

Consolidated Financial Statements  
(Expressed in United States dollars)

## **BUCKING HORSE ENERGY INC.**

For the years ended December 31, 2010 and 2009



**KPMG LLP**  
**Chartered Accountants**  
PO Box 10426 777 Dunsmuir Street  
Vancouver BC V7Y 1K3  
Canada

Telephone (604) 691-3000  
Fax (604) 691-3031  
Internet [www.kpmg.ca](http://www.kpmg.ca)

## INDEPENDENT AUDITORS' REPORT

To the Shareholders of Bucking Horse Energy Inc.

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

### *Management's Responsibility for the Consolidated Financial Statements*

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

### *Auditors' Responsibility*

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

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

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



*Opinion*

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

**KPMG LLP (signed)**

Chartered Accountants

March 30, 2011  
Vancouver, Canada

# BUCKING HORSE ENERGY INC.

Consolidated Balance Sheets  
(Expressed in United States dollars)

	As at December 31, 2010	As at December 31, 2009
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 4,425,957	\$ 6,751,735
Accounts receivable (note 11)	1,489,939	2,631,371
Promissory note (note 11)	-	79,924
Prepaid expenses	-	141,483
Derivative instruments (note 3(b))	6,036,956	2,130,604
Income taxes receivable	1,004,833	243,106
	12,957,685	11,978,223
Investments (note 4)	168,979	44,452
Oil and natural gas properties (note 5)	163,854,788	161,555,453
	\$ 176,981,452	\$ 173,578,128

## Liabilities and Shareholders' Equity

Current liabilities:		
Accounts payable and accrued liabilities	\$ 2,856,227	\$ 1,656,228
State resource taxes payable	605,721	902,112
Income taxes payable	77,460	430,200
	3,539,408	2,988,540
Long term credit facility (note 6)	18,500,000	18,500,000
State resource taxes payable	286,761	267,868
Convertible debentures (note 7)	28,134,784	25,101,563
Asset retirement obligation (note 8)	137,562	90,557
Future income taxes	56,360,899	53,689,493
	106,959,414	100,638,021
Shareholders' equity:		
Share capital (note 10)	60,833,093	61,374,762
Equity portion of debentures payable (note 7)	25,329,139	25,329,139
Issuer bid purchase	(4,825)	(22,627)
Accumulated other comprehensive loss	(1,121,920)	(3,528,458)
Deficit	(15,013,449)	(10,212,709)
	70,022,038	72,940,107
Commitment (note 5)		
Contingency (note 17)		
Subsequent events (notes 6 and 18)		
	\$ 176,981,452	\$ 173,578,128

See accompanying notes to consolidated financial statements.

Approved on behalf of the Board:

"Gordon Nielsen"

Director

"Michael Schoen"

Director

# BUCKING HORSE ENERGY INC.

Consolidated Statements of Operations and Deficit  
(Expressed in United States dollars)

	Year ended December 31, 2010	Year ended December 31, 2009
Revenue:		
Oil and natural gas revenue	\$ 13,852,004	\$ 12,609,517
Direct expenses:		
Depletion, depreciation and accretion	5,657,687	6,438,722
State resource taxes	1,253,995	1,096,087
Royalties	2,777	10,201
Operating expenses	5,541,952	5,378,584
	<u>12,456,411</u>	<u>12,923,594</u>
Net operating income	1,395,593	(314,077)
Other expenses (income):		
Interest expense	7,610,464	6,926,668
Accretion expense on debentures (note 7)	1,554,571	1,142,419
Professional fees	892,209	928,598
General and administration	831,097	682,907
Foreign exchange gain	(466,378)	(353,592)
Financing fees (note 6)	105,000	25,000
(Gain) loss on investments (note 4)	(48,547)	219,410
Interest income and other	(1,166)	(22,997)
Write down of promissory note (note 11)	-	3,909,729
Write down of receivable (note 11)	275,436	-
Write down of oil and natural gas properties (note 5)	621,967	1,588,951
Realized gain on derivative instruments (note 3(b))	(2,862,065)	(6,969,194)
Unrealized (gain) loss on derivative instruments (note 3(b))	(3,906,352)	2,202,893
	<u>4,606,236</u>	<u>10,280,792</u>
Loss before income taxes	(3,210,643)	(10,594,869)
Income tax expense (recovery):		
Current	1,063,044	1,303,562
Future	463,633	(568,761)
	<u>1,526,677</u>	<u>734,801</u>
Net loss for the year	(4,737,320)	(11,329,670)
Retained earnings (deficit), beginning of year	(10,212,709)	1,129,808
Cancellation of issued common shares (note 10(a))	(63,420)	(12,847)
Deficit, end of year	<u>\$ (15,013,449)</u>	<u>\$ (10,212,709)</u>
Basic and diluted loss per common share (note 9)	\$ (0.21)	\$ (0.49)
Weighted average number of shares outstanding	22,794,253	22,990,598

See accompanying notes to consolidated financial statements.

# BUCKING HORSE ENERGY INC.

Consolidated Statements of Comprehensive Loss  
(Expressed in United States dollars)

	Year ended December 31, 2010	Year ended December 31, 2009
Net loss for the year	\$ (4,737,320)	\$ (11,329,670)
Net unrealized gains on translating financial statements into reporting currency	2,373,859	7,741,911
Unrealized gain (loss) on available for sale investments, net of tax of \$4,670 (December 31, 2009 - \$4,366)	32,679	(30,560)
<b>Comprehensive loss for the year</b>	<b>\$ (2,330,782)</b>	<b>\$ (3,618,319)</b>

Consolidated Statements of Accumulated Other Comprehensive Loss  
(Expressed in United States dollars)

	Year ended December 31, 2010	Year ended December 31, 2009
Accumulated other comprehensive loss, beginning of year	\$ (3,528,458)	\$ (11,239,809)
Net unrealized gains on translating financial statements into reporting currency	2,373,859	7,741,911
Unrealized gain (loss) on available for sale investments, net of tax	32,679	(30,560)
<b>Accumulated other comprehensive loss, end of year</b>	<b>\$ (1,121,920)</b>	<b>\$ (3,528,458)</b>

See accompanying notes to consolidated financial statements.

# BUCKING HORSE ENERGY INC.

Consolidated Statements of Cash Flows  
(Expressed in United States dollars)

	Year ended December 31, 2010	Year ended December 31, 2009
Cash and cash equivalents provided by (used in):		
Operations:		
Net loss for the year	\$ (4,737,320)	\$ (11,329,670)
Items not involving cash:		
Depletion, depreciation and accretion	5,657,687	6,438,722
Accretion expense on debentures	1,554,571	1,142,419
Future income taxes	463,633	(568,761)
Loss on investments (note 4)	-	219,410
Unrealized loss (gain) on derivative instruments (note 3(b))	(3,906,352)	2,202,893
Foreign exchange gain	(466,378)	(353,592)
Non-cash interest	-	441,078
Write down of promissory note	-	3,468,651
Write down of petroleum and natural gas interests	621,967	1,588,951
Changes in non-cash working capital:		
Accounts receivable	1,246,365	122,116
Prepaid expenses	144,376	(130,051)
Income taxes receivable	(722,279)	2,742,294
Income taxes payable	(364,195)	395,920
Accounts payable and accrued liabilities	1,068,130	(2,947,896)
State resource taxes payable	(332,045)	(587,707)
	228,160	2,844,777
Investments:		
Oil and natural gas property expenditures	(2,018,293)	(5,181,302)
Proceeds on sale of investment	48,547	-
	(1,969,746)	(5,181,302)
Financing:		
Issuer bid purchase and shares returned to treasury (note 10(a))	(569,809)	(310,610)
Effect of foreign currency translation on cash and cash equivalents	(14,383)	531,556
Decrease in cash and cash equivalents	(2,325,778)	(2,115,579)
Cash and cash equivalents, beginning of year	6,751,735	8,867,314
Cash and cash equivalents, end of year	\$ 4,425,957	\$ 6,751,735

See accompanying notes to consolidated financial statements.

# BUCKING HORSE ENERGY INC.

Notes to Consolidated Financial Statements  
(Expressed in United States dollars, unless otherwise noted)

For the year ended December 31, 2010

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## 1. Nature of operations:

NRG Investments Inc. was incorporated under the laws of British Columbia, Canada on April 28, 2006. Effective March 4, 2008 the Company changed its name to Bucking Horse Energy Inc. (the Company or Bucking Horse) and acquired two additional wholly-owned subsidiaries, Gemini Energy Corp. (Gemini) and its subsidiary, Arrowhead Resources (U.S.A.) Ltd. (Arrowhead), through the purchase of 100% of the issued and outstanding shares of Gemini.

The Company's principal business activity is the exploration, development and production of petroleum and natural gas reserves located in Canada and the United States of America.

An assumption underlying the preparation of financial statements in accordance with Canadian generally accepted accounting principles is that the Company will be able to realize assets and discharge liabilities in the normal course of business. Accordingly, it is management's opinion that the going concern assumption is appropriate and all assets and liabilities have been valued accordingly.

## 2. Significant accounting policies:

### (a) Basis of consolidation:

The consolidated financial statements of the Company have been prepared in accordance with Canadian generally accepted accounting principles. The consolidated financial statements of the Company include its wholly-owned subsidiaries NRG Holdings Corp., incorporated in the State of Nevada, N Holdings Inc., incorporated in the State of Washington and Gemini, incorporated in the Province of British Columbia and its wholly-owned subsidiary, Arrowhead, incorporated in the State of South Dakota. All inter-company transactions and balances have been eliminated upon consolidation.

### (b) Adoption of accounting standards:

The Company did not adopt any new Canadian Institute of Chartered Accountants (CICA) accounting standards within the year.

### (c) Cash and cash equivalents:

Cash and cash equivalents are designated as held-for-trading and include short-term money market instruments with terms of maturity at the date of acquisition not exceeding ninety days, that are readily convertible to known amounts of cash, and which are subject to an insignificant risk of change in value.

# BUCKING HORSE ENERGY INC.

Notes to Consolidated Financial Statements  
(Expressed in United States dollars, unless otherwise noted)

For the year ended December 31, 2010

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## 2. Significant accounting policies (continued):

### (d) Financial instruments:

#### (i) Financial instruments:

Financial assets and liabilities designated as held-for-trading are measured at fair value with realized and unrealized gains and losses recognized in net earnings. Financial assets designated as held-to-maturity, loans and receivables, and financial liabilities other than those designated as held-for-trading, are measured at amortized cost. Financial assets designated as available for sale are measured at fair value with unrealized gains or losses recognized in accumulated other comprehensive income until the asset is sold and the gain or loss realized. The purchase and sale of a financial asset, where the contract requires the asset to be delivered within an established time frame, are recognized on a trade-date basis. Generally all derivatives, including embedded derivatives that must be accounted for separately from their host contract, must be designated as held-for-trading and recorded at fair value with gains and losses recognized in net earnings. Transaction costs for financial instruments classified as other than held-for-trading are expensed as incurred.

The Company classifies its financial instruments into categories as follows:

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Cash and cash equivalents	held for trading
Accounts receivable	loans and receivables
Promissory note	loans and receivables
Benefit under derivative financial instrument	held for trading
Investment in shares of a related entity	available for sale
Accounts payable and accrued expenses	other financial liabilities
Amounts payable to related parties	other financial liabilities
Convertible debentures	other financial liabilities
Bank indebtedness	other financial liabilities
Embedded derivatives	held for trading

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#### (ii) Embedded derivatives:

The Company has identified no embedded derivatives other than the conversion option in the convertible debentures (note 7) to be separately accounted for at December 31, 2010.

#### (iii) Derivative financial instruments:

The Company utilizes derivative financial instruments to manage interest rate and price risk. Derivative financial instruments are measured at fair value with gains and losses recorded in net earnings (loss) for the year.

# BUCKING HORSE ENERGY INC.

Notes to Consolidated Financial Statements  
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For the year ended December 31, 2010

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## 2. Significant accounting policies (continued):

### (e) Investments:

Investments include investments in shares and warrants of companies as described in note 4. The Company's investments in shares of related entities are classified as available-for-sale and are measured at cost. The carrying values of the investments are regularly reviewed for possible other than temporary impairment. When there is a loss in value that is other than a temporary decline, the investment is written down to recognize the loss with the write down recorded as a charge to income.

### (f) Oil and natural gas properties:

The Company follows the full cost method of accounting for oil and natural gas operations whereby all costs associated with the acquisition, exploration for and development of oil and natural gas reserves are capitalized. Such costs include land acquisition costs, geological and geophysical expenses, carrying charges on non-producing properties, costs of drilling both productive and non-productive wells and overhead charges directly related to acquisition, exploration and development activities.

The capitalized costs, together with the costs of production equipment, are depleted and depreciated on the unit-of-production method based on the estimated gross proven reserves as determined by external experts. Oil and natural gas reserves and production are converted into equivalent barrels of oil based upon the estimated relative energy content.

Costs of acquiring and evaluating unproven properties are initially excluded from the costs subject to depletion and depreciation. These unproven properties are assessed periodically to ascertain whether or not proved reserves are attributable to the properties or impairment has occurred. When proved reserves are attributed to the unproven properties or the property is considered to be impaired, the cost of the property or the amount of the impairment is added to the costs subject to depletion and depreciation.

The Company evaluates the carrying amounts for impairment annually. The carrying value is not considered to be impaired when the sum of the undiscounted net cash flows expected from the production of proved reserves, less any impairment of unproved properties and related major development projects exceeds the carrying amount of the cost centre (the ceiling test). When the carrying amount is not determined to be recoverable, an impairment loss is recognized to the extent that the carrying amount of the cost centre exceeds the sum of the discounted net cash flows expected from the production of proved and probable reserves less any impairment of unproven properties and related major development projects. The cash flows are estimated using expected future product prices and costs based on best information available and are discounted at an interest rate of 10%.

Proceeds from the sale of oil and natural gas properties are applied against capitalized costs, with no gain or loss recognized, unless such a sale would significantly alter the rate of depletion and depreciation.

Substantially all of the Company's exploration, development and production activities are conducted jointly with others and accordingly these consolidated financial statements reflect only the Company's proportionate interest in such activities.

# BUCKING HORSE ENERGY INC.

Notes to Consolidated Financial Statements  
(Expressed in United States dollars, unless otherwise noted)

For the year ended December 31, 2010

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## 2. Significant accounting policies (continued):

### (g) Asset retirement obligations:

The Company uses the fair value method of recording the obligation associated with closure, reclamation and restoration of oil and natural gas properties and other asset retirement costs. The fair value of the liability for the Company's asset retirement obligation is recorded in the period in which it is incurred, discounted to its present value using the Company's credit-adjusted, risk-free interest rate and the corresponding amount is capitalized to the carrying amount of the related oil and natural gas properties. The liability amount is increased each reporting period due to the passage of time and the amount of this accretion is charged to earnings in the period. Revisions to the estimated timing of cash flows or to the original estimated undiscounted cost could also result in an increase or decrease to the obligation. Actual costs incurred upon settlement of the retirement obligation are charged against the obligation to the extent of the liability recorded.

### (h) Revenue recognition:

Revenues from oil and natural gas operations are recognized when persuasive evidence of a sales agreement exists, the title and risk is transferred to the customer, collection is reasonably assured, and the price is reasonably determinable.

### (i) Foreign currency translation:

The Company's functional currency is Canadian dollars and its reporting currency is U.S. dollars. Accordingly, the consolidated financial statements are translated into U.S. dollars using the current rate method.

The Company's investments in NRG Holdings Corp. and N Holdings Inc. are accounted for as integrated foreign operations and accordingly are translated into Canadian dollars using the temporal method. Under this method, monetary items denominated in foreign currencies are translated to Canadian dollars at the exchange rate in effect at the balance sheet date and non-monetary items are translated at the month end rate of exchange in effect when the assets were acquired or obligations incurred. Revenue and expense items are translated at the average exchange rate for the year. Foreign exchange gains and losses are included in net earnings (loss) for the year.

Arrowhead is accounted for as a self sustaining foreign operation and accordingly is translated into Canadian dollars in accordance with the current rate method. Assets and liabilities are translated at the exchange rates prevailing at the balance sheet dates, and revenue and expenses are translated on the basis of average exchange rates during the periods. Any recognized and unrecognized gains or losses arising from the translation of these accounts are recorded in accumulated other comprehensive income (loss). An applicable portion of gains and losses is transferred to net earnings when there is a reduction of the net investment.

# BUCKING HORSE ENERGY INC.

Notes to Consolidated Financial Statements  
(Expressed in United States dollars, unless otherwise noted)

For the year ended December 31, 2010

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## 2. Significant accounting policies (continued):

### (j) Stock-based compensation:

The Company has a stock option plan as described in note 10(b). The Company accounts for all stock-based payments using the fair value method. Consideration paid on the exercise of stock options is recorded as share capital.

Under the fair value method, stock-based payments to non-employees are measured at the fair value of the consideration received, or the fair value of the equity instruments issued, or the liabilities incurred, whichever is more reliably measurable. The fair value of stock-based payments to non-employees is periodically re-measured until counterparty performance is complete, and any change therein is recognized over the period and in the same manner as if the Company had paid cash instead of paying with or using equity instruments. The cost of stock-based payments to non-employees that are fully vested and non-forfeitable at the grant date is measured and recognized at that date.

Under the fair value method, compensation cost for grants to employees is measured at fair value at the grant date and recognized over the vesting period. For awards that vest at the end of the vesting period, compensation cost is recognized on a straight-line basis; for awards that vest on a graded basis, compensation cost is recognized on a pro-rata basis over the vesting period.

### (k) Earnings (loss) per share:

Basic earnings per share is computed by dividing net earnings (loss) by the weighted average number of shares outstanding during the year. Diluted earnings per share is computed using the treasury stock method.

### (l) Income taxes:

The Company uses the asset and liability method of accounting for income taxes. Under the asset and liability method, future tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Future tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. A valuation allowance is recorded against any future income tax asset if it is more likely than not that the asset will not be realized. The effect on future tax assets and liabilities of a change in tax rates is recognized in earnings in the same period the substantive enactment occurred.

### (m) Use of estimates:

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant areas requiring the use of estimates is the evaluation of impairment of oil and natural gas properties, valuation of financial instruments, determination of asset retirement obligations, valuation allowances applied against the future income taxes assets, and rates for depreciation and depletion. Actual results could differ from such estimates.

# BUCKING HORSE ENERGY INC.

Notes to Consolidated Financial Statements  
(Expressed in United States dollars, unless otherwise noted)

For the year ended December 31, 2010

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## 2. Significant accounting policies (continued):

(n) Comparative figures:

Certain of the Company's comparative figures have been reclassified to conform to the financial statement presentation adopted in the current year.

(o) Future accounting pronouncements:

(i) Business Combinations:

In January 2009, the CICA issued Section 1582, *Business Combinations*, which requires that all assets and liabilities of an acquired business be recorded at fair value at acquisition. Obligations for contingent considerations and contingencies will also be recorded at fair value at the acquisition date. The standard also states that acquisition-related costs will be expensed as incurred and that restructuring charges will be expensed in the periods after the acquisition date. The Section applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period on or after January 1, 2011. The Company has not yet adopted this standard.

(ii) Consolidations and Non-Controlling Interest:

In January 2009, the CICA issued Section 1601, *Consolidations*, and Section 1602, *Non-Controlling Interests*. Section 1601 establishes standards for preparing consolidated financial statements and Section 1602 establishes standards for accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. These standards apply to interim and annual consolidated financial statements relating to fiscal years beginning on or after January 1, 2011. The Company has not yet adopted these standards.

(iii) International Financial Reporting Standards (IFRS):

The Canadian Accounting Standards Board (AcSB) announced that Canadian publicly accountable enterprises will be required to adopt IFRS, replacing Canada's own generally accepted accounting principles, effective January 1, 2011. The Company will publish its first unaudited interim *consolidated* financial statements under IFRS for the quarter ending March 31, 2011, with comparative financial information for the quarter ending March 31, 2010. The first audited annual consolidated financial statements will be for the year ending December 31, 2011 with comparative financial information for the year ending December 31, 2010.

# BUCKING HORSE ENERGY INC.

Notes to Consolidated Financial Statements  
(Expressed in United States dollars, unless otherwise noted)

For the year ended December 31, 2010

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### 3. Financial instruments:

(a) Fair value:

All financial instruments measured at fair value are categorized into a hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets (Level 1 measurement) and the lowest priority to unobservable inputs (Level 3 measurement). The three levels of the fair value hierarchy are described below:

- Level 1 – Values based on unadjusted quoted prices in active markets that are accessible at the measurement date for identical unrestricted assets or liabilities.
- Level 2 – Values based on inputs that are observable, either directly or indirectly, but do not qualify as Level 1 inputs (i.e. quoted prices for similar assets or liabilities).
- Level 3 – Values based on prices or valuation techniques that require inputs which are not based on observable market data and are significant to the fair value measurement.

The carrying values of cash and cash equivalents, accounts receivable, promissory note, income tax receivable and payable, accounts payable and accrued liabilities, and state resource taxes payable approximate their fair values due to the short terms to maturity of these financial instruments.

The long term credit facility is recorded at the principal amount. The carrying value of drawings on the long term credit facility included on the consolidated balance sheets approximate their fair value based on Level 2 inputs as they have floating interest rates that approximate market rates. The Company does not consider the credit risk associated with the counterparty of the long term credit facility to be significant.

The fair value of the convertible debentures is not readily determinable due to their related party nature and the absence of a market for such investments.

# BUCKING HORSE ENERGY INC.

Notes to Consolidated Financial Statements  
(Expressed in United States dollars, unless otherwise noted)

For the year ended December 31, 2010

### 3. Financial instruments (continued):

(a) Fair value (continued):

The fair values of the Company's financial assets and liabilities as of December 31, 2010 are as follows:

	Balance at December 31, 2010	Quoted prices in active markets for identical assets (\$)  (Level 1)	Significant other observable inputs (\$)  (Level 2)	Significant unobservable inputs (\$)  (Level 3)
Financial assets:				
Held for trading:				
Cash and cash equivalents	\$ 4,425,957	\$ 4,425,957	\$ -	\$ -
Benefit under derivative financial instrument (note 3(b))	6,036,956	-	6,036,956	-
Available for sale:				
Investments in shares of a related entity	168,978	168,978	-	-

The fair values of the Company's financial assets and liabilities as of December 31, 2009 were as follows:

	Balance at December 31, 2009	Quoted prices in active markets for identical assets (\$)  (Level 1)	Significant other observable inputs (\$)  (Level 2)	Significant unobservable inputs (\$)  (Level 3)
Financial assets:				
Held for trading:				
Cash and cash equivalents	\$ 6,751,735	\$ 6,751,735	\$ -	\$ -
Benefit under derivative financial instrument (note 3(b))	2,130,604	-	2,130,604	-
Available for sale:				
Investments in shares of a related entity	44,452	44,452	-	-

# BUCKING HORSE ENERGY INC.

Notes to Consolidated Financial Statements  
(Expressed in United States dollars, unless otherwise noted)

For the year ended December 31, 2010

## 3. Financial instruments (continued):

(b) Derivative instruments:

(i) Commodity Hedge Contracts:

At December 31, 2010, the Company had the following open commodity derivative financial contracts to manage price risk on a portion of its natural gas production for the periods referenced below.

Type	Volume MMBTU/Day	Contract period	Price US\$/MMBTU
Swap <sup>(1)</sup>	2,500	Calendar 2010	\$6.20 / MMBTU
Swap <sup>(1)</sup>	1,000	Calendar 2010	\$6.48 / MMBTU
Swap <sup>(1)</sup>	1,000	Calendar 2010	\$6.50 / MMBTU
Swap <sup>(1)</sup>	3,000	Calendar 2011	\$7.23 / MMBTU
Swap <sup>(1)</sup>	1,000	Calendar 2011	\$7.11 / MMBTU
Swap <sup>(1)</sup>	3,500	Calendar 2012	\$7.22 / MMBTU

<sup>(1)</sup> Dominion Appalachia basis

At December 31, 2009, the Company had the following open commodity derivative financial contracts to manage price risk on a portion of its natural gas production for the periods referenced below.

Type	Volume MMBTU/Day	Contract period	Price US\$/MMBTU
Swap <sup>(2)</sup>	2,500	Calendar 2009	\$9.66 / MMBTU
Swap <sup>(1)</sup>	2,500	Calendar 2010	\$6.20 / MMBTU
Swap <sup>(1)</sup>	1,000	Calendar 2010	\$6.48 / MMBTU
Swap <sup>(1)</sup>	1,000	Calendar 2010	\$6.50 / MMBTU
Swap <sup>(1)</sup>	3,000	Calendar 2011	\$7.23 / MMBTU
Swap <sup>(1)</sup>	1,000	Calendar 2011	\$7.11 / MMBTU
Swap <sup>(1)</sup>	3,500	Calendar 2012	\$7.22 / MMBTU

<sup>(1)</sup> Dominion Appalachia basis

<sup>(2)</sup> Panhandle Eastern basis

Derivative financial instruments are measured at fair value with gains and losses recorded in net earnings.

# BUCKING HORSE ENERGY INC.

Notes to Consolidated Financial Statements  
(Expressed in United States dollars, unless otherwise noted)

For the year ended December 31, 2010

## 3. Financial instruments (continued):

### (b) Derivative instruments (continued):

#### (ii) Foreign Exchange Hedge Contracts:

In May 2010, the Company contracted to purchase a total of CAD\$2,138,565 with terms referenced as follows:

US\$	Contract period	Exchange rate
\$83,333/month	September 2010 to May 2011	1.0642
\$83,333/month	September 2010 to May 2011	1.0744

On March 5, 2009, the Company contracted to purchase CAD\$4,584,600 during calendar 2010 at an exchange rate of CAD\$1.2735 per US\$. Foreign Exchange contracts existed for the periods referenced as follows:

US\$	Contract period	Exchange rate
\$300,000/month	January to December 2010	1.2735

On May 28, 2009, the Company monetized the calendar 2010 foreign currency contracts referred to above, and realized total gains of \$760,731 which were included in other income in the consolidated statement of operations.

The net realized gain on derivative financial contracts for the year ended December 31, 2010 of \$2,862,065 (2009 - \$6,969,194) has been included in other income in the consolidated statement of operations.

The unrealized gain on outstanding derivative financial contracts was \$3,906,352 for the year ended December 31, 2010 (2009 – loss of \$2,202,893), which has been included in other expenses in the statement of operations.

# BUCKING HORSE ENERGY INC.

Notes to Consolidated Financial Statements  
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For the year ended December 31, 2010

## 4. Investments:

	Number of shares 2010	Number of shares 2009	Balance 2010	Balance 2009
Investments in:				
Investment in shares of Giant Energy Ltd.	-	1,000,000	\$ -	\$ -
Investment in warrants of XXL	-	150,000	-	-
Investment in shares of XXL	933,700	333,700	168,978	44,452

During 2008, the Company participated in a private placement conducted by Giant Energy Limited ("Giant") pursuant to which the Company acquired 1,000,000 common shares of Giant. This was a non-arm's length transaction at the time, by virtue of a common officer of both companies and a common shareholder. The value of these common shares was written down by \$219,410 to zero during fiscal 2009. During the year ended December 31, 2010, the Company sold the shares for \$48,547. This was a non-arm's length transaction by virtue of a common shareholder.

During 2008, the Company acquired 333,700 common shares in XXL Energy Corp. (XXL) for a total purchase price of \$254,085 (CAD\$306,045). In March 2010, the Company received an additional 600,000 common shares in XXL as a negotiated settlement from Q Investments Ltd (QIL) (for further details, see note 11). These shares are classified as available for sale and are marked to market on an ongoing basis with changes in fair value recognized other comprehensive income, net of tax. The cumulative unrealized loss on the shares at December 31, 2010 of \$156,895 has been included in other comprehensive loss (2009 – unrealized loss on shares of \$189,574 included in comprehensive loss).

As at December 31, 2009, the Company held 150,000 warrants of XXL, each of which entitled the Company to purchase one common share of XXL at an exercise price of \$20.00 per share. At December 31, 2010 and 2009, these warrants were valued at nil. The warrants expired unexercised on August 18, 2010.

## 5. Oil and natural gas properties:

	2010	2009
Proven, explored and impaired properties:		
Exploration and drilling costs	\$ 67,380,338	\$ 68,041,720
Acquisition and lease costs	105,289,513	98,024,053
Well equipment	9,368,143	8,693,017
Asset retirement	110,230	72,676
	182,148,224	174,831,466
Less accumulated depletion and depreciation	(18,293,436)	(13,276,013)
	\$ 163,854,788	\$ 161,555,453

For the year ended December 31, 2010, the Company has not capitalized any general and administrative expenses (2009 - nil).

# BUCKING HORSE ENERGY INC.

Notes to Consolidated Financial Statements  
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## 5. Oil and natural gas properties (continued):

Due to disappointing drilling results in the area, the Company wrote down its Columbia River Basin (CRB) property to \$99,000 from \$1,687,951 during 2009. During 2010, the Company spent a further \$85,019 on the properties in the U.S., however, due to continued disappointing results, the Company further wrote down the properties by \$174,018 to \$1. Effective February 1, 2011, the Company elected to allow the undeveloped leases owned in respect of the CRB property to lapse by not paying annual rentals. As a result, the Company no longer owns any Washington State oil and gas property interests. As the CRB property was not a producing property, this disposition did not have any effect on the Company's continuing operations.

The Company has agreements to participate in the development of certain oil and natural gas wells associated with the Company's Pinedale properties in Wyoming, United States. As at December 31, 2010, the Company is committed to participate in 10 wells in the Pinedale area for a total commitment of \$11,300,000 of which approximately \$2,000,000 has been expended prior to year end. Failure by the Company to pay its share of a proposed capital program could result in a significant revenue penalty related to the wells.

The Company performed a ceiling test calculation at December 31, 2010 for its U.S. and Canadian properties, to assess the recoverable value of its oil and natural gas properties. The oil and natural gas future prices for the December 31, 2010 ceiling test are based on the December 31, 2010 commodity price forecast of the Company's independent reserve evaluators. These prices have been adjusted for commodity price differentials specific to the Company. The following table summarizes the benchmark prices used in the ceiling test calculation.

Year	Benchmark NYMEX WTI \$US/BBL	U.S. properties NGL / OIL \$US/BBL	Benchmark NYMEX GAS \$US/Mcf	U.S. properties GAS \$US/Mcf	Canadian properties GAS \$CAD/MMBTU
2011	\$85.00	\$74.99	\$4.50	\$4.32	\$3.68
2012	\$89.25	\$79.06	\$5.10	\$4.97	\$4.16
2013	\$91.55	\$81.16	\$5.70	\$5.60	\$4.74
2014	\$95.50	\$84.89	\$6.10	\$6.01	\$5.03
2015	\$102.85	\$92.03	\$6.50	\$6.43	\$5.28
2016	\$110.40	\$99.34	\$6.75	\$6.69	\$5.71
2017	\$112.60	\$101.34	\$7.05	\$7.00	\$6.05
2018	\$114.85	\$103.37	\$7.35	\$7.31	\$6.49
2019	\$117.15	\$105.41	\$7.60	\$7.56	\$6.78
2020	\$119.50	\$107.56	\$7.90	\$7.87	\$6.93

Based on these assumptions, the undiscounted value of future net revenues from the Company's proved reserves in the United States exceeded the carrying value of oil and natural gas properties at December 31, 2010 and, accordingly, no impairment was recorded on these properties.

Based on the ceiling test, the Wainwright property in Canada was written down by \$447,949, to reflect the value of its subsequent sale effective January 1, 2011 (note 18).

# BUCKING HORSE ENERGY INC.

Notes to Consolidated Financial Statements  
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## 6. Long-term credit facility:

Bucking Horse and Gemini (Guarantors) and Arrowhead (Borrower) entered into a credit agreement dated March 4, 2008 (the Credit Agreement) for a five year senior revolving credit facility (the Facility) in the aggregate principal amount of up to \$100,000,000, with an initial borrowing base of \$30,000,000, available pursuant to the terms set out in the Credit Agreement. The debt is secured by mortgages on the oil and gas properties of Arrowhead.

The Facility has an interest rate that floats, based on both the LIBOR rate and a spread, which will increase based on the percentage of availability drawn, resulting in a current interest rate of approximately 2.55% at December 31, 2010 (2009 – 1.99%). On August 23, 2010, the Credit Agreement was amended, increasing the borrowing base to \$38,000,000. The Company has drawn \$18,500,000 from the Facility and has \$19,500,000 left available as at December 31, 2010. Subsequent to year end on January 18, 2011, the Company drew an additional \$6,000,000 from the Facility leaving \$13,500,000 available.

The Company is required to ensure that Arrowhead's interest coverage ratio is greater than 2.5 to 1.0, that Arrowhead's ratio of total indebtedness to earnings before interest income taxes, depletion, depreciation and accretion, and exploration expenses is greater than 3.5 to 1.0, and that the Company's current ratio is greater than 1.0 to 1.0. The Company is in compliance with all bank covenants at December 31, 2010.

## 7. Convertible debentures:

	2010	2009
First Debentures (a)	\$ 19,103,157	\$ 18,078,021
Second Debentures (b)	10,054,293	9,514,748
Third Debentures (c)	20,108,584	19,029,496
	49,266,036	46,622,265
Less cumulative accretion remaining	(21,131,250)	(21,520,702)
	\$ 28,134,784	\$ 25,101,563

(a) The First Debentures were issued on March 4, 2008 and mature on March 4, 2018. They are convertible into units during the first five years at a conversion price of CAD\$4.875 per unit and into shares at a conversion price of CAD\$4.875 per share during the last five years and initially bore interest at a rate of 10% during the first six years and 15% during the remaining four years. Each unit consists of one common share of the Company and one share purchase warrant. Each share purchase warrant entitles the holder to purchase one additional common share of the Company for CAD\$4.875 until the fifth anniversary of the date of issuance, at which date these share purchase warrants will expire. The Debenture Holders may elect to accelerate the maturity date to the sixth anniversary date at any time during the first five years. Effective May 16, 2008, as a result of an interest rate acceleration provision, the interest rate applicable to the First Debentures increased from 10% to 15%.

# BUCKING HORSE ENERGY INC.

Notes to Consolidated Financial Statements  
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For the year ended December 31, 2010

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## 7. Convertible debentures (continued):

(a) Continued:

Repayment of the First Debentures is guaranteed by the Company's subsidiary Arrowhead, which has provided a mortgage and security agreement to each of the Lenders which is subordinated to other debt under the credit facility. The First Debentures are redeemable by the Company upon thirty days written notice without penalty or bonus; however, the Debenture Holders may elect to convert all or any of the First Debentures during the thirty-day notice period.

The equity portion of the First Debentures was assigned a total value of \$10,103,765 (CAD\$10,054,257) upon issuance of the First Debentures, which was recorded in equity portion of debentures payable. The First Debentures were initially recorded net of the conversion option and are being accreted to their face value over their term. For the year ended December 31, 2010, accretion of \$466,528 (2009 - \$301,912) has been included in accretion expense. Accretion of the First Debentures is calculated using an effective interest rate of 39.36%.

- (b) Each of the Second Debentures is in the principal amount of \$4,922,229 (\$5,000,000). The Second Debentures were issued on March 4, 2008, and mature on August 4, 2014. They are convertible into units up to August 4, 2009, at a conversion price of CAD\$4.00 per unit and into shares at a conversion price of CAD\$4.00 per share during the last five years and initially bore interest at a rate of 10% up to August 4, 2010 and 15% during the last four years. Effective May 16, 2008, as a result of an interest rate acceleration provision, the interest rate applicable to the Second Debentures increased from 10% to 15%.

Repayment of the Second Debentures is guaranteed by the Company's subsidiary Arrowhead, which has provided a mortgage and security agreement to each of the Lenders which is subordinated to other debt under the credit facility. The Second Debentures are redeemable by the Company upon thirty days written notice without penalty or bonus; however, the Debenture Holders may elect to convert all or any of the Second Debentures during the thirty-day notice period.

The equity portion of the Second Debentures was assigned a total value of \$4,589,831 (CAD\$4,567,341) upon issuance, which was recorded in equity portion of debentures payable. The Second Debentures were initially recorded net of the conversion option and are being accreted to their face value over their term. For the year ended December 31, 2010, accretion of \$596,961 (2009 - \$522,705) has been included in accretion expense. Accretion on the Second Debentures is calculated using an effective interest rate of 39.94%.

- (c) Each of the Third Debentures is in the principal amount of \$9,844,458 (CAD\$10,000,000). The Third Debentures were issued on March 4, 2008 and mature on March 4, 2018. They bear interest at a rate of 10% during the first six years and 15% during the last four years and are convertible into units during the first five years at a conversion price of CAD\$4.875 per unit and into shares at a conversion price of CAD\$4.875 per share during the last five years. Each unit consists of one common share of the Company and one share purchase warrant. Each share purchase warrant entitles the holder to purchase one additional common share of the Company for CAD\$4.875 until the fifth anniversary of the date of issuance, at which date these share purchase warrants will expire.

# BUCKING HORSE ENERGY INC.

Notes to Consolidated Financial Statements  
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## 7. Convertible debentures (continued):

(c) Continued:

The Debenture Holders may elect to accelerate the maturity date to the sixth anniversary date at any time during the first five years. Effective May 16, 2008, as a result of an interest rate acceleration provision, the interest rate applicable to the Third Debentures increased from 10% to 15%. Repayment of the Third Debenture is guaranteed by the Company's subsidiary Arrowhead, which has provided a mortgage and security agreement to each of the Lenders which is subordinated to other debt under the credit facility. The Third Debentures are redeemable by the Company upon thirty days written notice without penalty or bonus; however, the Debenture Holders may elect to convert all or any of the Third Debentures during the thirty day notice period.

The equity portion of the Third Debentures was assigned a total value of \$10,635,543 (CAD\$10,583,428) upon issuance of the Third Debentures, which was recorded in equity portion of debentures payable. The Third Debentures were initially recorded net of the Conversion Option and are being accreted to their face value over their term. For the year ended December 31, 2010, accretion of \$491,082 (2009 - \$317,802) has been included in accretion expense. Accretion on the Third Debentures is calculated using an effective interest rate of 39.36%.

## 8. Asset retirement obligations:

The Company's asset retirement obligations result from net ownership interest in oil and gas properties including well sites, gathering systems and processing facilities. The Company estimates the total undiscounted amount of cash flows required to settle its asset retirement obligations is approximately \$1,811,700. The majority of the costs will be incurred after 2050. An inflation factor of 2.0% has been applied to the estimated asset retirement costs. A discount rate of 10% was used to calculate the fair value of the asset retirement obligations. A reconciliation of the asset retirement obligations is provided below:

	2010	2009
Balance, beginning of year	\$ 90,557	\$ 69,176
Additions during the year	35,739	9,645
Accretion expense	11,266	1,736
Balance, end of year	\$ 137,562	\$ 90,557

## 9. Earnings (loss) per share:

As at December 31, 2010 and 2009, the conversion feature of the convertible debentures into 10,500,000 common shares would be anti-dilutive. Consequently, diluted net earnings (loss) per common share equates to basic net earnings (loss) per common share for both years presented.

# BUCKING HORSE ENERGY INC.

Notes to Consolidated Financial Statements  
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For the year ended December 31, 2010

## 10. Share capital:

### (a) Share transactions:

Authorized capital at December 31, 2010, and 2009 consists of unlimited common shares without par value.

Share transactions for the year ended December 31, 2010 were as follows:

	Number of shares	Amount (net)
Balance, December 31, 2008	22,994,513	\$ 61,648,395
Shares cancelled and returned to Treasury	(102,060)	(273,633)
Balance, December 31, 2009	22,892,453	61,374,762
Shares cancelled and returned to Treasury	(202,040)	(541,669)
Balance, December 31, 2010	22,690,413	\$ 60,833,093

During the year ended December 31, 2010, the Company repurchased 194,840 shares through a normal course issuer bid at a cost of \$569,809. The excess cost of the shares over the assigned value totaled \$63,420 and was charged to retained earnings. 65,640 of the shares repurchased, including 9,000 shares repurchased in 2009, were cancelled and returned to Treasury on March 19, 2010, 100,600 shares on July 28, 2010, 5,300 shares on October 19, 2010 and 30,500 shares on December 8, 2010. 1,800 shares repurchased in the year were cancelled and returned to treasury in 2011.

During the year ended December 31, 2009, the Company repurchased 111,060 shares through a normal course issuer bid at a cost of \$310,610. The excess cost of the shares over the assigned value totaled \$12,847 and was charged to retained earnings. On December 15, 2009, 102,060 shares were cancelled and returned to Treasury.

### (b) Stock option plan:

The Company has a stock option plan for its key employees, directors and certain other persons under certain conditions. Under the plan, options may be granted to purchase up to 10% of the outstanding shares of the Company to a maximum of 2,306,000 options. Options granted under the plan vest at a rate of 25% per year and expire five years after the date of grant. The exercise price of options granted may not be less than the closing trading price of the Company's shares on the last trading day preceding the date on which the options are granted. As at December 31, 2010 and December 31, 2009, no stock options have been issued under the plan.

# BUCKING HORSE ENERGY INC.

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## 11. Related party transactions:

Related party transactions are in the normal course of operations and measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

Related party transactions are as follows:

	2010	2009
General and administrative expenses:		
Office, rent, administration and professional services to a company controlled by a Debenture Holder	\$ 407,806	\$ 470,858
Oil and gas consulting and management services provided by a company controlled by a Debenture Holder	10,196	-
Directors fees	-	5,254
Interest paid to Debenture Holders	7,136,345	6,436,077

Amounts due to or prepaid to related parties are as follows:

	2010	2009
General and administrative expenses:		
Prepayment of fees for office, rent, administration and professional services charged by a company controlled by one of the Debenture Holders	\$ -	\$ 141,483
Amount receivable from Giant Energy Ltd. which formerly had a common Director	-	275,436
Amount receivable from a company controlled by one of the Debenture Holders	-	235,066

During the year ended December 31, 2010, the Company has determined that the amount receivable from Giant is no longer collectible and has accordingly written off the account. In addition, the Company had an investment in Giant shares described in note 4.

During 2008, the company granted a promissory note receivable to QIL in the amount of CAD\$4,045,200. During fiscal 2009, the Company entered into an agreement to settle the promissory note whereby QIL would transfer to the Company 600,000 shares of XXL (note 4). The promissory note was therefore written down during 2009 to the estimated fair value of the 600,000 XXL shares of \$79,924. In March 2010, the Company received the 600,000 shares of XXL in settlement of the promissory note.

# BUCKING HORSE ENERGY INC.

Notes to Consolidated Financial Statements  
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## 12. Income tax:

The Company's provision for income taxes differs from the amounts computed by applying a statutory Canadian income tax rate of 28.5% (2009 - 30%).

	2010	2009
Computed tax provision	\$ (915,033)	\$ (3,178,461)
Increase in valuation allowance	1,562,999	1,861,223
Permanent differences	415,039	2,999,198
Effects of foreign exchange on temporary differences and other	463,672	(947,159)
	<u>\$ 1,526,677</u>	<u>\$ 734,801</u>

Significant components of the Company's future tax assets and liabilities are shown below:

	2010	2009
Future tax assets:		
Write-down of investment	\$ 32,592	\$ 60,546
Non-capital loss carry forwards	5,390,354	4,465,492
Capital loss carry forwards	1,198,913	641,486
Oil and natural gas properties	772,663	630,136
Share issue costs	25,956	76,792
Unclaimed exploration and development expenditures	313,524	296,551
	<u>7,734,002</u>	<u>6,171,003</u>
Less valuation allowance	<u>(7,734,002)</u>	<u>(6,171,003)</u>
Net future tax assets	-	-
Future tax liabilities:		
Oil and natural gas properties	(54,328,078)	(52,989,358)
Derivative instrument	(2,074,566)	(724,405)
Asset retirement obligation	41,745	24,271
Net future tax liabilities	<u>(56,360,899)</u>	<u>(53,689,493)</u>
Net future income tax liability	<u>\$ (56,360,899)</u>	<u>\$ (53,689,493)</u>

In assessing the realizability of future tax assets, management considers whether it is more likely than not that some portion or all of the future tax assets will not be realized. The ultimate realization of future tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of future tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. The amount of the future tax assets considered realizable could change materially in the near term based on future taxable income during the carry forward period.

# BUCKING HORSE ENERGY INC.

Notes to Consolidated Financial Statements  
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For the year ended December 31, 2010

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## 12. Income tax (continued):

A valuation allowance has been provided against all future tax assets as the realization of such assets is unlikely.

The Company has losses for tax purposes of approximately \$21,561,417 (2009 - \$17,861,968) which are available to offset future years' taxable income in Canada, expiring between 2011 and 2030.

## 13. Supplemental cash flow information:

	2010	2009
Interest paid	\$ 7,607,985	\$ 6,903,053
Income taxes paid (received)	1,110,000	(946,832)

## 14. Financial risk exposure and risk management:

The Company is exposed in varying degrees to a number of risks arising from financial instruments. The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework. Management's close involvement in the operations allows for the identification of risks and variances from expectations. The Board approves and monitors the risk management process.

The types of risk exposure and the way in which such exposures are managed are as follows:

(a) Credit risk:

Credit risk is the risk of financial loss to the Company if a counterparty to a financial instrument fails to meet its payment obligations. The Company's exposure to credit risk includes cash and cash equivalents, accounts receivable, promissory note, and derivative instruments. The risk exposure is limited to their carrying amounts at the balance sheet date.

Cash and cash equivalents and derivative instruments are maintained with one financial institution. The risk is mitigated because the financial institution is a major institution with high credit rating.

Accounts receivable primarily consist of revenues due from the sale of oil and gas. To reduce credit risk, the Company regularly reviews the collectability of the accounts receivable. There is no indication that these amounts will not be fully recoverable. Canadian currency accounts receivable account for \$127,270 (CAD\$126,583) of the Company's total accounts receivable.

# BUCKING HORSE ENERGY INC.

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## 14. Financial risk exposure and risk management (continued):

### (b) Liquidity risk:

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due. The Company manages its liquidity risk by actively forecasting, planning, reviewing and monitoring expenditures and commitments and anticipated financial requirements.

Management believes that cash and cash equivalents on hand at December 31, 2010 and expected cash flows for the next 12 months are sufficient to fund the Company's ongoing operational needs.

In addition, the Company maintains a \$38,000,000 line of credit with the Bank of Montreal, of which it had drawn down \$18,500,000 at December 31, 2010.

Contractual obligations (US\$)	Payments due by period				
	Total	Less than 1 year	1 - 3 years	4 - 5 years	After 5 years
Long term debt <sup>(1)</sup>	\$ 49,266,036	\$ -	\$ -	\$ 10,054,293	\$ 39,211,743
Accounts payable and accrued liabilities	3,124,095	3,124,095	-	-	-
State resource taxes payable	624,614	337,853	286,761	-	-
Income taxes payable	77,460	77,460	-	-	-
Other long term obligations <sup>(2)</sup>	137,562	-	-	-	137,562
Long term credit facility	18,500,000	-	18,500,000	-	-
Development program	9,300,000	9,300,000	-	-	-
<b>Total contractual obligations</b>	<b>\$ 81,029,767</b>	<b>\$12,839,408</b>	<b>\$ 18,786,761</b>	<b>\$ 10,054,293</b>	<b>\$ 39,349,305</b>

<sup>(1)</sup> First, second, and third convertible debentures (CAD\$49,000,000 translated at current exchange rate).

<sup>(2)</sup> Asset retirement obligation.

### (c) Market risk:

Market risk is the risk that changes in market prices, such as natural gas prices, foreign exchange rates and interest rates will affect the Company's income. The object of market risk management is to manage and control market risk exposures within acceptable parameters, while optimizing the return on risk.

The Company buys and sells derivatives in the ordinary course of business in order to manage market risks.

#### (i) Commodity risk:

The Company is exposed to fluctuations in the price of oil and natural gas. It mitigates its risk by negotiating hedging contracts for up to 50% of its production (note 5(b)).

A 10% change in the price of natural gas during the period would have changed equity and net income by \$508,000.

# BUCKING HORSE ENERGY INC.

Notes to Consolidated Financial Statements  
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## 14. Financial risk exposure and risk management (continued):

### (c) Market risk (continued):

#### (ii) Currency risk:

The Company is exposed to the financial risk related to the fluctuation of foreign exchange rates. The Company operates in Canada and the United States and a portion of its expenses are incurred in Canadian dollars. A significant change in the currency exchange rates between the US dollar and the Canadian dollar could have an effect on the Company's results of operations, financial position or cash flows.

The Company is exposed to currency risk through the following assets and liabilities denominated in Canadian dollars:

	2010	2009
Cash and cash equivalents	\$ 1,862,432	\$ 534,033
Accounts receivable	126,543	60,356
Promissory note	-	84,000
Prepaid expenses	-	148,699
Investments	168,066	46,718
Oil and natural gas properties	118,728,618	120,538,880
Accounts payable and accrued liabilities	(469,607)	(267,015)
Convertible debentures	(27,982,856)	(26,381,743)
Asset retirement obligations	(14,702)	(20,151)
	<u>\$ 92,418,494</u>	<u>\$ 94,743,777</u>
U.S. foreign exchange rate	1.0054	0.9515
U.S. dollar equivalent	\$ 92,920,263	\$ 90,146,315

A 10% increase in the Canadian dollar against the United States dollar at December 31, 2010 would result in a change of \$262,324 to net income and \$5,010,472 to other comprehensive income.

#### (iii) Interest rate risk:

The majority of the Company's debt is in fixed rate debentures; however, the Company's income and cash flow are impacted by interest rate fluctuations on its bank loan of \$18,500,000. As at December 31, 2010, the Company did not have any interest rate hedges.

A change of 100 basis points in interest rates would have increased or decreased net income by \$331,000.

# BUCKING HORSE ENERGY INC.

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## 15. Capital management:

The Company considers its capital structure to include working capital and shareholders' equity. Management's objective is to ensure that there is sufficient capital to minimize liquidity risk and to continue as a going concern. Management reviews its capital management approach on an ongoing basis and believes that its approach, given the relative size of the Company is reasonable.

The Company's objectives when managing capital are to:

- ensure there are adequate capital resources to safeguard the Company's ability to continue as a going concern;
- maintain adequate levels of funding to support the acquisition, exploration and development of petroleum and natural gas properties; and
- provide returns for shareholders and benefits for other stakeholders.

The Board of Directors does not establish quantitative return on capital criteria for management, but rather relies on the expertise of the Company's management to sustain future development of the business. There were no changes in the Company's approach to capital management during the period. Neither the Company nor any of its subsidiaries are subject to externally imposed capital requirements other than to maintain debt covenants described in note 6.

## 16. Segmented information:

The Company's activities consist of the exploration and development of oil and natural gas properties in Canada and the United States.

Selected segmented information is as follows:

Year ended December 31, 2010	Canada	United States	Total
Oil & Gas Revenue	\$ 114,514	\$ 13,737,490	\$ 13,852,004
Operating earnings (loss)	(75,204)	1,470,797	1,395,593
Capital expenditures	2,900	7,276,304	7,279,204
Total assets	3,499,433	173,482,019	176,981,452

Year ended December 31, 2009	Canada	United States	Total
Oil & Gas Revenue	\$ 159,960	\$ 12,449,557	\$ 12,609,517
Operating earnings (loss)	(71,909)	(242,168)	(314,077)
Capital expenditures	5,359	5,175,943	5,181,302
Total assets	4,118,185	169,459,943	173,578,128

# BUCKING HORSE ENERGY INC.

Notes to Consolidated Financial Statements  
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## 16. Segmented information (continued):

The Company's revenues are derived from sales to customers in the oil industry. One customer buys all of the oil and gas produced by the Canadian property. The sales of oil and gas produced by the United States properties are made to three customers.

## 17. Contingency:

In 2006, the Company's wholly-owned subsidiary, Arrowhead and seven other unrelated defendants were served with a lawsuit alleging that certain properties, including some of the properties owned by Arrowhead, are subject to a 5% net profits interest owned by the plaintiffs and that all of the defendants, including Arrowhead, are in default of their obligations under this 5% net profits interest to pay money to the plaintiffs. Arrowhead leases that are encumbered by this lawsuit consist of five Pinedale leases totaling 2,040 gross acres (867 net acres) and at the time, 13 developed wells (5.5 net acres).

On March 23, 2010, the Wyoming Supreme Court upheld a lower courts' judgment against the defendants and following remand to the District Court, an amended judgment was entered into for \$4,812,111. The Company's share of this judgment totaled \$58,234 and was paid within the year; however, Management is of the opinion that the Company's share of the expenses for the years 2009 through to present are financially immaterial.

## 18. Subsequent events:

Subsequent to year end, a total of 43,700 common shares were purchased pursuant to the 2010 normal course issuer bid at an average purchase price of C\$3.31. To date, 42,700 common shares have been returned to treasury and cancelled.

On January 31, 2011, the Company purchased \$4.00 NYMEX put options for the period April 2011 through October 2011 on 5,000 MMBtu/day. for a total of 1,070,000 MMBtu.

On January 31, 2011, the Company sold its entire interest in a minor property located in Wainwright, Alberta area to a third party effective January 1, 2011 for gross proceeds of \$15,000. As a result, the Company no longer owns any Canadian oil and gas property interests (see note 5).