby the assets are written down to the value of the discounted future cash flows. Under IFRS, the impairment test compares the carrying value of the assets to the greater of the fair value of the assets and the value-in-use of the assets, which is a discounted cash flow measure. As a result, impairments will be recorded more frequently under IFRS. Future impairment tests may be required when management determines that indicators of impairment exist. Should impairment losses be recorded in accordance with IFRS, certain of those losses can reverse in the future if facts and circumstances change.

Depreciation under GAAP is calculated using a unit-of-production method based on total proved reserves for all accumulated costs (excluding unproved properties). Under IFRS, the net carrying value of development assets will still be depleted using a unit of production method; however, significant components with different useful lives will be accounted for as separate items and depreciated separately. In addition, IFRS allows depreciation to be calculated using either proved reserves or proved plus probable reserves. Arcan has not yet determined whether depreciation will be calculated using proved or proved plus probable reserves.

Under the full cost accounting guideline, gains or losses are not recognized upon the disposition of P&NG assets unless the disposition results in a significant change in the depletion rate. Under IFRS, gains and losses are recognized in net income on the disposal of an item of P&NG assets. The amount of the gain or loss is determined by comparing the proceeds from disposal with the carrying amount of the item. This will include transactions such as sales of assets, farm-outs, asset swaps and other non-monetary transactions which typically did not result in gains or losses being recorded under GAAP.

The quantitative impact to Arcan of these changes to accounting for P&NG assets has not been determined.

#### *Business Combinations*

Accounting for business combinations also differs under IFRS. Arcan intends to elect not to restate business combinations recorded prior to January 1, 2010 in accordance with IFRS standards. Any goodwill recognized in business combinations after January 1, 2010 recorded under IFRS will represent the excess of the cost of the acquisition over the net fair value of the identifiable assets, liabilities and contingent liabilities of the acquired entity. When the excess is negative, it will be recognized immediately in profit and loss. In addition, transaction costs which are included in the cost of the acquisition under GAAP will be expensed under IFRS.

#### *Deferred Income Taxes*

Deferred income taxes are calculated under IFRS using a liability approach which is conceptually similar to GAAP however there are differences in the manner in which deferred income taxes are calculated. The impact of these changes is being assessed and has not been quantified.

#### *Other Items*

There are other accounting policy changes with potentially material impacts, including accounting for asset retirement obligations ("**ARO**") and accounting for Stock Based Compensation. The ARO calculation differs under IFRS in some respects. On initial adoption of IFRS, the ARO liability will be recorded at its revised amount and the difference from the amount recorded under GAAP will be recorded as an adjustment to retained earnings at January 1, 2010. Under IFRS – Stock Based Compensation, Arcan's options that vest in three instalments must be accounted for as though each instalment is a separate option issue. This will result in front end loading of compensation expense. In addition, an estimate of forfeitures must be taken into consideration in the expense.

#### *Business Combinations*

In January 2009, the CICA issued Section 1582, Business Combinations. This section is effective January 1, 2011 and applies prospectively to business combinations for which the acquisition date is on or after the first annual reporting period beginning on or after January 1, 2011 for the Corporation. This section replaces Section 1581, Business Combination and harmonizes the Canadian standards with IFRS.

#### *Consolidated Financial Statements and Non-Controlling Interest*

In 2009, Section 1601 and Section 1602 were issued which replace the existing guidance under Section 1600, Consolidated Financial Statements. These standards provide guidance for preparing consolidated financial statements and for accounting for non-controlling interest in a subsidiary to a business combination. These standards are effective for business combinations occurring on or after January 1, 2011.

## Legal Advisories

*Boes may be misleading, particularly if used in isolation. The calculation of barrels of oil equivalent ("boe") is based on a conversion ratio of six thousand cubic feet of natural gas to one barrel of oil based on an energy conversion primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.*

*Additional information about the Corporation, including the Corporation's annual information form for the year ended December 31, 2009, is available on SEDAR at [www.sedar.com](http://www.sedar.com).*

## Forward-Looking Information and Statements

*This MD&A contains certain forward-looking information and statements within the meaning of applicable securities laws (collectively, "**forward-looking information**"). The use of any of the words "expect", "anticipate", "continue", "estimate", "guidance", "objective", "ongoing", "may", "will", "project", "should", "believe", "plans", "intends" and similar expressions are intended to identify forward-looking information. In particular, but without limiting the foregoing, this MD&A contains forward-looking information pertaining to the following: Arcan's income taxes, tax liabilities and tax pools; production volumes and product mix of Arcan's oil and gas production; the rate at which Arcan's existing wells will be tied in; Arcan's drilling inventory; oil and natural gas prices and Arcan's risk management programs; resource recovery; the timing and results of drilling operations; the impact of the Acquisition; the amount of asset retirement obligations; future liquidity and financial capacity and resources; cost and expense estimates; results from operations and financial ratios; cash flows; operating costs; financing of expenditures; expectations respecting commodity prices; royalty rates and their impact on Arcan's operations and results; and future growth, including development, exploration, and acquisition and development activities and related expenditures.*

*The forward-looking information contained in this MD&A reflects several material factors and expectations and assumptions of Arcan including, without limitation: that Arcan will continue to conduct its operations in a manner consistent with past operations; the general continuance of current or, where applicable, assumed industry conditions; availability of debt and/or equity sources to fund Arcan's capital and operating requirements as needed; the continuance of existing and, in certain circumstances, proposed tax and royalty regimes; the accuracy of the estimates of Arcan's reserve volumes; and certain commodity price and other cost assumptions. Arcan believes the material factors, expectations and assumptions reflected in the forward-looking information are reasonable at this time but no assurance can be given that these factors, expectations and assumptions will prove to be correct. The forward-looking information included in this MD&A is not a guarantee of future performance and should not be unduly relied upon. Such forward-looking information involves known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in such forward-looking information including, without limitation: changes in commodity prices; unanticipated operating results or production declines; changes in tax or environmental laws or royalty rates; increased debt levels or debt service requirements; inaccurate estimation of Arcan's oil and gas reserves volumes; limited, unfavourable or no access to debt or equity capital markets; increased costs and expenses; the impact of competitors; reliance on industry partners; and certain other risks detailed from time to time in Arcan's public disclosure documents including, without limitation, those risks identified in this MD&A, and in Arcan's annual information form for the year ended December 31, 2009, copies of which are available on Arcan's SEDAR profile at [www.sedar.com](http://www.sedar.com).*

*The forward-looking information contained in this MD&A speaks only as of the date of this MD&A, and Arcan does not assume any obligation to publicly update or revise such forward-looking information to reflect new events or circumstances, except as may be required pursuant to applicable laws.*

**Corporate Office**

Arcan Resources Ltd.  
Suite 3200, 450 - 1st Street SW  
Calgary, AB T2P 5H1  
(403) 262-0321

**Directors**

Ed Gilmet  
President and Chief Executive Officer,  
Arcan Resources Ltd.

Andy Fisher  
Executive Vice President, Arcan Resources Ltd.

Robert J. Dales  
Independent Director

J. Terry McCoy  
Independent Director

Michael J. Laffin  
Independent Director

**Auditors**

KPMG LLP

**Evaluation Engineers**

GLJ Petroleum Consultants Ltd.

**Banker**

Alberta Treasury Branches

**Investor Relations Contact**

Doug Penner  
Chief Financial Officer  
[dpenner@arcanres.com](mailto:dpenner@arcanres.com)  
(403) 513-7234

**Officers**

Ed Gilmet  
President and Chief Executive Officer

Andy Fisher  
Executive Vice President

Doug Penner  
Chief Financial Officer and Vice President,  
Finance

Graeme Ryder  
Controller

Michael J. Laffin  
Corporate Secretary

**Registrar and Transfer Agent**

Valiant Trust Company

**Stock Exchange Listing**

TSX-V (symbol "**ARN**")

**Legal Counsel**

Blake, Cassels & Graydon LLP