

# ***CALVALLEY PETROLEUM INC.***

## **2009 1<sup>st</sup> Quarter Interim Report to Shareholders**

**For the three months  
ended March 31, 2009**

# **1**



## **CORPORATE PROFILE**

Calvalley Petroleum Inc. is an international oil and gas company based in Calgary, Alberta which is focused on exploration and development of Block 9 in the Republic of Yemen and exploration of the Gimbi and Metema Blocks in Ethiopia. Calvalley is well-financed and debt-free and expects to maintain a healthy balance sheet by funding its 2009 capital program from cash generated by operating activities. . Calvalley's common shares are listed on the Toronto Stock Exchange under the symbol "CVI.A."

Calvalley's principal assets and operations are related to its 50% working interest in the Production Sharing Agreement for Block 9, which consists of 2,234 km<sup>2</sup> (552,000 acres) of land within the prolific Sayun-Masila basin. Calvalley has made several significant hydrocarbon discoveries on Block 9. Calvalley declared commerciality during 2005 and started commercial production in December of that year.

Calvalley also owns a 100% working interest in a Production Sharing Contract in Ethiopia for the Metema and Gimbi blocks which cover a total area of 46,470 km<sup>2</sup> (11.5 million acres). The two blocks lie adjacent to the Sudan border, offsetting the Melut/Muglad and Blue Nile Basins, both of which are proven oil basins which form part of the Central African rift system. The Central African rift system is a series of Cretaceous to Tertiary-aged failed rifts that trend across Central Africa from the Benue Trough in Nigeria, through Chad, into Sudan. This early stage project provides Calvalley with additional opportunities to diversify its asset base.

## **FORWARD LOOKING STATEMENTS**

Some of the statements contained herein including, without limitation, financial and business prospects and financial outlooks of the Company may be forward-looking statements which reflect management's expectations regarding future plans and intentions, growth, results of operations, performance and business prospects and opportunities. Words such as "may", "will", "should", "could", "anticipate", "believe", "expect", "intend", "plan", "potential", "continue", and similar expressions have been used to identify these forward-looking statements. These statements reflect management's current beliefs and are based on information currently available to management. Forward-looking statements involve significant risk and uncertainties. A number of factors could cause actual results to differ materially from the results discussed in the forward-looking statements including, but not limited to, changes in general economic, political and market conditions and other risk factors. Although the forward-looking statements contained herein are based upon what management believes to be reasonable assumptions, management cannot assure that actual results will be consistent with these forward-looking statements. Investors should not place undue reliance on forward-looking statements. These forward-looking statements are made as of the date hereof.

Forward-looking statements and other information contained herein concerning the oil and gas industry and Calvalley's general expectations concerning this industry are based on estimates prepared by management using data from publicly available industry sources as well as from reserve reports, market research and industry analysis and on assumptions based on data and knowledge of this industry which Calvalley believes to be reasonable. However, this data is inherently imprecise, although generally indicative of relative market positions, market shares and performance characteristics. While Calvalley is not aware of any misstatements regarding any industry data presented herein, the industry involves risks and uncertainties and is subject to change based on various factors. See "Risk Factors."

Calvalley does not undertake any obligation to update publically or revise any forward-looking statements contained in this or in any other document filed with Canadian securities regulatory authorities, whether as a result of new information, future events or otherwise, except as required by applicable securities laws.

## ABBREVIATIONS

bbls barrels  
 mbbls thousands of barrels  
 bopd barrels of oil per day  
 mmcfd million cubic feet per day  
 km<sup>2</sup> square kilometre

## HIGHLIGHTS

### Financial

These key financial indicators are discussed in more detail in the following sections.

(in thousands of US dollars)	Three months ended March 31	
	2009	2008
Revenue from crude oil sales (net of royalties)	4,160	12,456
EBITDA <sup>(1)</sup>	(44)	9,309
Operating income <sup>(1)</sup>	(1,794)	6,532
Net income (loss)	(2,045)	5,599
Capital expenditures	2,399	7,359
Funds flow from operations <sup>(1)</sup>	(149)	8,401
Cash flow from operating activities	(962)	309

<sup>(1)</sup> See "Non-GAAP Measures"

- Calvalley's revenue from crude oil sales net of royalties was \$4.1 million for the first quarter ended March 31, 2009 (2008 - \$12.5 million). The sales decline was due to soft commodity prices and the timing of lifts.
- Net loss was \$2.0 million for the three months March 31, 2009, as compared to net income of \$5.6 million for the same period of 2008. The net loss was largely attributable to a \$1.1 million expense for facilities usage which was billed retroactively from the commencement of production at Block 9 by the Government of Yemen. A significant portion of this charge, \$1.0 million, related to deliveries that occurred prior to January 1, 2009. Low sales volumes due to the timing of lifts also contributed to this loss.
- Funds flow from operations was \$(0.1) million for the three months ended March 31, 2009, as compared to \$8.4 million for the same period of 2008.
- Calvalley continues to be well financed and capitalized with no outstanding debt and working capital of \$72.6 million.

## Operating

(barrels of oil per day)	Three months ended	
	March 31, 2009	March 31, 2008
Total Block 9 production	4,532	4,602
Calvalley working interest (50.0%)	2,266	2,301

- Average daily production from the Block 9 for the three months ended March 31, 2009 was 4,532 gross barrels per day (Calvalley working interest 2,266 bopd), an increase from the previous quarter's average of 3,989 bopd (1,994 bopd working interest share) and comparable to 4,602 bopd (2,301 bopd working interest share) for the first quarter of 2008.
- Construction of water and gas injection facilities at Hiswah continues with completion targeted for mid-2009.
- Calvalley is constructing a heavy crude blending facility at the CPF, which will enable the Company to produce from the currently shut-in Al Roidhat field. Wells at Al Roidhat are being worked over to prepare them for production.

## CHAIRMAN AND CHIEF EXECUTIVE OFFICER'S REPORT

Calvalley remains in an excellent position for future growth with a strong balance sheet and opportunities for organic growth through the drill bit. The Company has working capital of US\$72.6 million with no debt. Our production capability continues to grow and our growing inventory of both development and exploration drilling locations continues to support a multi-year drilling program.

Although the Company experienced increased production during the first quarter over the previous quarter, Calvalley's production is currently hindered by limited access to Safer (Block 18) facilities due to a crude quality differential. As a result, certain wells in the Hiswah field have been recently shut in and the field is producing suboptimally from an average of 16 producing wells of the existing 23 wells. We are working diligently to resolve this issue to increase production as our reserves base and shut-in wells support material production growth opportunities. During the quarter, we made progress towards removing these obstacles by working with other operators of blocks in Yemen in order to optimize production from both existing and future discoveries on Block 9.

Calvalley continued to make progress towards the completion of key infrastructure projects including the blending facilities, and water and gas injection, which are key to our production growth from existing and future discoveries. We expect to complete these facilities in the second half of the year. The CPF, which has the capability to process 60,000 bopd, is now fully commissioned

The Qarn Qaymah 2 testing program was halted during the quarter due to the lack of specialized downhole equipment that was needed to complete the extensive testing program. The complex nature of the reservoirs encountered necessitates an extensive testing program for the well. The necessary equipment is now on-site and we have mobilized the required services to re-test the fractured granitic basement in June. Upon completion of the test of the fractured basement, we will move uphole to perforate and test the Kohlan gas/condensate discovery.

Commodity prices were weak in the first quarter with Calvalley's average sales price averaging \$38.75 per barrel. The net loss for the quarter totaled \$2.0 million or \$0.02 per share. Capital expenditures for the quarter were \$2.4 million, primarily for the injection and blending facility projects and preparation of the Al Roidhat wells for production. With working capital of \$72.6 million, Calvalley remains debt-free and well positioned to fund its capital program without further dilution to its shareholders. The company continued with its ongoing share buy back program spending \$1.1 million to buy back 1,148,622 shares during the quarter. In addition, in May, the board of directors has approved a new buyback program of approximately 4.9 million additional shares.

Our exploration team has identified 42 exploration plays and prospects with numerous high impact exploration targets, two of which are planned to be drilled in the second half of the year: Ras Nowmah and Salmin. The two prospects are shallower multi-horizon targets with total depth not exceeding 1,500 meters and have a combined unrisksed mean oil-in-place potential of approximately 200 million barrels.

### ***"Edmund Shimon"***

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Edmund M. Shimon  
Chairman and Chief Executive Officer  
May 14, 2009

## **OPERATIONS REPORT**

### **Production Overview**

During the first quarter of 2009, daily production from Block 9 averaged 4,532 barrels of oil per day (“bopd”) (2007 - 4,602 bopd), with the Company’s working interest share being 2,266 bopd (2008 – 2,301 bopd). All of our production came from the partially developed Hiswah oil field, which produces high-quality, lighter sweet crude oil that is sold at a price comparable to Dated Brent Crude.

Despite expected performance from the existing producing wells at the Hiswah field, production has been constrained due to the limitation of sales volume that is accepted by the Safer Facilities at Block 18 (“Safer”). Production from the Hiswah field continues to be limited to an average of sixteen of twenty-three existing horizontal wells due to this limitation. The Facility Usage Agreement at Block 18 dictates that blended crude at the facility shall not exceed 0.12% in sulfur content by weight. The sulfur content of Safer production is 0.09%. After blending Safer production with the production from Block 9, the sulfur content averages 0.12%. Increases or decreases in Safer’s production impact the sales volume that can be accepted for blending from Block 9. Safer’s production at Block 18 has been continuously declining and consequently, Block 9 has been forced to reduce its crude oil volume to keep overall sulfur content at Safer under 0.12%. Calvalley’s crude is sweet and has an average of 0.43% sulfur which is comparable to 0.42% which is the standard for Dated Brent Crude.

Calvalley has initiated a number of alternative solutions to sell blended crude oil from all discoveries at Block 9 including production from wells that are currently shut-in. Two of the alternative sales are Block 14 or Block 51. Discussions toward delivering Block 9 crude to one of these blocks are proceeding with the operator. The Government of Yemen has formed a “tie-committee” to oversee the progress of these discussions. Once an agreement to evacuate all types of crude from Block 9 is signed, Calvalley will commence the construction process of the main sales pipeline which has been approved by the government.

In anticipation of finding an alternative solution for all kinds of crude discovered at Block 9, Calvalley has substantially completed a heavy crude blending facility at the CPF. The blending facility will enable the Company to process production from the currently shut-in Al Roidhat field. Currently, four wells at Al Roidhat are fully equipped and ready to produce. An additional four wells have been drilled and are undergoing completion. Once fully developed, Al Roidhat is expected to reach peak production of 10,000 bopd based on the existing reserves. However, the Al Roidhat field will remain shut-in until a marketing solution is finalized. We expect to produce from this field prior to yearend.

### **Hiswah Field Development**

During the first quarter, no development wells were drilled at the Hiswah field. However, a number of workover programs were carried out to enhance well performance. The 2009 budget includes the drilling of six horizontal development wells expected to commence in July 2009.

## **Facilities**

The CPF, with a 60,000 barrel per day processing capability, is now fully functional. Construction of key components of water injection and gas re-injection facilities for the Hiswah field has advanced significantly. Water injection facilities have been constructed and delivered to Block 9. On-site construction is expected to be completed during the second quarter and water injection is expected to commence in the third quarter. The gas injection facilities are currently being constructed in Dubai. The Hiswah field currently produces approximately 5.5 mmcf/d of solution gas which is being flared and will be utilized for pressure maintenance once these facilities are completed.

## **Exploration Drilling Program**

No exploration wells were drilled during the first quarter. Testing of the Qarn Qaymah 2 ("QQ-2") well was halted due to lack of specialized downhole equipment including smaller diameter (2 7/8 inch) production tubing. All required equipment has now been received and Calvalley will re-test the fractured granitic basement at QQ-2 commencing in June. Upon full evaluation of fractured basement, we will move up hole to perforate and test the Kohlan sand gas condensate discovery. Completion of QQ-2 will enable us to high-grade and then proceed with drilling a number of very attractive deep wells in the greater Qarn Qaymah area.

Calvalley plans to drill two exploration wells at shallower depths (less than 1500 meters) during 2009. These wells are to be drilled in Ras Nowmah and Salmin prospects, both of which are on a proven oil fairway. Salmin is situated approximately five (5) kilometers northwest of the Auqban discovery targeting a light oil carbonate structure with an estimated mean oil-in-place volume of 45 million barrels. The Ras Nowmah structure is situated between Hiswah and Al Roidhat with a potential of 149 million barrel of mean oil-in-place.

## **Future Plans**

During 2009, Calvalley plans to drill six horizontal development wells at Hiswah, and two exploration wells at Ras Nowmah and Salmin prospects. Once Calvalley resolves the marketing issue of all its crude from Block 9, we expect to accelerate development and exploration activities substantially to unlock the potential of the block.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

References to "Calvalley" or the "Company" refer to Calvalley Petroleum Inc. and its share of consolidated subsidiaries and joint ventures unless the context indicates otherwise. All currency references are to United States dollars unless otherwise specifically indicated. References to "C\$" are to Canadian dollars.

The purpose of this Management's Discussion and Analysis is to provide readers the ability to view Calvalley in much the same way as Management. The following combination of historic and prospective information and financial and business analyses, together with the consolidated financial statements, are intended to impart useful knowledge to investors and other readers. This Management's Discussion and Analysis should be read in conjunction with the unaudited interim consolidated financial statements and related notes of Calvalley for the three month period ended March 31, 2008. Additional information relating to the Company, including the Company's Annual Information Form, is available on SEDAR at [www.sedar.com](http://www.sedar.com) or on the Company's web site at [www.calvalleypetroleum.com](http://www.calvalleypetroleum.com).

This Management's Discussion and Analysis is as of May 15, 2009.

### Forward-Looking Statements

This Management's Discussion and Analysis contains certain forward-looking statements. Some of the statements contained herein including, without limitation, financial and business prospects and financial outlooks of the Company may be forward-looking statements which reflect management's expectations regarding future plans and intentions, growth, results of operations, performance and business prospects and opportunities. Words such as "may", "will", "should", "could", "anticipate", "believe", "expect", "intend", "plan", "potential", "continue", and similar expressions have been used to identify these forward-looking statements. These statements reflect management's current beliefs and are based on information currently available to management. Forward-looking statements involve significant risk and uncertainties. A number of factors could cause actual results to differ materially from the results discussed in the forward-looking statements including, but not limited to, changes in general economic, political and market conditions and other risk factors. Although the forward-looking statements contained herein are based upon what management believes to be reasonable assumptions, management cannot assure that actual results will be consistent with these forward-looking statements. Investors should not place undue reliance on forward-looking statements. These forward-looking statements are made as of the date hereof.

Forward-looking statements and other information contained herein concerning the oil and gas industry and Calvalley's general expectations concerning this industry are based on estimates prepared by management using data from publicly available industry sources as well as from reserve reports, market research and industry analysis and on assumptions based on data and knowledge of this industry which Calvalley believes to be reasonable. However, this data is inherently imprecise, although generally indicative of relative market positions, market shares and performance characteristics. While Calvalley is not aware of any misstatements regarding any industry data presented herein, the industry involves risks and uncertainties and is subject to change based on various factors. See "Risk Factors."

Calvalley does not undertake any obligation to update publicly or revise any forward-looking statements contained in this or in any other document filed with Canadian securities regulatory authorities, whether as a result of new information, future events or otherwise, except as required by applicable securities laws.

## Non-GAAP Measures

Funds flow from operations is a non-GAAP measure that represents funds generated from operating activities before changes in non-cash working capital. Funds flow from operations should not be considered an alternative to, or more meaningful than, cash flow from operating activities. Management believes that funds flow from operations is a useful supplemental measure to analyze the Company's ability to generate cash flow to fund capital investment and working capital requirements. Funds flow from operations may not be comparable to similar measures used by other companies.

Earnings before interest, taxes, depreciation and amortization ("EBITDA") and operating income are non-GAAP measures. The Company calculates EBITDA as revenue net of royalties, operating expenses and general and administrative expenses. The Company calculates operating income by deducting depletion, depreciation and accretion expense from EBITDA. Management believes that EBITDA and operating income are useful supplemental measures to analyze operating performance and to provide an indication of the results generated by the Company's principal business activities prior to the consideration of other income and expenses. EBITDA and operating income may not be comparable to similar measures used by other companies.

Netback is a non-GAAP measure that represents revenue net of royalties, operating expenses and current taxes. Management believes that netback is a useful supplemental measure to analyze operating performance and provide an indication of the results generated by the Company's principal business activities prior to the consideration of other income and expenses. Netback may not be comparable to similar measures used by other companies.

## Overall Performance

Net loss for the three month period ended March 31, 2009 was \$2.0 million versus net income of \$5.6 million for 2008. Funds flow from (used in) operations decreased to (\$149,000) from \$8.4 million in 2008. Working capital at March 31, 2009 was \$72.6 million versus \$75.8 million at December 31, 2008. Funds flow from operations is anticipated to finance the Company's capital program during 2009 without the requirement for external financing.

## Business Environment

The Company's financial results are significantly influenced by fluctuations in commodity prices. The following table shows select market benchmark prices for 2008 and Q1 2009:

	Q1 2009	Q4 2008	Q3 2008	Q2 2008	Q1 2008
Dated Brent average oil price (\$/bbl)	44.46	54.91	114.78	121.38	96.90

The price of Dated Brent oil averaged \$44.46/bbl in Q1 2009, a decrease of 54% from the Q1 2008 price of \$96.90/bbl. The price of Dated Brent oil reached a record high of \$144.23/bbl in July 2008. However, financial market instability and a worldwide recession resulted in a steep decline in the price of Dated Brent oil in from August to December 2008. The closing price of Dated Brent oil at March 31, 2009 was \$46.52/bbl.

The current global financial crisis has reduced liquidity in financial markets, restricted access to financing and caused significant volatility in commodity prices. These factors will continue to impact the performance of the global economy going forward. Companies such as Calvalley, with no debt, strong cash generation from operations, and the availability of cash and cash equivalents, will be well positioned to manage through the crisis. Furthermore, Calvalley's approach is to operate within a balanced budget and the Company does not expect to incur long-term debt in the near future.

### **Canadian Oil and Gas Properties**

The Company disposed of most of its Canadian oil and gas properties in 2004 and existing properties are comprised of a working interest in one property in Saskatchewan and some overriding royalties. The remaining Canadian properties are not material to the overall financial position and results of operations of the Company.

### **Comparability with Prior Periods**

Revenue may fluctuate from year to year due to the timing of shipments of oil from the Ras Isa Oil Terminal. Revenue is recognized only when oil is loaded onto a tanker. Oil in storage at period-end is recorded as inventory at the average cost of production and depletion and in situations where the take-or-pay provisions of the crude marketing agreement take effect. Amounts receivables related to those provisions are recorded in the accounts as deferred revenue. At March 31, 2009, the Company's share of take-or-pay revenue was \$1.7 million. The Company's share of oil inventory at period end was \$3.6 million.

In April 2009, the Government of Yemen charged Calvalley \$1.1 million for facilities usage. All producers of crude oil in Yemen are subject to the Facility Usage Fee ("FUF"). The charge was applied retroactively from the commencement of production at Block 9. The portion of the charge related to deliveries that occurred prior to January 1, 2009 amounts to \$1.0 million. The balance of the charge in the amount of \$81,000 (\$0.40/bbl) relates to oil that was delivered to the government facility during Q1 2009. The FUF is recoverable from the Company's share of cost oil in accordance with the terms of the Production Sharing Agreement.

### **Block 9 Republic of Yemen – Exploration and Development Program**

#### *Joint Operating Agreement*

Substantially all of Calvalley's operations and assets are related to its 50% working interest in the Block 9 Production Sharing Agreement ("PSA") with the Government of Yemen. Calvalley is the operator of Block 9 pursuant to the Joint Operating Agreement ("JOA") between Calvalley, HoodOil Ltd. ("HoodOil"), Reliance Industries Limited ("Reliance") and a subsidiary of the Yemen Oil and Gas General Corporation ("Yemen Co."), an entity owned by the Government of Yemen. Yemen Co.'s interest under the JOA consists of a 15% overriding royalty on the joint venture's allocation of profit oil under the PSA.

### Production Sharing Agreement

The Company has a 50% working interest in Block 9. Oil and gas production from Block 9 is allocated between the Joint Venture (the "JV") and agencies of the Government of Yemen pursuant to the terms of the PSA. The Government of Yemen receives a 10% royalty in kind from all Block 9 production, after which the remaining oil production is shared between the JV and the Government of Yemen. The JV is first allocated up to 45% of gross production to recover capital and operating costs incurred in order to operate Block 9. To the extent that recoverable costs exceed 45% of the fair value of gross production, any excess costs are carried forward for recovery against future production. After deducting cost oil, the remaining profit oil is allocated between the Government of Yemen and the JV as follows:

- 39.23% of total profit oil to the JV (before deducting 35% income tax on JV's share of profit oil and after deducting 15% override to Yemen Co.); and
- 60.77% to the Government of Yemen (including Yemen Co.'s override and before including income tax on JV's share of profit oil).

Provided that total recoverable costs do not exceed 45% of gross production, the JV may recover operating costs during the year in which they are incurred and may deduct 50% of capital costs incurred during the year of expenditure and 50% during the following year.

As at March 31, 2009, the Company's share of capital costs to be carried forward for recovery against future production was approximately \$53 million. Until these costs have been recovered, together with future operating and capital costs that become eligible for recovery during that time period, the Company's net oil production will equal 31.33% of gross oil production (22.5% from cost oil and 8.83% from profit oil). Following full recovery of past operating costs, the Company's net oil production will range between 17.65% and 31.33% of gross oil production, which will vary depending upon prevailing crude oil selling prices and the capital and operating costs incurred by the JV. The Company's share of profit oil is subject to 35% income tax to the Government of Yemen.

### **Outlook**

The Company's 2009 program is designed to debottleneck production by executing a marketing solution for all kinds of crudes discovered on Block 9 and continue to add reserves at attractive costs. The budget has been developed to maintain the strength of the Company's balance sheet by funding the entire capital expenditure program of approximately \$18 million with internally generated cash flow. The capital program calls for six horizontal development wells at Hiswah and two exploration wells: one at Ras Nowmah and one at Salmin prospects. However, should the marketing issue be resolved, our contingent capital program calls for increased drilling capital by drilling additional development wells at Hiswah and Roidhat and additional exploration wells.

While Calvalley increased its production capability in 2008, significant production was shut-in due to the lack of a marketing solution for Al Roidhat. Calvalley expects to bring Al Roidhat production on stream in the second half of 2009 by concluding the ongoing marketing efforts for crude from this field. In addition, the 2009 program focuses on unlocking the potential of deeper horizons (fractured basement and Kohlan sands) in the Qarn Qaymah area.

Major milestones are subject to factors noted in the Risk Factors section of this Management Discussion and Analysis. Milestones planned for 2009 include the following:

- Increase total production by concluding a marketing agreement for heavy crude from the Al Roidhat field;
- Complete the initial phase of the pressure maintenance program (water and gas injection) to commence full field development at Hiswah;
- Continue to add new reserves and production through new exploration and development;
- Fully evaluate the Qarn Qaymah discovery through additional testing of the fractured basement and completion of the Kohlan sands gas/condensate discovery;
- Drill a minimum of six horizontal producers at Hiswah Field;
- Develop an appraisal program in the Qarn Qaymah area, based on test results from QQ-2, which will include a 3D seismic program and future well locations;
- Drill a minimum of two exploration locations on Block 9;
- High-grade the existing exploration portfolio of 42 prospects and leads;
- Undertake a gravity/magnetic survey at Metema and Gimbi blocks in Ethiopia; and
- Continue to take advantage of Calvalley's strong balance sheet and its international operating experience by continuing to evaluate the potential acquisition of additional assets in the Middle East and Africa.

### **Key Financial Indicators**

Calvalley uses key financial indicators to help assess its business performance and manage its operations. These financial indicators measure business growth (revenue and capital expenditures), cash generation (EBITDA and funds flow from operations) and profitability (operating income and net income). These key financial indicators are discussed in more detail in the following sections.

#### *Production*

Substantially all of Calvalley's crude oil production in 2009 and 2008 came from the Hiswah oil field, which produces high-quality, lighter crude oil that is sold at prices comparable to the Dated Brent crude oil reference price. All of the Company's crude oil production was trucked more than 250 kilometers to the Safer Exploration and Production Operations Co. processing facility on Block 18, where the crude oil was processed and shipped via pipeline to the Ras Isa marine terminal facility for export. During the first quarter of 2009, the Company's working interest oil production averaged 2,266 barrels of oil per day ("bopd") (2008 – 2,301 bopd), from which the Company was allocated 1,420 bopd net (2008 - 1,440 bopd) pursuant to the PSA. Production during the first quarter of 2009 recovered from the levels of the fourth quarter of 2008 as shut in production came on-stream as pumps became available. Fourth quarter 2008 production also suffered due flooding during the month of October which essentially shut in the Hiswah field for four days.

The following table sets forth the Company's production and sales information for the periods indicated.

Production and sales information

	2009		2008			
	Q1	2008 Total	Q4	Q3	Q2	Q1
Block 9 Oil Production (bopd)	4,532	4,522	3,989	4,743	4,759	4,602
Company working interest share (bopd)	2,266	2,261	1,994	2,372	2,380	2,301
Company net share (bopd) <sup>(1)</sup>	1,420	1,417	1,250	1,484	1,489	1,440
Company net production (mdbl)	128	518	115	137	135	131
Company net sales (mdbl) <sup>(2)</sup>	111	431	36	141	130	124

(1) Company net share is equal to the working interest share less government share of production under the terms of the PSA before income taxes.

(2) Company net sales before income taxes varies from Company net production due to changes in inventory and shrinkage.

The following table sets forth the key financial indicators for 2009 and 2008.

Selected operating information (thousands of dollars)

	2009		2008			
	Q1	2008 Total	Q4	Q3	Q2	Q1
Oil sales	6,860	74,686	4,060	25,082	25,434	20,110
Royalties	(2,700)	(28,440)	(1,609)	(9,534)	(9,643)	(7,654)
Operating expenses	2,113 <sup>(1)</sup>	(7,741)	(837)	(2,045)	(2,841)	(2,018)
Current taxes	(418)	(4,622)	(257)	(1,550)	(1,572)	(1,243)
Netback <sup>(2)</sup>	1,629	33,883	1,357	11,953	11,378	9,195

General and administration	(1,165)	(4,376)	(1,094)	(509)	(1,540)	(1,233)
EBITDA <sup>(2)</sup>	(44)	34,682	691	13,178	11,504	9,309
Operating income loss <sup>(2)</sup>	(1,794)	25,318	(13)	10,072	8,727	6,532
Net income (loss)	(2,045)	19,161	25	9,105	4,432	5,599
Capital expenditures	2,399	27,504	4,687	5,965	9,493	7,359
Funds flow from operations <sup>(2)</sup>	(149)	31,131	414	12,050	10,266	8,401
Cash flow from operating activities	(962)	37,220	(1,661)	4,511	34,061	309

(1) For the purpose of calculating Netback, operating expenses in the first quarter of 2009 have been adjusted to exclude the portion of the Facility Usage Fee which relates to deliveries of crude oil prior to January 1, 2009 in the amount of \$1,025. See discussion on Operating Expenses for further details.

(2) See "Non-GAAP Measures".

Netbacks are calculated on barrels sold as government royalties, sales taxes and operating expenses are recognized when the underlying oil is sold. Government royalties and taxes taken in kind are attributed value at the price received by Calvalley for its production as follows:

(dollars per bbl)	2009		2008			
	Q1	2008 Total	Q4	Q3	Q2	Q1
Oil sales	38.75	108.23	70.50	111.12	123.60	100.05
Royalties	(15.72)	(41.67)	(27.58)	(42.75)	(47.41)	(38.61)
Operating expenses	(11.93) <sup>(1)</sup>	(11.22)	(14.53)	(9.06)	(13.81)	(10.04)
Current taxes	(2.39)	(6.69)	(4.36)	(6.87)	(7.64)	(6.18)
Netback <sup>(2)</sup>	8.70	48.65	24.03	52.44	54.75	45.21

(1) For the purpose of calculating Netback, operating expenses in the first quarter of 2009 have been adjusted to exclude the portion of the Facility Usage Fee which relates to deliveries of crude oil prior to January 1, 2009 in the amount of \$5.79/bbl. See discussion on Operating Expenses for further details.

(2) See "Non-GAAP Measures".

### Revenue

Calvalley recorded oil revenue of \$6.9 million during the three month period ended March 31, 2009 as compared to \$20.1 million for the three month period ended March 31, 2008. The significant decrease in revenue is primarily attributable to a 61.3% decrease in the average selling price realized in the first quarter of 2009 compared with the first quarter of 2008. In addition, the Company recognized revenue on the sale of 177,069 barrels during the three months ended March 31, 2009 compared with 201,006 barrels in three months ended March 31, 2008 representing an 11.9% decrease in volume. The decrease in sales volume is attributable to the timing of lifts and is not correlated with production which was 203,955 in 2009 versus 212,769 in 2008.

### Other Revenue

Other revenue, comprised primarily of interest revenue, amounted to \$0.4 million for the first quarter of 2009 as compared to \$0.6 million for the quarter ended March 31, 2008. Interest revenue resulted from maintaining significant cash reserves and GIC's throughout the quarter. Interest income has declined from 2008 due to reductions in interest rates. Interest rates on US denominated deposits declined as the Federal Reserve attempted to stimulate the US economy by reducing its borrowing rates.

### Operating Expenses

Operating expenses during the three months ended March 31, 2009 were \$2.1 million (\$11.93/bbl) as compared to \$2.0 million (\$10.04/bbl) in the first quarter of 2008.

In 2009, the Government of Yemen charged Calvalley \$1.1 million for facilities usage. All producers of crude oil in Yemen are subject to the Facility Usage Fee ("FUF"). The charge was applied retroactively from the commencement of production at Block 9. The portion of the charge related to deliveries that occurred prior to January 1, 2009 amounts to \$1.0 million and has been excluded from operating expenses for the purpose of this MD&A to maintain comparability of operating expenses by including the portion which represents a current charge and will be continued in future quarters. The balance of the charge in the amount of \$81,000 (\$0.40/bbl) relates to oil that was delivered to the government facility during the first quarter of 2009. The FUF is recoverable from the Company's share of cost oil in accordance with the terms of the Production Sharing Agreement.

As a result of the current global financial crisis and falling oil prices, the oil industry has cut back or delayed certain capital intensive projects, which may in turn lead to less demand and lower costs. Calvalley attempts to manage operating costs through competitive bidding, long term contracts and, recently, renegotiation of current contract terms, where possible.

Operating expenses include \$5.47 (2008 - \$5.37) per gross barrel for trucking costs, third party processing costs, and tariffs for use of pipeline and marine terminal facilities.

#### Netback

Netbacks for the quarter were \$8.70 per barrel compared to \$45.21 for 2008. Commodity price declines of \$61.30 per barrel is the main contributor to this decline. This is partially offset by the decline in royalties. The Company is implementing strict cost control measures in all of its operations to preserve the highest netbacks possible.

#### General and Administration

General and administration expenses, net of \$0.4 million that was capitalized into resource development costs, totaled \$1.2 million for the three month period ended March 31, 2009 which was consistent with \$1.2 million for the quarter ended March 31, 2008. General and administrative costs directly associated with Block 9 become recoverable costs and will be recovered from revenue associated with cost oil under the terms of the PSA.

#### EBITDA

During the first quarter of 2009, the Company generated a loss before interest, taxes, depreciation and amortization of \$44,000 compared with EBITDA \$9.3 million during the first quarter of 2008. The decrease is primarily related to the significant decrease in commodity prices during the first quarter of 2009 in comparison with the first quarter of 2008. The facility usage charge referred to above in the discussion on operating expenses was a major contributor to the negative EBITDA recognized in the first quarter. EBITDA is also impacted by the timing of lifts by the purchaser of the Company's crude oil.

#### Depletion and Depreciation

Calvalley recorded depletion, depreciation and accretion expenses of \$1.8 million for the three months ended March 31, 2009 as compared to \$2.8 million for the first quarter of 2008. The decrease is primarily related to upward technical revisions to the Company's reserves as estimated by independent reserve engineers at December 31, 2008.

#### Operating Income

During the quarter, the Company generated an operating loss of \$1.8 million compared with operating income of \$6.5 million during the first quarter of 2008. Operating income was impacted by the same factors as those affecting netbacks and EBITDA.

#### Foreign Exchange Loss

The Company recognized a small exchange gain of \$0.04 million during the first quarter of 2009 compared with a loss of \$0.1 million during the first quarter of 2008.

### Income Taxes

Current income tax expense in the first quarter of 2009 of \$0.4 million (2008 - \$1.2 million) represents income taxes incurred and paid under the laws of Yemen pursuant to the PSA. The income tax is calculated as 35% of the Company's profit oil revenue in Yemen, and is paid by the Government of Yemen out of its portion of profit oil.

### **Consolidated Cash Flow**

#### Operating Activities

(thousands of dollars)	2009		2008			
	Q1	2008 Total	Q4	Q3	Q2	Q1
Funds flow from operations	<b>(149)</b>	31,131	414	12,050	10,266	8,401
Change in non-cash working capital	<b>(817)</b>	6,136	(2,081)	(7,445)	23,675	(8,012)
Unrealized foreign exchange gain(loss) relating to non-cash working capital	<b>4</b>	(48)	6	(94)	120	(80)
Cash provided by (used in) operations	<b>(962)</b>	37,219	(1,661)	4,511	34,061	309

As at March 31, 2009, the Company held cash and cash equivalents of \$5.7 million compared with \$21.0 million at the end of the preceding year. Additionally, the Company held Guaranteed Investment Certificates with an initial term of greater than 90 days in the amount of \$47.2 million (December 31, 2008 - \$42.7 million). The Company invests its cash reserves in Guaranteed Investment Certificates issued by an Alberta credit union guaranteed by the Province of Alberta.

#### Investing Activities

(thousands of dollars)	2009		2008			
	Q1	2008 Total	Q4	Q3	Q2	Q1
Additions to property, plant and equipment	(2,399)	(27,504)	(4,687)	(5,965)	(9,493)	(7,359)
Change in non-cash working capital	(6,403)	1,629	2,721	583	(1,163)	(512)
Net investment in GIC's	(4,441)	(37,719)	279	12,269	(23,513)	(26,754)
Cash provided by (used in) investing activities	<b>(13,243)</b>	(63,594)	(1,687)	6,887	(34,169)	(34,625)

During the first quarter of 2009, the Company made capital expenditures of \$2.4 million compared with \$7.4 million during the first quarter of 2008. During the quarter, the Company invested in the construction of additional facilities for water and gas injection and the blending of crude oil. Expenditures were also incurred to prepare the Al-Roidhat wells for production on the completion of marketing arrangements for the blended crude. The Company funded expenditures on behalf of its partners in excess of payments received from them in the amount of \$6.4 million during the quarter. The Company also invested cash reserves in GICs in the three months ended March 31, 2009.

### Financing Activities

(thousands of dollars)	2009		2008			
	Q1	2008 Total	Q4	Q3	Q2	Q1
Issuance of common shares	-	514			400	114
Common share repurchase	(1,094)	(4,822)	(371)	(2,098)	(2,353)	
	(1,094)	(4,308)	(371)	(2,098)	(1,953)	114

During the first quarter of 2009, the company repurchased 1,148,622 common shares on the open market pursuant to its normal course issuer bid at a total cost of \$1.1 million. During the first quarter of 2008, proceeds from the issuance of Class "A" common voting shares was related solely to the exercise of stock options and totaled \$114,000.

### **Consolidated Financial Position**

(thousands of dollars)	2009		2008		
	Q1	Q4	Q3	Q2	Q1
Cash and cash equivalents	5,697	20,989	24,414	15,151	17,412
Guaranteed Investment Certificate	47,187	42,746	43,025	55,294	31,781
Accounts receivable	2,302	3,296	4,144	5,544	13,918
Prepaid expenses	280	281	262	351	247
Due from joint venture partners	22,719	18,419	19,565	14,144	23,722
Oil inventory	3,621	2,995	240	684	413
Property and equipment	83,887	83,863	80,876	77,929	71,340
Total Assets	165,683	172,406	172,526	169,097	158,833

As at March 31, 2009, the Company's total assets were \$165.7 million, a decrease of \$6.7 million from December 31, 2008. Cash and cash equivalents amounted to \$5.7 million compared with \$21.0 million at the beginning of the year.

During the three months ended March 31, 2009, accounts receivable decreased by \$1.0 million to \$2.3 million. The balance at March 31, 2009 relates to revenue and deferred revenue receivable and due in April 2009 from oil sold during February 2009. Amounts due from joint venture partners increased from \$18.4 million at the beginning of the year to \$22.7 million as at March 31, 2009. Management is working with the JV partners to decrease this receivable during the second quarter of 2009.

Oil inventory increased from \$3.0 million to \$3.6 million as a result of production which was not lifted in the first quarter of 2009. The oil inventory relates to oil production in storage at the end of the quarter, valued at the average cost of production.

Property, plant and equipment increased to \$83.9 million as at March 31, 2009 compared with \$83.7 million at the end of December 2008. The increase in property, plant and equipment resulted from capital expenditures of \$2.4 million, which was partially offset by depletion, depreciation and amortization expense of \$1.8 million.

(thousands of dollars)	2009		2008		
	Q1	Q4	Q3	Q2	Q1
Accounts payable and accrued liabilities	7,554	9,693	12,703	15,992	11,182
Deferred revenue	1,653	3,255	-	-	-
Share Capital	116,888	118,243	118,697	119,400	119,643

Accounts payable and accrued liabilities decreased to \$7.5 million as at March 31, 2009, compared with \$9.7 million as at December 31, 2008. The primary reason for this decrease is related to the reduction in capital spending due to the completion of the Central Processing Facility and reduced capital spending on drilling operations during the first quarter.

Share capital decreased to \$116.9 million as at March 31, 2009 from \$118.2 million as at the end of 2008 as a result of the repurchase of Common Shares through the Company's normal course issuer bid.

### Liquidity and Capital Resources

Calvalley's principal source of liquidity has been funds flow from operations. Calvalley manages its liquidity risk by regularly monitoring its cash flows from operating activities and holding adequate amounts of cash and cash equivalents. The Company does not invest its funds in speculative securities. The 2009 budget is expected to be funded from cash flow from operations and existing cash resources. Should the prevailing Brent Crude price continue to be depressed for the balance of 2009, Calvalley has sufficient flexibility in its capital budget to adjust capital expenditures to ensure they continue to be funded by internally generated cash flow. Fluctuations in commodity prices, product demand, foreign exchange rates, interest rates and various other risks relating to factors beyond the control of Calvalley may impact capital resources.

Calvalley has no outstanding bank debt or other interest bearing indebtedness as at March 31, 2009. The Company has not arranged any undrawn operating lines of credit with any financial institution as the Company intends to fund its near-term capital expenditure programs from available cash on hand, funds flow from operations and, if required, from the issuance of additional share capital.

As at March 31, 2009, the Company's total assets were \$165.7 million, a decrease of \$6.7 million from December 31, 2008. Cash and cash equivalents amounted to \$5.7 million compared with \$21.0 million at the beginning of the year. Cash equivalents are invested with high quality financial institutions with terms to maturity of less than three months. Additionally, the Company held GIC's with an initial term of greater than 90 days. Total cash and cash equivalents plus GIC's decreased from \$63.7 million at December 31, 2008 to \$52.9 million at March 31, 2009.

Interest rates on US denominated funds have decreased substantially over the past year as the Federal Reserve attempts to stimulate the US economy by reducing its borrowing rates. Most of Calvalley's funds are deposited at a credit union where deposits are guaranteed by the Government of Alberta.

As at March 31, 2009 the Company's working capital was \$72.6 million as compared to \$75.8 million as at December 31, 2008.

At December 31, 2008 the Company had Canadian tax pools of approximately \$28.2 million of which \$10.8 million were non-capital losses, \$5.6 million were Canadian resource tax pools, \$8.4 million were undepreciated capital cost allowance and \$3.4 million were deferred financing costs. No provision has been made to record these pools as an asset because the Company is not likely to take advantage of them due to the insignificance of its Canadian operations and assets.

The Company has no long-term contractual obligations in Canada other than an operating lease for office space of approximately \$0.3 million in 2009 and \$0.2 million in 2010. Its long-term commitments regarding its Yemen property include its 50% proportionate share of government allowances and bonuses payable under the terms of the PSA of \$0.45 million per year, plus its 50% proportionate share of certain other bonus payments of \$2 million, \$3 million and \$4 million when and if sustainable production exceeds 25,000, 75,000 and 100,000 barrels of oil per day, respectively.

Calvalley entered into its first Production Sharing Contract ("PSC") with the Ethiopian Government for the exploration, development and production of petroleum resources in the Gimbi and Metema blocks under a single contract covering a total area of over 46,470 square kilometers (11.5 million acres). Both blocks are located in the western part of the country, adjacent to the Sudan border. As part of the PSC, the Company has entered into certain commitments to spend approximately \$8.5 million during the first four years of its work program.

Calvalley had no off balance sheet arrangements as at March 31, 2009 or at December 31, 2008.

### **Economic Sensitivities**

The following table shows the estimated after-tax effect that changes to crude oil prices, gross crude oil production, operating costs and interest rates would have had on Calvalley's net income for the three month period ended March 31, 2009, had these changes occurred on January 1, 2009. These calculations are based on business conditions, production and sales volumes existing for the current period. The 1,000 bopd increase assumes the increase is to gross field production and that all incremental production was sold at the price received during the quarter, and Calvalley's entitlement is calculated according to the provisions of the PSA and JOA.

<b>Economic Sensitivities</b>	<b>Change (+)</b>	<b>Net Income impact (US\$ millions)</b>	<b>Net Income impact (\$ per basic share)</b>
Average realized price	\$10.00/bbl	1.0	0.01
Crude oil production (gross at field level)	1,000 bbls/d	0.0	(0.00)
Operating expenses	\$1.00/bbl	(0.2)	(0.00)
Interest rate	1%	0.1	0.00

The impact of the above changes may be compounded or offset by changes to other business conditions. In addition, the table does not reflect any inter-relationships between the above factors. Changes in the foreign exchange rates have not been considered in this analysis.

## **Related Party Transactions**

There were no related party transactions during 2009 or 2008.

## **Risk Factors**

Calvalley is exposed to a number of risks inherent in exploring for, developing and producing oil and gas. This section describes the risks and other matters that would be most likely to influence an investor's decision to purchase securities of Calvalley.

Calvalley manages a number of risks in its business in order to achieve an acceptable level of risk without hindering the ability to maximize returns. Management has adopted procedures to identify and manage significant operational and financial risks.

### Commodity Risk

Calvalley's principal business is the production and sale of crude oil. Revenues, earnings and cash flows from the sale of crude oil are sensitive to change in market prices, over which the Company has little or no control. The Company has the ability to address its price related exposures through the limited use of options, future and forward contracts, but generally does not enter into such arrangements.

### Currency Fluctuations

Calvalley undertakes transactions in currencies other than the United States dollar. The Company's primary foreign exchange risk is to changes in the value of the Canadian dollar relative to the United States dollar. Fluctuations in exchange rates between the United States dollar and other currencies will give rise to foreign currency exposure, either favourable or unfavourable, which may have material effects on the Company's operations and financial condition. The Company has the ability to address its currency related exposures through the use of foreign exchange contracts. It generally does not enter into such hedging arrangements but maintains a portion of its currency in Canadian dollars to meet its Canadian dollar requirements.

### Interest Rates

The Company has no interest bearing debt. The Company invests surplus cash balances in short-term investments with recognized Canadian financial institutions. Fluctuations in interest rates, either favourable or unfavourable, may have material effects on the Company's interest income on short-term cash investments.

### Credit risk and concentration of sales risk

In January 2007, the Company entered into a long-term crude oil marketing agreement under which the Company sells all of its crude oil production to a single purchaser for a period of eighteen months. The purchaser is a subsidiary of Reliance Industries Limited, India's largest business enterprise, which is a party to the JOA for Yemen Block 9. The purchaser's obligations under the crude oil marketing agreement are guaranteed by Reliance Industries Limited, which has been assigned credit ratings of Baa2 Stable Outlook by Moody's and BBB Stable Outlook by S&P (above Sovereign Rating). The contract was extended in March 2008 for an additional period which expires in June, 2009 and can be extended for additional twelve month periods if agreed by the Company and the purchaser.

Credit risk also relates to the risk that joint venture partners may not fulfill their contractual obligations for financial contributions towards exploration, development, appraisal and production operations.

During the initial agreement negotiations and ratification, these risks are considered and incorporated into the terms of the applicable contracts. Furthermore, cash calls can be made in advance of incurring costs to help ensure costs are recovered. However, it is possible that the interest of Calvalley and its joint venture partners are not aligned resulting in project delays, additional costs or disagreements, which could adversely affect business results.

#### Insurable Risk

Calvalley employs risk management practices to reduce and mitigate operational risks and other hazard risks and exposures, although it is impossible to completely protect its operations from all such risks. The Company places types and an amount of insurance that it considers consistent with industry practice to the extent coverage is available and cost effective. Such coverage includes third-party liability insurance and property and business interruption insurance.

The Company may become liable for damages arising from unforeseen events which it cannot insure against or chooses to self-insure. Costs incurred to repair such uninsured damage or to pay associated liabilities may have a material effect on the financial condition of the Company.

#### Legal Contingencies

The Company has been named in a claim filed in the Commercial Court of Yemen by a Saudi Arabian company. The claimant alleges that, pursuant to an agency agreement entered into in 1996, it is entitled to a percentage of the net profit attributable to the Company. The matter was heard and a ruling was made which awarded the claimant 10% of the Company's profit oil, calculated as being the oil produced in excess of the production that the Company is entitled to for cost recoveries as defined in the PSA, from the production of Block 9 from the date of commercial production to February 13, 2008.

The decision of the Commercial Court of Yemen is now under appeal by both parties. The Company's legal advisors in Sana'a and Calgary are pursuing the appeal jointly. The outcome of the action in the Yemen Commercial Court of Appeal is undeterminable at this time. No amounts have been accrued in the financial statements for the year ended December 31, 2008 as the ultimate resolution is uncertain. The Company will record any amounts due once the outcome of the contingency is likely and estimable.

As the ruling now stands, management does not anticipate a material impact on the Company. Both parties have appealed the ruling and the final decision of the Yemen Commercial Court of Appeal could vary significantly from the ruling of the lower court.

#### Concentration of Producing Assets

Substantially all of Calvalley's production is generated from highly productive individual wells in Yemen. The production and sale of crude oil in Yemen involves the use of central production facilities, oil pipelines, and export terminals, either operated by the Company or by third parties. As significant production is generated from each of these assets, any single event causing an interruption to any one of these operations could result in the loss of production and reserves as a result.

#### Exploration, Development and Production Risks

Acquiring, developing and exploring for oil and natural gas involves many risks which include but are not limited to encountering unexpected formations or pressures, premature declines of reservoirs, blow-outs, well bore collapse, equipment failures and other accidents, craterings and sour gas releases, uncontrollable flows of oil, natural gas or well fluids, and environmental risks.

In many oil and natural gas producing countries, oil and gas properties, together with related production and transportation infrastructure, are often situated in remote areas. In addition to the operational risks described above, oil and gas properties in some of these countries may be vulnerable to premeditated acts of violence which have the potential to cause significant damage to oil and gas operations and injury to personnel. The Company relies on the Government of Yemen's support in providing appropriate security for crude oil operations in Block 9.

Calvalley may not be fully insured against all of these risks. Losses resulting from the occurrence of these risks could have a material impact on the Company's financial results.

#### Reserve Additions

Calvalley's future crude oil reserves and production, and therefore its operating cash flows and results of operations, are highly dependent upon the Company's success in exploiting its current reserve base and acquiring or discovering additional reserves. Without reserve additions through exploration, development or acquisitions, the Company's reserves and production will decline over time as reserves are produced. The business of exploring for, developing or acquiring reserves is capital intensive. To the extent cash flows from operations are insufficient and external sources of capital become limited or unavailable, Calvalley's ability to make the necessary capital investments to maintain and expand its oil and reserves will be impaired.

#### Environment, Health, Safety and Regulatory Approvals

Environmental, health and safety laws and regulations are continually evolving. Compliance with such laws and regulations can require significant expenditures which may materially affect the Company's financial condition or results of operations.

Expansion of existing operations and the development of new operating sites generally require approval of regulatory authorities. If such approvals are delayed or not achieved, the Company's ability to meet project schedule or cost objectives or to operate at expanded or existing levels could be materially impacted.

Workplace health and safety risks for workers arise from the inherent nature of the Company's operations and the jurisdictions within which it operates.

#### Competition

There is strong competition relating to all aspects of the oil and gas industry. Calvalley actively competes for skilled industry personnel which are in high demand, particularly at its Canadian headquarters, with a substantial number of other oil and gas companies, many of which have significantly greater financial and other resources.

#### Changes in Legislation

There can be no assurance that laws and regulations relating to the oil and gas industry will not be changed in a manner which would adversely affect the operations of the Company. Under the PSA, the Company is not obligated to comply with regulatory changes that are inconsistent with the provisions of the PSA. Further, the PSA stipulates that the interests, rights and obligations of the Government of Yemen and the Company shall be solely governed by the provisions of the PSA unless altered or amended by mutual agreement. In particular, the PSA requires that the Government of Yemen pay profit taxes on the Company's behalf, out of the Government of Yemen's share of profit oil.

## Selected Quarterly Information

(\$000)	Revenue	Expenses	Net Income (Loss) for the Period	Earnings (Loss) per Basic Share	Earnings (Loss) per Diluted Share	Total Assets	Long Term Debt
<b>2009</b>							
<b>First quarter</b>	<b>4,543</b>	<b>6,210</b>	<b>(2,045)</b>	<b>(\$0.02)</b>	<b>(\$0.02)</b>	<b>165,683</b>	<b>-</b>
<b>2008</b>							
Fourth Quarter	2,901	2,617	25	\$0.00	\$0.00	172,406	-
Third Quarter	16,066	5,370	9,105	\$0.10	\$0.10	172,526	-
Second Quarter	16,242	10,134	4,432	\$0.03	\$0.03	169,097	-
First Quarter	13,150	6,149	5,599	\$0.06	\$0.06	158,833	-
<b>2007</b>							
Fourth Quarter	21,858	10,614	10,322	\$0.10	\$0.10	162,730	-
Third Quarter	15,194	6,858	7,907	\$0.08	\$0.08	151,325	-
Second Quarter	1,733	2,814	889	\$0.01	\$0.01	138,724	-

The past eight quarters have witnessed the stabilization of Calvalley's business. The Company continues to develop the field and build related infrastructure. The Company has invested in significant studies of the existing pools and exploration areas of Block 9 and expects to increase production during 2009 as a result of this groundwork. Volatility of revenue amounts can be caused by the timing of loading crude oil onto tankers (See "Comparability with Prior Periods").

## **Critical Accounting Estimates**

Because a precise determination of certain assets and liabilities is dependent upon future events, the preparation of financial statements necessarily involves the use of estimates and approximations, which have been made using careful judgment. The financial information provided in this Management's Discussion and Analysis and in the consolidated financial statements has, in management's opinion, been properly prepared within reasonable limits of materiality and within the framework of the accounting policies summarized below. Financial results incorporate estimates on the following items:

- depletion, depreciation and accretion are based on estimates of oil and gas reserves;
- estimated value of income tax liabilities;
- estimated value of asset retirement obligations that is dependent upon the future costs and timing of related expenditures;
- ceiling tests in respect of oil and gas properties are based on estimates of oil and gas reserves; and
- estimated fair value of stock-based compensation.

Proven and probable reserve estimates are determined based on professional evaluations provided by internal or external qualified persons. Reserve estimates should not be interpreted as assurances of the life or of the profitability of current or future operations. Estimates of the reserves may change based on additional knowledge gained subsequent to the assessment date. This may include additional data available from continuing exploration and development, results from the reconciliation of actual production data against the original reserve estimates, or the impact of economic factors such as changes in the price of commodities or the cost of components of production.

The estimation of reserves is a subjective process, which is subject to numerous uncertainties and various interpretations. A change in the estimate of reserves will result in a change in the rate of depletion and amortization of the related assets or could result in impairment of the assets resulting in a write down.

## **Measurement Uncertainty**

The preparation of consolidated 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 consolidated financial statements and revenue and expenses during the reporting period. Actual results, including petroleum and natural gas sales, royalties and operating expenses can differ from these estimates.

In particular, amounts recorded for depreciation and depletion and amounts used for ceiling test calculations are based on estimates of petroleum and natural gas reserves and future costs required to develop those reserves. The Company's reserve estimates are evaluated annually by an independent engineering firm. By their nature, these estimates of reserves and the related future cash flows are subject to measurement uncertainty and the impact on the consolidated financial statements of future periods could be material.

Computations of provisions and estimates for income taxes involve management making judgments with respect to interpretation of tax regulations and related legislation which is continually changing. In addition, there are tax matters that have not yet been confirmed by taxation authorities. While management believes the provision for income taxes is adequate, these amounts are subject to measurement uncertainty. Adjustments required, if any, to these provisions will be reflected in the period where it is determined that adjustments are warranted.

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options which were fully tradable with no vesting restrictions. This option valuation model requires the input of highly subjective assumptions including the expected stock price volatility. Because the Company's stock options and warrants have characteristics significantly different from those of traded options and because changes in the subjective input assumptions can materially affect the calculated fair value, such value is subject to measurement uncertainty.

Amounts recorded as due from joint venture partners are based on the Company's interpretation of underlying agreements and may be subject to joint approval. The Company has recorded balances due based on costs incurred and its interpretation of allowable expenditures. Any adjustments required as a result of joint venture audits are recorded in the period of settlement with joint venture partners.

### **Additional Information**

As at March 31, 2009, the Company had 99.1 million common shares outstanding. Additionally, there were 4.3 million options outstanding which were issued pursuant to the Company's stock option plan.

### **Disclosure Controls and Procedures**

As of March 31, 2009, an evaluation was carried out under the supervision of, and with the participation of Calvalley's management including the Chief Executive Officer and the Chief Financial Officer, of the design and effectiveness of Calvalley's disclosure controls and procedures. Based on that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the design and operation of Calvalley's disclosure controls and procedures were effective as at March 31, 2009, and would provide reasonable assurance that material information relating to Calvalley and its consolidated subsidiaries would be made known to them by others within those entities.

### **Internal Controls over Financial Reporting**

As of March 31, 2009, an evaluation was carried out under the supervision of, and with the participation of Calvalley's management including the Chief Executive Officer and the Chief Financial Officer, of the design of Calvalley's internal control over financial reporting ("ICFR"). Based on that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the design of internal control over financial reporting was effective as at March 31, 2009, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP.

Although management has been able to reach this conclusion, we have identified certain weaknesses in ICFR which are:

- due to the limited number of staff, it is not possible to achieve segregation of all duties; and
- due to the limited number of staff, the Company has a risk of material misstatement related to non-routine complex accounting matters that may arise.

These weaknesses essentially arise because of the small size of the Company's accounting staff. Management and the board of directors have attempted to mitigate the risk of material misstatement in financial reporting related to segregation of duties through a combination of extensive and detailed review by the Chief Financial Officer of the financial reports, the integrity and reputation of senior financial and accounting personnel, and the candid discussion of this risk with our external advisors. The Company also employs outside consultants and accounting firms to assist with complex accounting and technical issues. Additionally, steps have been taken to augment the accounting department with additional personnel to reduce this risk. In spite of management's best efforts, there can be no assurance that these risks can be reduced to less than a remote likelihood of a material misstatement.

There have been no other changes in Calvalley's internal control over financial reporting during the three month period ended March 31, 2009 that have materially affected, or are reasonably likely to materially affect, Calvalley's internal control over financial reporting.

## **EFFECT OF FUTURE CHANGES IN ACCOUNTING POLICIES**

### **International Financial Reporting Standards ("IFRS")**

In February 2008, the Accounting Standards Board confirmed that all Canadian publicly accountable enterprises will be required to adopt IFRS for interim and annual reporting purposes for fiscal years beginning on or after January 1, 2011. Calvalley is currently assessing the impact of the convergence of Canadian GAAP with IFRS on the Company's results of operations, financial position and disclosures. A preliminary diagnostic of potential areas of impact has been completed to aid in the management of this transition, with the aim to ensure successful implementation within the required timeframe. The results of this preliminary diagnostic indicate that the significant impact to Calvalley's results of operations, financial position and disclosures will be on Property, Plant and Equipment, as it relates to the Company's policy of full-cost accounting for its exploration assets and the continued ability to utilize this policy, how these assets are ultimately depreciated and how impairment is ultimately determined and measured. Other areas of potential impact include stock-based compensation and joint venture accounting.

Calvalley continues to develop an implementation plan, including the consideration of the resources required to complete the conversion to IFRS and the impact to its' financial systems.

## **NORMAL COURSE ISSUER BID**

On April 21, 2009, the Company made the necessary filings, and received the necessary approvals, to make a normal course issuer bid through the facilities of the Toronto Stock Exchange commencing April 23, 2009 and ending April 22, 2010, or on such earlier date as Calvalley may complete its purchases under the bid. A copy of the notice filed with the Toronto Stock Exchange can be obtained by any shareholder of the Company, without charge, by contacting the Company.

A total of 4,948,029 Class A Common Shares (the "Common Shares") may be acquired under the bid, representing 5% of the 98,960,580 Common Shares outstanding as of April 15, 2008. Calvalley will acquire Common Shares under the bid at the market price at the time of purchase, and all Common Shares acquired will be canceled. Unless Calvalley is utilizing a Block Purchase Exemption as permitted by the TSX, purchases are subject to a daily purchase restriction equal to 25% of the average daily trading volume of the Common Shares over the past six calendar months, or a maximum of 28,824 Common Shares per trading day.

In the opinion of Calvalley's Board of Directors, Calvalley's Common Shares are, from time to time, undervalued by the market, and the cost of acquiring the shares is an expense prudently incurred by Calvalley to increase shareholder value.

A total of 203,000 shares have been acquired to May 15, 2009 under the bid.

**Calvalley Petroleum Inc.  
Unaudited Consolidated Financial  
Statements  
For the Three Months Ended  
March 31, 2009 and 2008  
(Expressed in United States Dollars)**

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**Calvalley Petroleum Inc.**  
**CONSOLIDATED BALANCE SHEETS**  
(Unaudited - Expressed in United States Dollars)

(\$000)	March 31, 2009 \$	December 31, 2008 \$
<b>ASSETS</b>		
<b>Current</b>		
Cash and cash equivalents [note 3]	5,697	20,989
Guaranteed Investment Certificates [note 4]	47,187	42,746
Accounts receivable	2,302	3,293
Prepaid expenses	280	281
Due from joint venture partners [note 5]	22,719	18,419
Oil inventory [note 6]	3,621	2,995
	<b>81,806</b>	<b>88,723</b>
<b>Property, plant and equipment [note 7]</b>	<b>83,877</b>	<b>83,683</b>
	<b>165,683</b>	<b>172,406</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Current</b>		
Accounts payable and accrued liabilities	7,554	9,693
Deferred revenue	1,653	3,255
	<b>9,207</b>	<b>12,948</b>
<b>Commitments and contingency [note 15]</b>		
<b>Shareholders' equity</b>		
Share capital [note 8]	116,888	118,243
Contributed surplus [note 9]	7,190	6,772
Accumulated other comprehensive income	3,963	3,963
Retained earnings	28,435	30,480
	<b>156,476</b>	<b>159,458</b>
	<b>165,683</b>	<b>172,406</b>

*See accompanying notes*

On behalf of the Board:

*"Signed"*

Edmund Shimoon

*"Signed"*

Gary Robertson

**Calvalley Petroleum Inc.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
(Unaudited - Expressed in United States Dollars)

For the three months ended March 31	2009	2008
(\$000)	\$	\$
<b>REVENUE</b>		
Oil sales	6,860	20,110
Royalties	(2,700)	(7,654)
	4,160	12,456
Management fees	99	104
Interest and other	284	544
	4,543	13,104
<b>EXPENSES</b>		
Operating	3,138	2,018
General and administration, net of recoveries	1,165	1,233
Stock-based compensation	157	121
Depletion, depreciation and accretion	1,750	2,777
	6,210	6,149
Income (loss) before other items	(1,667)	6,955
Foreign exchange gain (loss)	40	(113)
<b>Income (loss) before income tax</b>	<b>(1,627)</b>	<b>6,842</b>
Income tax	418	1,243
<b>Net income (loss) and comprehensive income (loss)</b>	<b>(2,045)</b>	<b>5,599</b>
<b>Earnings (Loss) per share [note 13]</b>		
<b>Basic</b>	<b>\$(0.02)</b>	<b>\$0.06</b>
<b>Diluted</b>	<b>\$(0.02)</b>	<b>\$0.06</b>

*See accompanying notes*

**Calvalley Petroleum Inc.**  
**CONSOLIDATED STATEMENTS OF RETAINED EARNINGS**  
(Unaudited - Expressed in United States Dollars)

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For the three months ended March 31

(\$000)	2009 \$	2008 \$
<b>Retained earnings, beginning of period</b>	<b>30,480</b>	14,350
<b>Net income (loss) for the period</b>	<b>(2,045)</b>	5,599
<b>Retained earnings, end of period</b>	<b>28,435</b>	19,949

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**Calvalley Petroleum Inc.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(Unaudited - Expressed in United States Dollars)

For the three months ended March 31	2009	2008
(\$000)	\$	\$
<b>OPERATING ACTIVITIES</b>		
Net income (loss) for the period	(2,045)	5,599
Add (deduct) items not affecting cash		
Stock-based compensation	157	121
Depletion, depreciation and accretion	1,750	2,777
Unrealized foreign exchange gain	(11)	(96)
	(149)	8,401
Change in non-cash working capital [note 11]	(817)	(8,012)
Unrealized foreign exchange loss (gain) relating to non-cash working capital	4	(80)
	(962)	309
<b>INVESTING ACTIVITIES</b>		
Additions to property, plant and equipment	(2,399)	(7,359)
Change in non-cash working capital [note 11]	(6,403)	(512)
Investment in GICs	(53,780)	(26,754)
Redemption of GICs	49,339	-
	(13,243)	(34,625)
<b>FINANCING ACTIVITIES</b>		
Issuance of common shares [note 8]	-	114
Common share repurchases [note 8]	(1,094)	-
	(1,094)	114
Foreign exchange gain on cash and cash equivalents held in foreign currencies	7	172
Decrease in cash and cash equivalents	(15,292)	(34,030)
Cash and cash equivalents, beginning of period	20,989	51,442
<b>Cash and cash equivalents, end of period</b>	<b>5,697</b>	<b>17,412</b>

See note 11 for supplemental cash flow information

**Calvalley Petroleum Inc.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
(Unaudited - Expressed in thousands of United States Dollars)

March 31, 2009 and 2008

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**1. BASIS OF PRESENTATION**

The interim consolidated financial statements include the accounts of Calvalley Petroleum Inc. and its subsidiaries ("Calvalley" or the "Company") for the three month periods ended March 31, 2009 and 2008 and are presented in accordance with Canadian generally accepted accounting principles on the same basis as the audited consolidated financial statements as at and for the year ended December 31, 2008, except as outlined in Note 2. These interim consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto in Calvalley's Annual Report for the year ended December 31, 2008 as the disclosures in these interim financial statements do not conform in all respects to the requirements of generally accepted accounting principles for annual financial statements. In these interim consolidated financial statements, unless otherwise indicated, all dollars are expressed in thousands of United States (US) dollars. All references to US\$ or to \$ are US dollars and references to C\$ are to Canadian dollars.

**2. CHANGES IN ACCOUNTING POLICIES**

On January 1, 2009 the company adopted CICA Handbook Section 3064, "Goodwill and Intangible Assets" which replaced Section 3062, "Goodwill and Other Intangible Assets" and Section 3450, "Research and Development Costs". Section 3064 incorporates guidance addressing when an internally developed intangible asset meets the criteria for recognition as an asset. The adoption of this standard did not impact the Company's consolidated financial statements.

Effective January 1, 2009 the Company adopted EIC 173, "Credit Risk and the Fair Value of Financial Assets and Financial Liabilities". This abstract concludes that for all financial assets and liabilities measured at fair value an entity's own credit risk and the credit risk of the counterparty should be taken into account when determining the fair values of financial assets and financial liabilities, including derivative instruments. The adoption of this abstract did not impact the Company's consolidated financial statements.

**3. CASH AND CASH EQUIVALENTS**

Cash and cash equivalents at March 31, 2009 include a short-term deposit of \$3,439 (December 31, 2008 - \$18,772), bearing interest at 0.50% (2008 - 1% - 3.25%) and maturing on April 14, 2009, and \$2,257 (December 31, 2008 - \$2,217) of cash.

**4. GUARANTEED INVESTMENT CERTIFICATES**

Guaranteed investment certificates ("GICs") with original maturity dates in excess of 90 days at March 31, 2009 as follows:

<u>Maturity</u>	<u>Face Value</u>	<u>Interest Rate</u>
December 10, 2009	\$10,111	2.25%
January 16, 2010	\$9,627	1.50%
September 21, 2009	\$27,344	1.50%

GICs are carried at cost plus interest, which approximates fair value and can be redeemed at any time without penalty.

**Calvalley Petroleum Inc.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
(Unaudited - Expressed in thousands of United States Dollars)

March 31, 2009 and 2008

**5. DUE FROM JOINT VENTURE PARTNERS**

Amounts due from joint venture partners are comprised primarily of amounts due for operating costs and capital expenditures. The balances are due under normal trade terms.

**6. OIL INVENTORY**

Inventory sold is expensed through production and depletion expenses in the period when it is sold. During the three months ended March 31, 2009, \$2,995 (2008 - \$71) was expensed with respect to oil inventory which was sold.

**7. PROPERTY, PLANT AND EQUIPMENT**

	March 31, 2009		
	Cost	Accumulated Depletion and Depreciation	Net Book Value
(\$000)	\$	\$	\$
<b>Canada</b>			
Oil and gas properties	129	73	56
Other capital assets	293	124	169
	422	197	225
<b>Yemen</b>			
Oil and gas properties	113,538	30,254	83,284
<b>Ethiopia</b>			
Oil and gas properties	368	-	368
	114,328	30,451	83,877

	December 31, 2008		
	Cost	Accumulated Depletion and Depreciation	Net Book Value
(\$000)	\$	\$	\$
<b>Canada</b>			
Oil and gas properties	128	67	61
Other capital assets	269	120	149
	397	187	210
<b>Yemen</b>			
Oil and gas properties	111,190	28,059	83,131
<b>Ethiopia</b>			
Oil and gas properties	342	-	342
	111,929	28,246	83,683

**Calvalley Petroleum Inc.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
(Unaudited - Expressed in thousands of United States Dollars)

March 31, 2009 and 2008

**7. PROPERTY, PLANT AND EQUIPMENT (Continued)**

**Canada**

Existing properties are comprised of a working interest in one property in Saskatchewan and overriding royalties.

**Yemen**

The Company has a 50% working interest in the Malik Block 9 Joint Venture in Yemen. The Company's right to produce crude oil under the Production Sharing Agreement ("PSA") continues to 2025, with a provision for a 5 year extension. The ownership of all assets, tangible and intangible, remains with the Yemen authority.

During the period, the Company capitalized overhead costs relating to oil and gas exploration and development activities of \$409 (2008 - \$504). The Company excluded from capital costs subject to the depletion expense calculation an amount of \$Nil (2008 - \$12,769) in respect of the capital costs incurred for processing facilities under construction. Costs related to processing facilities have been included in costs subject to depletion beginning in December 2008 which is the date when the facilities were available for use.

**Ethiopia**

During 2008, the Company signed a Production Sharing Contract ("PSC") with the Ethiopian Government on the Metema and Gimbi Blocks covering a total area of 11.5 million acres.

Properties in Ethiopia are unproven and the costs incurred have been excluded from costs subject to depletion and depreciation.

**8. SHARE CAPITAL**

**a. Common shares**

**Authorized:**

Unlimited number of Class A Common Voting Shares.

**Issued:**

<b>Three month period ended March 31, 2009</b>	<b>Number</b>	<b>Amount \$</b>
<b>Class A Common Voting Shares</b>		
<b>Shares outstanding, beginning of period</b>	<b>100,265,602</b>	<b>118,243</b>
<b>Repurchased and cancelled (i)</b>	<b>(1,148,622)</b>	<b>(1,355)</b>
<b>Balance, end of period</b>	<b>99,116,980</b>	<b>116,888</b>

Three month period ended March 31, 2009.

- (i) The Company repurchased 1,148,622 of its common shares pursuant to a Normal Course Issuer Bid at a net cost of \$1,094. The cost to repurchase shares at prices below their average book value has been credited to contributed surplus.

**Calvalley Petroleum Inc.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
(Unaudited - Expressed in thousands of United States Dollars)

March 31, 2009 and 2008

**8. SHARE CAPITAL (continued)**

Year ended December 31, 2008	Number	Amount \$
Class A Common Voting Shares		
Shares outstanding, beginning of year	101,430,498	119,485
Issued on the exercise of options (i)	440,000	514
Contributed surplus reclassified on exercise of options (i)	-	137
Repurchased and cancelled (ii)	(1,604,896)	(1,893)
<b>Balance, end of year</b>	<b>100,265,602</b>	<b>118,243</b>

Year ended December 31, 2008.

- (i) The Company issued 440,000 Class A Common Voting Shares upon the exercise of options for proceeds of \$514. An amount of \$137 related to stock based compensation expensed in prior years was reclassified from contributed surplus to share capital in connection with options exercised in 2008.
- (ii) The Company repurchased 1,604,896 of its common shares pursuant to a Normal Course Issuer Bid at a cost of \$4,822. The cost to repurchase common shares at prices in excess of their average book value has been charged to retained earnings. The cost to repurchase shares at prices below their average book value has been credited to contributed surplus.

**b. Stock options**

The Company's restated stock option plan, as approved effective May 21, 2006 provides for the issue of stock options to directors, officers, employees and consultants. Vesting terms are determined by the Board as they are granted and currently include periods ranging from immediately to evenly over 3 or 5 years. The options' maximum term is 5 years (10 years for options granted prior to October 1, 2001).

A total of 9,911,698 (December 31, 2008 – 10,026,560) shares have been reserved for issue under this plan. Options which are forfeited are available for reissue.

The following is a continuity of stock options outstanding:

	Three months ended March 31, 2009		Three months ended March 31, 2008	
	Options (000s)	Weighted Average Exercise Price – C\$	Options (000s)	Weighted Average Exercise Price – C\$
<b>Opening balance</b>	<b>4,358</b>	<b>3.29</b>	2,970	3.15
<b>Granted</b>	<b>120</b>	<b>1.5</b>	-	-
<b>Forfeited</b>	<b>(180)</b>	<b>3.38</b>	(60)	7.38
<b>Exercised</b>	-	-	(40)	2.83
<b>Ending balance</b>	<b>4,298</b>	<b>3.24</b>	2,870	3.86

**Calvalley Petroleum Inc.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
(Unaudited - Expressed in thousands of United States Dollars)

March 31, 2009 and 2008

**8. SHARE CAPITAL (continued)**

Stock options outstanding at March 31, 2009 were as follows:

Number of Options (000s)		Exercise Price	Expiry Date
Granted	Exercisable		
		<b>C\$</b>	
50	50	1.40	2009
500	500	1.60	2009
75	75	1.60	2010
125	125	3.80	2010
380	380	4.05	2010
350	350	4.20	2010
50	50	0.90	2011
75	75	6.86	2011
100	33	6.05	2012
200	200	7.61	2012
950	950	4.50	2013
500	-	4.00	2013
150	150	4.25	2013
20	-	4.25	2013
55	-	3.45	2013
30	-	2.54	2013
468	-	1.50	2013
100	100	2.00	2013
100	-	1.50	2014
20	-	1.50	2014
<b>4,298</b>	<b>3,108</b>	<b>3.29</b>	

During the three months ended March 31, 2009, stock based compensation costs of \$157 (2008 - \$121) were expensed and credited to contributed surplus. The fair value of the options granted during the period was C\$72 (2008 - C\$Nil) or C\$0.60 (2008 - C\$Nil) per option using a Black-Scholes Option Pricing model with the following assumptions:

	<u>2009</u>	<u>2008</u>
<b>Risk-free interest rate</b>	<b>1.85%</b>	n/a
<b>Expected hold period to exercise</b>	<b>5 years</b>	n/a
<b>Volatility in the price of the Company's shares</b>	<b>70% - 71%</b>	n/a
<b>Dividend yield</b>	<b>Nil</b>	n/a

**Calvalley Petroleum Inc.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
(Unaudited - Expressed in thousands of United States Dollars)

March 31, 2009 and 2008

**9. CONTRIBUTED SURPLUS**

	Three months ended March 31, 2009 \$	Year ended December 31, 2008 \$
(\$000)		
Opening balance	6,772	4,019
Stock based compensation	157	2,789
Stock based compensation associated with exercised options	-	(137)
Shares repurchased and cancelled	261	101
Closing balance	<b>7,190</b>	<b>6,772</b>

**10. CAPITAL DISCLOSURE**

The Company defines and computes its capital as follows:

	March 31, 2009 \$	December 31, 2008 \$
(\$000)		
Shareholders' equity	156,476	159,458
Long-term debt	-	-
Cash	(5,697)	(20,989)
Guaranteed Investment Certificates	(47,187)	(42,746)
Total capital	<b>103,592</b>	<b>95,723</b>

The Company's objectives when managing capital are to safeguard the Company's ability to continue as a going concern, so that it can continue to provide returns for shareholders and benefits for other stakeholders. The Company sets the amount of capital in proportion to risk. The Company manages the capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of the underlying assets. In order to maintain or adjust the capital structure, the Company may adjust the amount of dividends paid to shareholders, return capital to shareholders, issue or repurchase shares, incur debt or sell assets to reduce debt.

The Company currently has no requirement for debt financing and has not required debt financing over the last two completed fiscal years. The objectives and strategy for utilizing capital are monitored to provide the appropriate capital structure for the risk profile of corporate objectives.

The Company has no financial covenants.

**Calvalley Petroleum Inc.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
(Unaudited - Expressed in thousands of United States Dollars)

March 31, 2009 and 2008

**11. SUPPLEMENTAL CASH FLOW INFORMATION**

(\$000)	Three months ended March 31,	
	2009 \$	2008 \$
Changes in non-cash working capital		
Accounts receivable	991	3,057
Due from joint venture partners	(4,300)	(1,503)
Oil inventory	(171)	(282)
Prepaid expenses	1	(68)
Accounts payable and accrued liabilities	(2,139)	(9,728)
Deferred revenue	(1,602)	-
	<b>(7,220)</b>	<b>(8,524)</b>
Changes in non-cash working capital		
Operating activities	(817)	(8,012)
Investing activities	(6,403)	(512)
	<b>(7,220)</b>	<b>(8,524)</b>

During the three month period ended March 31, 2009, the Company paid \$Nil in interest (2008 – \$Nil) and \$Nil in taxes (2008 - \$Nil). Yemen income taxes are paid to the government through their allocation of oil under the PSA.

**12. GEOGRAPHICAL INFORMATION**

The Company has defined its continuing operations as oil and gas operations. The majority of the Company's oil and gas operations are located in Yemen with lesser operations in Canada and Ethiopia.

Segmented information is as follows:

**Period ended March 31, 2009**

	Ethiopia	Yemen	Canada	Total
(\$000)	\$	\$	\$	\$
Revenue	-	6,928	315	7,243
Property, plant and equipment	368	83,284	225	83,877

**Period ended March 31, 2008**

	Yemen	Canada	Total
(\$000)	\$	\$	\$
Revenue	12,682	468	13,150
Property, plant and equipment	71,163	177	71,340

**13. PER SHARE AMOUNTS**

For the three month period ended March 31, 2009, the weighted average number of shares used in the computation of basic earnings (loss) per share was 99,866,641 (2008 – 101,470,498). The calculation of diluted loss per share for the three month period ended March 31, 2009 excludes all options warrants as the effect is anti-dilutive. The weighted average number of shares used in the computation of diluted earnings per share for the three month period ended March 31, 2008 was 101,677,567. At March 31, 2008, a total of 465,000 options were not in the money and were excluded from the dilutive calculation.

**Calvalley Petroleum Inc.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
(Unaudited - Expressed in thousands of United States Dollars)

March 31, 2009 and 2008

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#### 14. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

##### Carrying Values and Estimated Fair Values of Financial Assets and Liabilities

The Company has classified its cash and cash equivalents and GIC's as assets held for trading which are measured at fair value with changes being recognized in net income. Accounts receivable and amounts due from joint venture partners are classified as loans and receivables, which are measured at amortized cost.

The carrying value and fair value of financial assets and liabilities are summarized as follows:

<u>Classification</u>	<u>Carrying Value</u>	<u>Fair Value</u>
Financial assets held for trading	\$52,884	\$52,884
Loans and receivables	\$25,021	\$25,021

##### Credit Risk

The majority of the accounts receivable are in respect of oil and gas operations and are due from the Company's joint venture partners or its customer for oil sales. Management believes the risk is mitigated by the size and reputation of the companies to which the Company extends credit. The Company has not experienced any material credit loss in the collection of accounts receivable to date.

The Company is currently under contract to sell all of its production to one purchaser until July 1, 2010. The selling price is based on the quoted Brent price on the date of shipment adjusted for the official selling price differential posted by the Government of Yemen. At March 31, 2009, \$2,273 (December 31, 2008 - \$3,255) was receivable under the contract and was received in April 2009. Payment is secured by a guarantee issued by the purchaser's parent company. The Company has an option to extend the contract on the same terms for a further 12 months.

The Company funds capital and operating costs and bills joint venture partners their share of those costs. In the event that a joint venture partner was incapable of fulfilling its obligation to pay its share of the costs, the Company could, under the terms of the joint operating agreement, recover the costs from the joint venture partner's share of proceeds from crude oil sales.

Trade and other receivables from continuing operations are analyzed in the table below. With respect to the trade and other receivables that are neither impaired nor past due, there are no indications as of the reporting date that the debtors will not meet their payment obligations.

##### Trade and other receivables at March 31, 2009

Neither impaired nor past due	\$10,012
Not impaired and past due in the following period:	
Within 30 days	1,122
31 – 60 days	3,290
61 – 90 days	2,404
Over 90 days	8,193

##### Interest rate risk

The Company has exposure to interest rate risk as it relates to investments in GICs. Interest rate risk relates to the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Company incurs interest rate risk on its cash and cash equivalents and GICs. All cash balances are current and available immediately. The Company does not hedge its exposure to interest rate risk.

March 31, 2009 and 2008

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#### **14. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (Continued)**

##### **Liquidity Risk**

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due. Liquidity describes a company's ability to access cash. Companies operating in the upstream oil and gas industry require sufficient cash in order to fund capital programs necessary to maintain and increase production and proved reserves, to acquire strategic oil and gas assets, and to repay debt. The Company actively monitors its cash requirements to ensure it has sufficient available funds to meet current and foreseeable financial requirements at a reasonable cost. The Company prepares annual capital expenditure budgets, which are regularly monitored and updated as considered necessary. The Company also utilizes authorizations for expenditures to further manage capital expenditures.

The Company's obligations coming due in the next twelve months are accounts payable and accrued liabilities of \$7,554. In addition, the Company has commitments under existing agreements as described in note 15. Given the Company's working capital position, management assesses liquidity risk as being low.

##### **Commodity Price Risk Management**

While the Company is exposed to business risk associated with fluctuations in the price of crude oil, the Company does not hold financial instruments whose fair values are susceptible to variability resulting from changes in the price of crude oil.

##### **Foreign Exchange Risk**

The Company holds substantially all of its cash, cash and equivalents and GICs at one financial institution. The Company invests its cash reserves in GICs issued by an Alberta Credit Union guaranteed by the Province of Alberta. Approximately \$581 of the \$5,697 cash and cash equivalents is held in Canadian dollar denominated accounts. As such, the Company is exposed to foreign currency risk. The impact to net income of a 10% change in the foreign exchange rates between the Canadian and United States dollars at March 31, 2009 would have been approximately \$34 (\$0.00/share).

#### **15. COMMITMENTS AND CONTINGENCY**

There have been no material changes or developments with respect to the Company's commitments and contingency as disclosed in the Company's audited financial statements for the year ended December 31, 2008.

#### **16. COMPARATIVE FIGURES**

Certain comparative figures have been reclassified to conform to current year presentation.

The presentation of oil sales revenue has been restated to report oil sales before royalties paid in kind to government agencies in Yemen. Royalties taken in kind are then shown as a reduction to revenue. The change in presentation does not result in a change to prior period earnings.



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