

CALVALLEY PETROLEUM INC.

2010 1st Quarter Interim Report to Shareholders

**For the three months
ended March 31, 2010**

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ABBREVIATIONS

bbls	barrels
mbbls	thousands of barrels
bopd	barrels of oil per day
mmcf/d	million cubic feet per day
km²	square kilometre

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 2010 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 km² (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 km² (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.

HIGHLIGHTS

Financial

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

(in thousands of US dollars except per share amounts)	Three months ended March 31	
	2010	2009
Revenue (Gross)	14,449	6,860
Revenue from crude oil sales (net of royalties)	8,921	4,160
EBITDA ⁽¹⁾	6,071	(44)
Operating income (loss) ⁽¹⁾	3,737	(1,764)
Net income (loss)	2,725	(2,045)
Per share	\$0.03	\$(0.02)
Capital expenditures	3,199	2,399
Funds flow from operations ⁽¹⁾	5,269	(149)
Per share	\$0.05	\$0.00
Cash flow (deficiency) from operating activities	5,122	(962)

⁽¹⁾ See "Non-GAAP Measures"

- Calvalley's revenue from crude oil sales was \$14.4 million (gross) and \$8.9 million (net of royalties) for the quarter ended March 31, 2010 (2009 - \$6.9 million (gross) and \$4.2 million (net of royalties)). The sales increase was caused by stronger commodity prices, period over period.
- Net income was \$2.7 million (\$0.03 per share) for the three months ended March 31, 2010, as compared to a net loss of \$2.0 million ((\$0.02) per share) for the same period of 2009. The increase in net income was largely attributable to stronger commodity prices and the \$1.1 million expense for facilities usage which was billed

retroactively in the first quarter of 2009 from the commencement of production at Block 9 by the Government of Yemen.

- Funds flow from operations was \$5.3 million (\$0.05/share) for the three months ended March 31, 2010, as compared to \$(149,000) (\$0.00/share) for the same period of 2009.
- Operating costs during the first quarter of 2010 were \$1.9 million (\$9.92/bbl) as compared to \$2.1 million (\$11.93/bbl) for the three months ended March 31, 2009.
- Calvalley continues to be well financed and capitalized with no outstanding debt and working capital of \$72.2 million.

Operating

The following table sets forth key operating information:

Production (barrels of oil per day)	Three months ended March 31	
	2010	2009
Total Block 9 production	4,597	4,532
Calvalley working interest (50.0%)	2,299	2,266

- Average daily production from Block 9 for the three months ended March 31, 2010 was 4,597 gross barrels per day (Calvalley working interest 2,299 bopd), an increase from the previous quarter's average of 4,404 bopd (2,202 bopd working interest share) and an increase from 2009 first quarter average production of 4,532 bopd (2,266 bopd working interest share).
- The Company expects to re-inject all water produced in the Hiswah area into the main reservoir for pressure maintenance commencing in July 2010.
- Fabrication of the remaining equipment for gas injection has been completed in Dubai and the equipment is currently being transported to Yemen for installation and start-up.
- Calvalley has finalized and signed a one year contract to utilize a larger rig for drilling deep Qarn Qaymah wells. The rig is expected to arrive at Block 9 in June 2010.

Crude Oil Marketing

- Calvalley successfully finalized the crude oil transportation agreements which will enable the Company to transport blended crude of 26o API or better to market through the Masila facility. Calvalley will blend heavier crude oil from the currently shut-in Al Roidhat field with lighter oil produced from other fields within Block 9 to achieve the 26o API blend for shipment to Masila. The Masila Blend consists of different quality crude oils produced by various Third Party Users ("TPU") with an average gravity of 32o API. All TPU's who ship crude oil through the Masila facility receive the Masila Blend price for their crude. Consequently, Calvalley expects to receive the Masila Blend price for its crude oil shipped through the facility. The Official Selling Price for Masila crude oil is based on Dated Brent and is currently set at a slight discount to Dated Brent for June supply. The key aspect of the agreement is that Malik Block 9 Blend will be treated in the same manner as all other TPUs of the Masila System with respect to crude price and Facility Usage Fees.

Ethiopia

- Surface geological work was conducted in the first quarter and was completed after quarter-end at the Metema and Gimbi blocks in Ethiopia.

CHAIRMAN AND CHIEF EXECUTIVE OFFICER'S REPORT

During the first quarter of 2010 several key milestones were achieved. These achievements are expected to provide production increases on two fronts: commence production from shut-in wells at Al-Roidhat, and new wells at Hiswah and evaluate and commence production from recent discoveries at Qarn Qaymah and Ras Nowmah.

The most critical achievement for the future of Block 9 was the finalization of the transportation agreements which will allow Calvalley to blend production from all of its discoveries on the Block and deliver blended crude of at least 260 API to the Masila system for export at prices based on Dated Brent. This achievement removes a key bottleneck which had been imposed on Block 9. It will allow Calvalley to commence production from the shut-in Al-Roidhat field and to step up its drilling program both at Al-Roidhat and exploring for all kinds of crude oil on the Block. The long-lead materials for the construction Truck Offloading Facilities ("TOF") at Block 51 have been ordered. The construction phase is expected to commence shortly.

Pressure maintenance at the Hiswah field is expected to benefit Calvalley both through increased recovery factors and through increased production. The initial short-term water injection test at Hiswah-26 was successful. We are currently in the process of preparing the well for longer-term injectivity which is expected to commence in June. Gas injection facilities have been fabricated and are in transit to Block 9. We expect gas injection to commence during the third quarter of 2010.

The 2010 drilling campaign calls for a total of 20 firm wells and an additional four contingent wells including two firm and four contingent exploration/appraisal wells at Qarn Qaymah and Ras Nowmah. The development drilling program is proceeding at Hiswah with one well drilled and completed during the quarter, a second well spudded during the quarter and completed in April and a third well which was spudded on May 3, 2010. Additionally, a contract for a second rig capable of drilling deep wells has been finalized and operations are expected to commence in the third quarter at Qarn Qaymah with the drilling of QQ-3.

Commodity prices strengthened during the first quarter with Calvalley's sales price averaging \$75.91 per barrel. Net income for the quarter totaled \$2.7 million or \$0.03 per share. Capital expenditures for the quarter were \$3.2 million, primarily for the injection and blending facility projects and additional drilling expenditures. Calvalley remains debt-free and with working capital of \$72.2 million is well positioned to fund its capital program without further dilution to its shareholders. The company continued with its share buyback program spending \$843,000 to buy back 351,792 shares during the quarter.

"Edmund Shimon"

Edmund M. Shimon
Chairman and Chief Executive Officer
May 14, 2010

OPERATIONS REPORT

Production Overview

Average daily production from Block 9 for the three months ended March 31, 2010 was 4,597 gross barrels per day (Calvalley working interest 2,299 bopd), an increase from the previous quarter's average of 4,404 bopd (2,202 bopd working interest share) and an increase from 2009 first quarter average production of 4,532 bopd (2,266 bopd working interest share). All 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.

Gross field production at Hiswah continues to fluctuate between 4,200 to 5,200 (2,100 to 2,600 net) bopd. While producing wells are performing as expected, production continues to be constrained due to the limitation of the volume that is accepted by the Safer Facilities at Block 18 ("Safer"). Production from the Hiswah field is restricted to an average of twenty horizontal wells due to this limitation. In addition, production at the Hiswah field is choked back to minimize solution gas flaring. Upon full implementation of the field pressure maintenance program through water and gas injection, we expect to see a meaningful increase in well productivity as indicated by the simulation study.

Calvalley has commenced construction of offloading facilities at Block 51 to leverage the transportation agreements for blended crude oil from all discoveries at Block 9. This will allow the Company to activate wells that are currently choked back or shut-in. Upon completion of this facility Calvalley expects to ramp up production to 10,000 bopd (5,000 bopd net) by the end of 2010.

DRILLING, COMPLETION, AND TESTING

Development wells at Hiswah

Calvalley successfully completed the drilling of the Hiswah 31 horizontal producer at Hiswah. The well was placed on production during the quarter at an initial flow rate of approximately 300 bopd with no water. The drilling of the Hiswah 32 producer commenced on March 28, 2010.

Qarn Qaymah-2 ("QQ-2")

As previously announced, Calvalley completed the initial testing of QQ-2 which included separate testing of the Fractured Granitic Basement ("FGB") and the Kohlan sands. QQ-2 is currently shut-in for pressure build up to further assess the extension of the Kohlan sands and potential areas of improved recovery.

The initial test of the FGB confirmed that the Qarn Qaymah structure lies within a high quality oil system. The seismically defined structure covers an area exceeding 37 square kilometres. The estimated hydrocarbon column at QQ-2 exceeds 380 meters. Smaller diameter tubing (2 7/8 inch) utilized during the testing enabled the well to flow naturally. Production tests produced 430+ API sweet crude, 550+ API condensate and associated solution gas continuously over an extended period of time at fluctuating rates reaching a maximum of 2,350 bopd of liquids (oil and condensate) with no formation water. However, a sustainable production rate could not be achieved due to excessive hydrostatic overhead (> 3,500 meters). This zone is currently shut-in. Possible future plans include the isolation of the gas cap from the oil leg and installation of a slim hole Electric Submersible Pump ("ESP"). ESP's are currently used by most of the FGB producers in Yemen. Any future work on this well will only commence after the drilling of the QQ-3 appraisal well.

The second stage of QQ-2 completion and testing involved the isolation of the FGB and testing the Kohlan Sands. The Kohlan sands were perforated twice over an interval of 13

meters. After the first set of perforations were shot the well flowed condensate-rich natural gas at an initial rate of up to 3.8 million cubic feet per day ("mmcf/d"). After several days, the rate dropped and stabilized at approximately 350 mcf/d as the well bore started loading up with condensate. The result of the first flow test indicated ineffective initial perforations and potential formation damage. As a result, Calvalley re-perforated the Kohlan with mild acidization. This additional work improved the well productivity significantly. The well continued to flow liquid-rich gas over an extended period with rates ranging from 2.0 to 3.5 mmcf/d with a condensate yield of approximately 70 bbl per mmcf of gas. After the flow test, the Kohlan zone was shut-in for pressure build up. There were no signs of depletion confirming management's belief that the Kohlan has an extensive arial extension. However, the build up showed that the reservoir has low permeability and as a result, future wells will likely require acid fracing which is expected to enchanche productivity of this high pressure zone significantly.

Kohlan sands in the Qarn Qaymah fairway represent a significant resource play and displays regional blanket sand characteristics with the fairway extending over 34 km² of Block 9.

Based on the encouraging results of QQ-2 and despite the technical challenges of this initial well in the FGB of the Qarn Qaymah Area, Calvalley plans to initiate an appraisal drilling campaign of up to four (4) deep wells on the same fairway during 2010 extending into 2011. We have finalized a 12 month contract for a deeper rig which is expected to commence drilling the first appraisal well at Qarn Qaymah (QQ-3) in July.

Ras Nowmah-1

Calvalley completed the drilling of the Ras Nowmah-1 exploration well in November 2009. The well encountered a total of 45 meters of gross oil pay in high quality reservoir rock including 35 meters in the Qishn and 10 meters in the Saar formation. As outlined in Calvalley's third quarter report, the wellbore was side-tracked with a 30 degree deviation due to technical difficulties encountered while drilling.

On January 2, 2010, a service rig was mobilized to Ras Nowmah-1 to set 4.5 inch production casing to test the pay zones. The production casing was successfully set but despite several attempts, the downhole completion assembly could not be released from the wellbore. The technical work by a third party service company to fish the stuck tool from the wellbore has been completed. However, the fishing job of the stuck tools and the completion and testing of this well has been deferred until the next appraisal well (Ras Nowmah-2) has been drilled. This well will be approximately 350 meters from Ras Nowmah -1 and drilling is scheduled to commence in June 2010.

Salmin-1

As previously announced, on December 25, 2009, Calvalley commenced drilling of the Salmin-1 exploration well with a primary target of a seismically identified carbonate build up prospect in the Madbi Formation and secondary targets of Kohlan sand and Fractured Basement. The well encountered moderate hydrocarbon shows in a thin (10 feet) Kohlan sand. However, the Madbi Formation contained non-reservoir quality rock. Accordingly, Calvalley abandoned the wellbore.

Ethiopia

Surface geological work was conducted in the first quarter and completed after quarter-end at the Metema and Gimbi blocks in Ethiopia. The next phase will be an airborne gravity survey which is expected to take place during the second half of 2010.

MANAGEMENT DISCUSSION & 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 (MD&A) is to provide readers the ability to view Calvalley in much the same way as Company management. The following combination of historical 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 MD&A should be read in conjunction with the unaudited consolidated financial statements and related notes of Calvalley for the three month period ended March 31, 2010. Additional information relating to the Company, including the Company's Annual Information Form, is available on SEDAR at www.sedar.com or on the Company's website at www.calvalleypetroleum.com.

References in text or tables throughout this document to "2010", "2009", and "2008" refer to the years ended December 31, 2010, 2009 and 2008, respectively. References in text or tables labelled "Q4", "Q3", "Q2" and "Q1" refer to the periods ended December 31, September 30, June 30 and March 31, respectively, of the year indicated.

This MD&A contains information current to May 11, 2010.

NON-GAAP MEASURES

Funds flow from operations

Funds flow from operations is a measure not recognized under Canadian generally accepted accounting principles (GAAP) 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.

EBITA and Operating income

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 amortization 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

Netback is a non-GAAP measure that represents oil and natural gas 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.

SELECTED QUARTERLY INFORMATION

	2010	2009				2008		
(\$000s unless otherwise noted)	Q1	Q4	Q3	Q2	Q1	Q4	Q3	Q2
Avg. production volume – Calvalley share (Bopd)	2,299	2,202	2,092	2,082	2,266	1,995	2,372	2,380
Average sales volume (Bopd)	2,115	2,081	2,020	3,695	1,967	625	2,454	2,261
Average realized price (\$/bbl)	75.91	73.83	67.74	51.30	38.75	70.50	111.12	123.60
Oil Sales	14,449	14,136	12,591	17,252	6,860	4,060	25,082	25,434
Oil Sales, net of royalties	8,921	8,742	7,766	10,686	4,160	2,451	22,612	15,791
Cash flow from operating activities	5,122	9,271	3,587	3,325	(962)	(1,661)	4,511	34,061
Funds flow from operations ⁽¹⁾	5,269	4,652	4,453	4,644	(149)	414	12,050	10,266
Funds flow from operations per share (\$/share) ⁽¹⁾								
- Basic and Diluted	0.05	0.05	0.04	0.05	0.00	0.00	0.12	0.10
Net income (loss)	2,725	2,109	2,122	765	(2,045)	25	9,105	4,432
Net income (loss) per share (\$/share)								
- Basic and Diluted	0.03	0.02	0.02	0.01	(0.02)	0.00	0.10	0.03
Working Capital	72,182	70,705	71,278	72,059	72,599	75,775	79,003	75,235
Total Assets	172,378	172,991	165,178	164,193	165,683	172,406	172,526	169,097
Long-term debt	-	-	-	-	-	-	-	-

(1) See "Non-GAAP Measures".

OVERALL PERFORMANCE

Net income for the three month period ended March 31, 2010 was \$2.7 million versus a \$2.0 million loss for 2009. Working capital at March 31, 2010 increased to \$72.2 million from \$70.7 million at December 31, 2009. Funds flow from operations for the period ended March 31, 2010 improved to \$5.3 million from \$149,000 funds used in operations in the first quarter of 2009.

The Company's ability to generate positive funds flow from operations enabled it to finance its capital program and to buy back 351,792 shares at a cost of \$843,000 representing an average cost of \$2.40/share. The Company continues to generate cash flow from its operations at Block 9 in the Republic of Yemen.

BUSINESS ENVIRONMENT

The Company's financial results are significantly influenced by fluctuations in commodity prices. The following table shows selected market benchmark prices as well as the Company's realized selling price of oil for the four most recent quarters:

	2010 Q1	2009 Q4	2009 Q3	2009 Q2	2009 Q1
Dated Brent average oil price (\$/bbl)	76.37	74.53	68.08	59.13	44.46
Calvalley realized price (\$/bbl)	75.91	73.83	67.74	51.30	38.75

The price of Dated Brent oil averaged \$76.37/bbl in Q1 2010, an increase of 172% from the Q1 2009 price of \$44.46/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 from August to December 2008. During 2009 and into the first quarter of 2010, the price of oil recovered some of this decline. The closing price of Dated Brent oil at March 31, 2010 was \$80.29/bbl.

The global financial crisis has reduced liquidity in financial markets, restricted access to financing and caused significant volatility in commodity prices. Despite recent signs of a recovery, these factors may continue to impact the performance of the global economy. Calvalley, with no debt, strong cash generation from operations, and the availability of cash and cash equivalents, remains 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.

OUTLOOK

During the first quarter of 2010, management completed complex multi-party negotiations and executed a series of oil transportation agreements (the "Agreements"). The Agreements provide for the Company to deliver blended crude (26° API or better) from Block 9 through Block 51 to the Masila System (Block 14) for export. Calvalley will blend heavier crude oil from the currently shut-in Al Roidhat field with its lighter oil produced from other reservoirs on Block 9 to achieve the 26° API blend for shipment to the Masila System. The Company expects to receive the Masila Blend Official Selling Price for its crude oil blend delivered pursuant to the Agreements.

The Company will initially truck its blended oil to Block 51. Essentially of all long-lead items for the facility has been ordered. Management expects construction of the TOF to be completed before the end of 2010 and delivery of blended crude to Block 51 to commence immediately thereafter. Management is also in the initial planning stages for the construction of a pipeline to deliver blended oil from its central processing facility at Block 9 to Block 14.

Calvalley is positioning itself to increase production of blended crude to the maximum allowable trucking capacity of 10,000 bopd (5,000 bopd net) before the yearend. The Company plans to drill up to 8 development wells in the Al Roidhat area and nine wells in the Hiswah area. During the first quarter of 2010, the Company drilled three wells in Hiswah.

Appraisal work in the Qarn Qaymah and Ras Nowmah areas will continue for the balance of the year. Well site preparation for Ras Nowmah-2 has commenced and the well is expected to spud in June. Site preparation for Qarn Qaymah-3 well is expected to commence immediately after the contractor is released from Ras Nowmah-2 site. Additional contingent drilling locations are planned at both the Ras Nowmah and Qarn Qaymah structures.

Surface geological work has been completed at the Metema and Gimbi blocks in Ethiopia. The Company is in the process of awarding a contract to a geophysical service company to conduct an aeromagnetic and gravity survey in the second half of the year. This survey will enable the company to determine the focus area for 2D seismic acquisition.

The following table sets out 2010 deliverables, management's previously disclosed mid/long-term outlook, along with a description of progress to the date of this MD&A.

2010 Deliverable	Q1 Progress	Mid / Long-term outlook
Transportation – Complete construction of truck offloading facility (TOF) to commence trucking of blended crude to Block 51 by the end of the third quarter of 2010.	Management has defined the scope of the TOF project and has engaged the services of an engineering firm to complete detailed construction plans. The facility is expected to be commissioned before year-end	Engineering studies will commence in 2010 for the construction of a pipeline to ship blended crude to the Masila system.
Ras Nowmah – Complete appraisal of Ras Nowmah structure.	The Company has identified an appraisal drilling location and is developing the detailed work plan for appraisal wells at Ras Nowmah	Drill up to two appraisal wells during 2010 to delineate reserves and begin planning for full field development.
Qarn Qaymah – Conduct operations to provide further appraisal of the Qarn Qaymah structure.	The Company has identified an appraisal well location (QQ-3).	Drill up to four additional exploration/appraisal wells during 2010 to delineate reserves and begin planning for full field development.
Al Roidhat – Upon completion of the truck offloading facility, commence production from the shut-in wells.	Existing wells in the Al Roidhat area were prepared for production during Q1 2010.	Drill up to eight additional development wells during 2010 to boost production. Up to 50 additional wells could be drilled on 10-acre spacing units.
Hiswah – Drill up to nine development wells and commence water and gas injection to maintain reservoir pressure and increase recoverability.	During Q1 2010, three Hiswah wells were drilled and completed. The final equipment necessary to commence gas injection is being shipped to Yemen. Reservoir pressure maintenance through water and gas injection is expected to begin in Q2 2010.	Drill up to 20 additional development wells
Auqban – Acidize Auqban 1 to attempt to increase production from the tight formation.	Program for acidizing of Auqban well was finalized. The well is expected to be acidized in the second quarter.	Further appraisal and development of the Auqban structure to follow, depending on results of acidizing treatment.
Ethiopia – Complete geological mapping and conduct an airborne gravity survey during the second half of 2010.	Surface geological mapping is well underway and the work is expected to be complete in the second quarter.	Commence aeromagnetic and gravity survey in the second half of 2010.. Expect to drill the first well in late 2011 / early 2012.

EXPLORATION AND DEVELOPMENT PROGRAM

Block 9 – Republic of Yemen

Joint Operating Agreement (JOA)

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 the Block 9 Joint Venture (JV) pursuant to the JOA among 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 JV's allocation of profit oil under the PSA.

Production Sharing Agreement

Oil and natural gas production from Block 9 is allocated between 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, 2010, the Company's share of capital costs to be carried forward for recovery against future production was approximately \$49 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 which is paid by the Government of Yemen out of its share of profit oil.

Ethiopia

Production Sharing Contract

In 2008, Calvalley entered into its first Production Sharing Contract with the Ethiopian Government for the exploration, development and production of petroleum substances in the Gimbi and Metema blocks under a single contract covering a total area of over 46,470 km² (11.5 million acres).

Calvalley has a 100% operated working interest in both blocks for an exploration period of eight years, consisting of an initial period of four years followed by two subsequent option periods consisting of two years each. The option periods will be activated at the discretion of Calvalley. Furthermore, subject to hydrocarbon discovery during the total eight year period, the PSC provides for an additional 25 year development period with a 10 year optional extension. The PSC gives Calvalley the rights to explore, develop, and produce hydrocarbons including oil, condensate, natural gas and associated liquids.

Total work obligations under the PSC, during the initial 4 year exploration program amount to approximately \$8.5 million and consist of the acquisition and processing of 400 km of 2D seismic and the drilling of one exploration well.

KEY PERFORMANCE 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 and sales information

	2010	2009				
	Q1	Year Total	Q4	Q3	Q2	Q1
Block 9 Oil Production (bopd)	4,597	4,320	4,404	4,184	4,164	4,532
Company working interest share (bopd)	2,299	2,160	2,202	2,092	2,082	2,266

Production

Substantially all of Calvalley's crude oil production in 2010 and 2009 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 kilometres 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 2010, the Company's working interest oil production averaged 2,299 barrels of oil per day (bopd) (2009 – 2,266 bopd).

Production rates during the first quarter of 2010 stabilized to levels comparable to the first quarter of 2009. Production decreased during the second quarter of 2009 because the facility through which the Company sells its oil restricted the volumes of oil it would accept from Block 9. The restriction resulted from the facility seeking to achieve target sulphur content in the oil blend exiting the facility. The facility's blended sulphur content had increased due to decreased production from other fields feeding the facility. The Company consequently shut-in certain higher-sulphur producing wells to meet the requirements of this externally imposed restriction. The restriction has been removed and the production rate has recovered.

During the first quarter of 2010 the Company finalized transportation agreements which will provide for the Company's use of alternate facilities at Block 51 and Block 14. Once shipments to Block 51 commence, the Company will begin production from the Al Roidhat field. The Company's working interest oil production has improved and in April 2010 averaged 2,309 bopd.

The following table sets forth key indicators for the periods indicated:

Selected operating information

(\$000)	2010	2009				
	Q1	Year Total ⁽¹⁾	Q4	Q3	Q2	Q1 ⁽¹⁾
Oil sales	14,449	50,839	14,136	12,591	17,252	6,860
Royalties	(5,528)	(19,485)	(5,394)	(4,825)	(6,566)	(2,700)
Operating expenses	(1,888)	(10,313)	(2,321)	(2,141)	(3,738)	(2,133)
Current taxes	(886)	(3,143)	(880)	(779)	(1,066)	(418)
Netback ⁽²⁾	6,147	17,898	5,541	4,846	5,882	1,629
General and administrative expenses	(1,063)	(4,413)	(1,095)	(657)	(1,496)	(1,165)
EBITDA ⁽²⁾	6,071	15,992	5,433	5,055	5,548	(44)
Operating income (loss) ⁽²⁾	3,737	6,142	3,000	3,032	1,904	(1,764)
Net income (loss)	2,725	2,951	2,109	2,122	765	(2,045)
Capital expenditures	3,199	11,803	4,813	1,781	2,812	2,399
Funds flow from operations ⁽²⁾	5,269	13,600	4,652	4,453	4,644	(149)
Cash flow (deficiency) from operating activities	5,122	13,971	9,271	3,587	3,325	(962)

(1) For the purpose of calculating netback, operating expenses for the first quarter and year total of 2009 were adjusted to exclude the portion of the Facility Usage fee (FUF) 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 sales revenue less government royalties, taxes and operating expenses and 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:

Netbacks

(\$/bbl)	2010	2009				
	Q1	Year Total ⁽¹⁾	Q4	Q3	Q2	Q1 ⁽¹⁾
Oil sales	75.91	57.08	73.83	67.74	51.30	38.75
Royalties	(29.09)	(21.92)	(28.28)	(26.00)	(19.53)	(15.28)
Operating expenses	(9.92)	(11.58)	(12.12)	(11.52)	(11.12)	(11.93)
Current taxes	(4.69)	(3.53)	(4.56)	(4.19)	(3.17)	(2.39)
Netback ⁽²⁾	32.21	20.05	28.87	26.03	17.48	9.14

(1) For the purpose of calculating netback, operating expenses for the first quarter and year total of 2009 were adjusted to exclude the portion of the FUF which relates to deliveries of crude oil prior to January 1, 2009 in the amount of \$5.79/bbl. See "Operating Expenses".

(2) See "Non-GAAP Measures".

Revenue

During the first quarter of 2010, Calvalley recorded oil revenue of \$14.4 million as compared to \$6.9 million for the three month period ended March 31, 2009. The significant increase in revenue is primarily attributable to a 96% increase in the average selling price realized during the first quarter of 2010 (\$75.91/bbl) in comparison to the first quarter of 2009 (\$38.75/bbl). The Company also recognized revenue on the sale of 190,350 barrels

during the three months ended March 31, 2010 compared with 177,069 barrels during the first quarter of 2009, representing a 7.5% increase in volume. The increase in sales volume is attributable to the timing of lifts and is not directly correlated with production, which was 206,885 bbls in 2010 versus 203,955 bbls in 2009.

Other Revenue

Other revenue amounted to \$0.2 million for the three months ended March 31, 2010 as compared to \$0.4 million for the quarter ended March 31, 2009. Interest revenue resulted from maintaining significant cash reserves and guaranteed investment certificates (GICs) throughout the period. Interest income has declined from 2009 due to reduced interest rates throughout the year. Interest rates on interest-bearing deposits declined throughout 2008 and 2009, and have remained depressed during 2010 as central banks attempt to stimulate their economies by reducing borrowing rates.

Operating Expenses

Operating expenses during the three months ended March 31, 2010 were \$1.9 million as compared to \$3.1 million in the period ended March 31, 2009. Operating expenses were higher in the first quarter of 2009 on an absolute basis as a result of \$1.7 million of operating expenses that were included in inventory at December 31, 2008. The operating expenses and depletion that were included in inventory were recognized as an expense when the oil inventory was sold during the first quarter of 2009. Operating costs for the three month period ended March 31, 2010 amounted to \$9.92/bbl versus \$11.12/bbl in the first quarter of 2009. Operating costs on a per barrel basis have decreased due to the Management's ongoing efforts to control costs and the timing of certain operational activities.

During the first quarter of 2009, the Government of Yemen charged Calvalley \$1.1 million for facilities usage. All producers of crude oil in Yemen are subject to the 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 amounted to \$1.0 million and has been excluded from operating expenses for the purpose of this MD&A to maintain comparability of operating expenses. The balance of the charge in the amount of \$81,000 (\$0.40/bbl) related 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 PSA.

As a result of the global financial crisis and falling oil prices, the oil industry cut back or delayed certain capital-intensive projects, which has led to less demand and lower costs for certain goods and services. Calvalley manages operating costs through competitive bidding, long-term contracts and, recently, renegotiation of current contract terms.

Operating expenses include \$5.21 (2009 - \$5.47) per gross barrel for trucking costs, third-party processing costs, and tariffs for use of pipeline and marine terminal facilities.

Netback

Netbacks for the first quarter of 2010 were \$32.21/bbl compared to \$8.70/bbl for the first quarter of 2009. Fluctuations in netbacks are primarily attributable to changes in the prevailing price of crude oil. Netbacks are also impacted by fluctuations in operating costs as discussed above.

General and Administrative Expenses (G&A)

G&A, net of \$0.5 million that was capitalized into resource development costs, totalled \$1.1 million for the three month period ended March 31, 2010 as compared to \$1.2 million for the quarter ended March 31, 2009. G&A 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 2010, the Company generated EBITDA of \$6.1 million compared with a loss before interest, taxes, depreciation and amortization in the amount of \$44,000 during the three months ended March 31, 2009. The fluctuation in EBITDA is primarily attributable to changes in the prevailing price of crude oil. The FUF referred to above in the discussion on operating expenses was a major contributor to the negative EBITDA recognized in the first quarter of 2009. EBITDA is also impacted by the timing of lifts by the purchaser of the Company's crude oil.

Depletion, Depreciation and Amortization (DD&A) Expenses

	2010	2009				
	Q1	Year Total	Q4	Q3	Q2	Q1
DD&A (\$000)	2,334	9,850	2,433	2,023	3,644	1,750
DD&A (\$/bbl)	12.26	11.06	12.71	10.88	10.84	9.88

Calvalley recorded DD&A expenses of \$2.3 million for the period ended March 31, 2010 as compared to \$1.8 million for the quarter ended March 31, 2009. The increase in the 2010 versus 2009 annual DD&A rate per barrel is primarily related to adjustments as reflected in the Company's December 31, 2009 reserve report.

Operating Income

During the first quarter of 2010, the Company generated operating income of \$3.7 million compared with an operating loss of \$1.8 million during the three month period ended March 31, 2009. Operating income was impacted by the same factors as those affecting netbacks and EBITDA.

Income Taxes

Current income tax expense in the first quarter of 2010 of \$0.9 million (2009 – \$0.4 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 share of profit oil.

CONSOLIDATED CASH FLOW

Operating Activities

	2010	2009				
	Q1	Year Total	Q4	Q3	Q2	Q1
(\$000)						
Funds flow from operations	5,269	13,600	4,652	4,453	4,644	(149)
Change in non-cash working capital	(147)	371	3,369	(866)	(1,319)	(813)
Cash provided by (used in) operations	5,122	13,971	8,021	3,587	3,325	(962)

As at March 31, 2010, the Company held cash and cash equivalents of \$12.4 million compared with \$20.0 million at the end of 2009. Additionally, the Company held GICs with an initial term greater than 90 days in the amount of \$58.9 million (2009 – \$50.4 million). The Company invests its cash reserves in GICs issued by an Alberta credit union in which deposits are guaranteed by the Province of Alberta.

Funds flow from operations of \$5.3 million during the first quarter of 2010 was sufficient to fund all of the additions to property, plant and equipment in the amount of \$3.2 million. During the first quarter of 2009, funds flow used in operations was \$149,000.

Investing Activities

(\$000)	2010	2009				
	Q1	Year Total	Q4	Q3	Q2	Q1
Additions to property, plant and equipment	(3,199)	(11,803)	(4,811)	(1,781)	(2,812)	(2,399)
Change in non-cash working capital	(281)	6,960	5,608	4,080	3,675	(6,403)
Net investment in GICs	(8,509)	(7,637)	(6,359)	(151)	3,314	(4,441)
Cash provided by (used in) investing activities	(11,989)	(12,480)	(5,562)	2,148	4,177	(13,243)

During the first quarter of 2010, the Company made capital expenditures of \$3.2 million compared with \$2.4 million during the three months ended March 31, 2009. 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 and complete the Al-Roidhat wells for production, to drill development wells in the Hiswah area, and to drill exploration wells in the Ras Nomah and Salmin area. Payments received from the Company's partners exceeded the Company's funding of expenditures on behalf of its partners in the amount of \$2.5 million during the period. Of these payments, \$1.5 million related to capital expenditures. The Company also invested in GICs during the first quarter of 2010.

Financing Activities

(\$000)	2010	2009				
	Q1	Year Total	Q4	Q3	Q2	Q1
Issuance of common shares	114	776	19	65	692	-
Common share repurchase	(843)	(3,342)	(521)	(265)	(1,462)	(1,094)
	(729)	(2,566)	(502)	(200)	(770)	(1,094)

During the first quarter of 2010, the Company repurchased 351,792 Class A Common Voting Shares on the open market pursuant to its normal course issuer bid at a cost of \$843,000 representing an average cost of \$2.40/share. Proceeds from the issuance of Class A Common Voting Shares during the period were related solely to the exercise of stock options and totalled \$114,000.

CONSOLIDATED FINANCIAL POSITION

Assets (\$000)	2010	2009			
	Q1	Q4	Q3	Q2	Q1
As at period-end					
Cash and cash equivalents	12,437	20,043	17,997	12,420	5,697
GICs	58,892	50,383	44,024	43,873	47,187
Accounts receivable	3,007	2,821	2,707	2,570	2,302
Due from joint venture partners	6,607	9,112	12,143	20,058	22,719
Oil inventory	428	225	266	379	3,621
Prepaid expenses	201	341	373	259	280
Property and equipment	90,806	90,066	87,668	84,634	83,887
Total assets	172,378	172,991	165,178	164,193	165,683

As at March 31, 2010, the Company's total assets were \$172.4 million, a decrease of \$0.6 million from December 31, 2009. Cash and cash equivalents amounted to \$12.4 million compared with \$20.0 million at the beginning of the year. The decrease was offset by an increase of \$8.5 million in GICs.

Accounts receivable increased by \$0.2 million to \$3.0 million as at March 31, 2010. The balance at March 31, 2010 primarily relates to revenue earned from oil sold during March 2010. The amount due from JV partners decreased from \$9.1 million at the beginning of the year to \$6.6 million as at March 31, 2010.

Oil inventory increased from \$0.2 million to \$0.4 million. Oil inventory relates to oil production in storage at the end of a period, valued at the average cost of production.

Property and equipment increased to \$90.8 million as at March 31, 2010. The movement in property and equipment resulted from capital expenditures of \$3.2 million, which was offset by DD&A expense of \$2.3 million plus \$0.1 million in net adjustments to depletion related to oil in inventory.

Liabilities and Shareholders' Equity (\$000)	2010	2009			
	Q1	Q4	Q3	Q2	Q1
As at period-end					
Accounts payable and accrued liabilities	9,390	12,220	6,232	7,500	7,554
Deferred revenue	-	-	-	-	1,653
Share capital	116,143	116,387	116,622	116,671	116,888

Accounts payable and accrued liabilities decreased to \$9.4 million as at March 31, 2010, from \$12.2 million as at December 31, 2009. The primary reason for this decrease is the increased capital spending related to heightened exploration and development activity during the last two months of 2009 and the timing of payments made to suppliers and contractors.

Share capital decreased to \$116.1 million as at March 31, 2010 from \$116.4 million as at the end of 2009 as a result of the repurchase of common shares through the Company's normal course issuer bid. The decrease was partially offset by the issuance of Class "A" Common Voting Shares from the exercise of stock options during the period.

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 2010 budget is expected to be funded from cash flow from operations and existing cash resources. Should the prevailing Dated Brent Crude price decline to lower than budgeted, Calvalley has sufficient flexibility in its capital budget to adjust capital expenditures to enable the capital program to be funded through internally generated cash flow. Fluctuations in commodity prices, product demand, foreign exchange rates and interest rates, as well as 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, 2010. 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, 2010, the Company's total assets were \$172.4 million, a decrease of \$0.6 million from December 31, 2009. Cash and cash equivalents amounted to \$12.4 million compared with \$20.0 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 GICs with an initial term greater than 90 days. Total cash and cash equivalents plus GICs increased from \$70.4 million at December 31, 2009 to \$71.3 million at March 31, 2010.

Interest rates on interest-bearing deposits have remained depressed over the past year as central banks attempt to stimulate the economy by reducing 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, 2010 the Company's working capital increased to \$72.2 million as compared to \$70.7 million as at December 31, 2009.

At December 31, 2009 the Company had Canadian tax pools of approximately \$31.3 million, of which \$13.5 million were non-capital losses, \$6.7 million were Canadian resource tax pools, \$9.8 million were undepreciated capital cost allowance and \$1.3 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 \$0.2 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 bopd day, respectively.

During 2008, Calvalley entered into its first Production Sharing Contract (PSC) with the government of the Federal Democratic Republic of Ethiopia. Pursuant to 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, 2010 or December 31, 2009.

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, 2010, had these changes occurred on January 1, 2010. 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 Calvalley's entitlement is calculated according to the provisions of the PSA and JOA.

	Change (+)	Net income impact (\$ millions)	Net income impact (\$ per basic share)
Average realized price	\$10.00/bbl	1.1	\$0.01
Crude oil production	1,000 bopd	0.9	\$0.01
Increase in operating expenses	\$1.00/bbl	(0.2)	\$0.00
Interest rate	1%	0.2	\$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 as they do not have a significant impact on Calvalley's operations.

RELATED-PARTY TRANSACTIONS

On June 10, 2009 the Company advanced \$113,000 to a member of the Board of Directors. The advance was included in accounts receivable, was non-interest-bearing, repayable within 90 days, and secured by shares of the Company. The advance was repaid in full during August 2009.

RISK FACTORS

Calvalley is exposed to a number of risks inherent in exploring for, developing and producing oil and natural 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 18 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, 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 April 2009 for an additional period which expires in June, 2010 and can be extended for additional 12-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 JV 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. Over the past several months, this issue has been referred between the Commercial Court of Yemen, the Yemeni Court of Appeal and the Supreme Court of Yemen on a number of procedural issues and has now been sent back to the Supreme Court of Yemen for reassessment. Interim judgments have been issued and both parties appealed an initial ruling which limited the plaintiff's entitlement to an interest on the net profit from profit oil

production prior to February, 2008. Calvalley has cross-appealed on a number of matters of substance and procedure.

The Company's legal advisors in Sana'a and Calgary are pursuing the appeal jointly. The outcome of the action in the Supreme Court of Yemen is undeterminable at this time. No amounts have been accrued in the financial statements for the year ended December 31, 2009 as the ultimate resolution is uncertain. The Company will record any amounts due, if any, once the outcome of the contingency is likely and estimable. Both parties have appealed the ruling and the final decision of the Supreme Court of Yemen could vary significantly from the ruling of the lower court.

From 2004 through 2007, the Company billed its Block 9 JV partners for fees in accordance with the terms of the PSA which governs the JV operating activities on Block 9. The JV partners contend that certain of these fees are not billable under the terms of the JOA between the Company and the JV partners. Pending resolution of this matter, the Company has not charged the JV partners for the fees in question during 2008 and 2009. The Company and its JV partners have agreed in principle to enter into a binding expert determination to interpret the terms of the JOA and rule on whether the fees in question are billable. While management is not able to determine the likelihood of a positive or negative outcome, the maximum liability to the Company related to fees charged from 2004 to 2007 is \$1 million. Conversely, should the fees be deemed billable, the Company would recover fees which have not previously been recorded in the accounts in the amount of \$657,000.

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 natural gas properties, together with related production and transportation infrastructure, can be situated in remote areas. In addition to the operational risks described above, oil and natural 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 natural gas operations and injury or death 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 production 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 natural gas industry. Calvalley actively competes for skilled industry personnel who are in high demand, particularly at its Canadian headquarters, with a substantial number of other oil and natural 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 natural 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.

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 when 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, 2010, the Company had 97,942,792 common shares outstanding. Additionally, there were 4,003,100 options outstanding which were issued pursuant to the Company's stock option plan.

DISCLOSURE CONTROLS AND PROCEDURES

Disclosure Controls and Procedures ("DC&P") are designed to provide reasonable assurance that information required to be disclosed is recorded, processed, summarized and reported within the time periods specified in applicable securities legislation, and include controls and procedures designed to ensure that information required to be disclosed is accumulated and communicated to management, including the CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

As at March 31, 2010, an evaluation of the design of the Company's DC&P was carried out under the supervision of, and with the participation of management including its certifying officers. Based on that evaluation, the Company's certifying officers concluded that the design of the Company's DC&P was effective as at March 31, 2010 and would provide reasonable assurance that material information relating to the Company and its consolidated subsidiaries would be made known to them by others within those entities during the period in which the interim filings were prepared, and that information required to be disclosed by the Company would be recorded, processed, summarized and reported within the time periods specified under applicable securities legislation.

INTERNAL CONTROLS OVER FINANCIAL REPORTING

Internal Controls over Financial Reporting ("ICFR") are designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with Canadian GAAP. ICFR can only provide reasonable assurance and may not prevent or detect misstatements. Projections of an evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate due to changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate. As at March 31, 2010, an evaluation of the design of the Company's ICFR was carried out under the supervision of, and with the participation of management including its certifying officers. Based on that evaluation, the Company's certifying officers concluded that the design of the Company's ICFR was effective as at March 31, 2010 and would provide reasonable assurance that material weaknesses in ICFR would be made

known to them, and reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP.

EFFECT OF FUTURE CHANGES IN ACCOUNTING POLICIES

International Financial Reporting Standards (IFRS)

In February 2008, the CICA's 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 continually assessing the impact of the convergence of Canadian GAAP with IFRS on the Company's results of operations, financial position and disclosures. Under the direction and oversight of the Board of Directors and Audit Committee, the Company has assembled a project team to manage the transition and to ensure successful implementation within the required timeframe.

The Company recognizes that the changeover to IFRS has complex implications on a combination of accounting, financial reporting, information technology and business systems. Consequently, senior management has engaged external consultants to conduct a business impact study, to assist in the development a project plan, and to provide assistance in considering various accounting policy decisions which will be required throughout the transition period. Company personnel involved with the transition project have also received appropriate training and education.

The overall IFRS transition project consists of five phases: (i) Scope; (ii) Plan; (iii) Design and Build; (iv) Implement; (v) Review. The Scope phase, which consisted of identifying the significant differences between Canadian GAAP and IFRS, has been completed.

The Company has concluded that the following key issues will have the most significant impact on Calvalley's results of operations, financial position and disclosures:

IFRS 1 – First-time adoption of International Financial Reporting Standards;

IFRS 6 – Exploration and Evaluation of Mineral Resources;

IFRS 16 – Property, Plant and Equipment;

International Accounting Standard 36 – Impairment of Assets;

The Company has also completed the Plan phase. During this phase, the Company gathered information and financial data to assess the potential impacts of the differences identified during the Scope phase. Management has determined the resources that will be required to complete the transition to IFRS, has assembled an IFRS transition project team, and has established internal milestones and timelines.

The Company is now progressing through the Design and Build phase of the transition project. The IFRS project team is currently developing recommendations for IFRS policy decisions which are based on appropriately documented consideration of the following factors:

Impact on financial and key performance indicators;

Impact on information technology and systems;

Impact on the internal control and disclosure control frameworks;

Transition and maintenance costs;

Impact on communications with key stakeholders; and

Other general business impacts.

The IFRS project team has conducted a preliminary detailed analysis of IFRS 1, 6, and 16 and has identified the impact of the available policy alternatives to the Company's financial reports. Upon management discussion and approval of the recommendations from the IFRS project team, the recommendations will be submitted to the Audit Committee for approval and to the Company's external auditors for review. Management expects to internally approve the Company's transition balance sheet and accounting policies governing accounting for oil and gas assets prior to the end of the second quarter of 2010.

The Company has not formally approved specific IFRS policies and consequently has not quantified the impact of such policies on individual elements of the financial statements. As the Company adopts IFRS policies, management will quantify the impact of these policies on the financial statements. Implementation of the necessary changes to business process, financial systems, accounting policies, DC&P and ICFR will also be executed as policy choices are finalized.

The Company has begun assessing whether the transition to IFRS will have an impact on business activities. While management has not identified any instances where IFRS would have major implications on existing contractual arrangements or other business activities, formal conclusions on this matter have not been completed.

In respect of information technology systems implications, management has communicated with software suppliers to confirm that systems in place are sufficient to enable the IFRS transition. Management is also in the process of developing a strategy for implementing IFRS-compliant financial reporting processes during 2010 using the existing accounting software suite and financial reporting infrastructure.

The Company is currently adhering to the timelines established in its transition project plan.

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 (TSX) 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, 2009. Calvalley will acquire Common Shares under the bid at the market price at the time of purchase, and all Common Shares acquired will be cancelled. 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 1,657,688 shares were acquired under the bid at an average cost of C\$1.93/share.

COMPARABILITY WITH PRIOR PERIODS

Revenue may fluctuate from period to period 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, any receivable related to those provisions is recorded in the accounts as deferred revenue. At March 31, 2010, the Company had no take-or-pay revenue and oil inventory was \$0.4 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 and was accrued in the first quarter 2009 financial statements. The portion of the charge related to deliveries that occurred prior to January 1, 2009 amounted to \$1.0 million. The balance of the charge in the amount of \$81,000 (\$0.40/bbl) related to oil that was delivered to the government facility during Q1 2009. The Company will continue to incur the \$0.40/bbl FUF in future periods. The FUF is recoverable from the Company's share of cost oil in accordance with the terms of the Production Sharing Agreement.

FORWARD-LOOKING STATEMENTS

This MD&A 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 natural 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.

**Calvalley Petroleum Inc.
Unaudited Consolidated Financial Statements
For the three months ended
March 31, 2010 and 2009
(Expressed in Thousands of United States Dollars)**

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

	March 31, 2010	December 31, 2009
	\$	\$
ASSETS		
Current		
Cash and cash equivalents (note 2)	12,437	20,043
Guaranteed investment certificates (note 3)	58,892	50,383
Accounts receivable	3,007	2,821
Oil inventory (note 4)	428	225
Due from joint venture partners (note 5)	6,607	9,112
Prepaid expenses	201	341
	81,572	82,925
Property, plant and equipment (note 6)	90,806	90,066
	172,378	172,991
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current		
Accounts payable and accrued liabilities	9,390	12,220
	9,390	12,220
Commitments and contingencies (note 14)		
 Shareholders' equity		
Share capital (note 7)	116,143	116,387
Contributed surplus (note 8)	7,307	7,146
Accumulated other comprehensive income	3,963	3,963
Retained earnings	35,575	33,275
	162,988	160,771
	172,378	172,991

See accompanying notes

On behalf of the Board:

"Edmund Shimoon"

Edmund Shimoon

"Gary Robertson"

Gary Robertson

Calvalley Petroleum Inc.

CONSOLIDATED STATEMENTS OF OPERATIONS AND RETAINED EARNINGS
(Expressed in thousands of United States Dollars)

For the three months ended March 31	2010 \$	2009 \$
REVENUE		
Oil sales	14,449	6,860
Royalties	(5,528)	(2,700)
	8,921	4,160
Management fees	101	99
Interest and other	91	284
	9,113	4,543
EXPENSES		
Operating	1,888	3,138
General and administrative, net of recoveries	1,063	1,165
Stock-based compensation	221	157
Depletion, depreciation and amortization	2,334	1,750
	5,506	6,210
Income (loss) before other items	3,607	(1,667)
Foreign exchange gain	4	40
Income (loss) before income tax	3,611	(1,627)
Income tax	886	418
Net income (loss) and comprehensive income (loss)	2,725	(2,045)
Retained earnings, beginning of period	33,275	30,480
Common share repurchases	(425)	-
Retained earnings, end of period	35,575	28,435
Earnings (loss) per share (note 12)		
Basic	0.03	\$(0.02)
Diluted	0.03	\$(0.02)

See accompanying notes

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

For the three months ended March 31	2010	2009
	\$	\$
OPERATING ACTIVITIES		
Net income (loss) for the period	2,725	(2,045)
Add (deduct) items not affecting cash:		
Stock-based compensation	221	157
Depletion, depreciation and amortization	2,334	1,750
Unrealized foreign exchange gain	(11)	(11)
	5,269	(149)
Change in non-cash working capital (note 10)	(147)	(813)
	5,122	(962)
INVESTING ACTIVITIES		
Additions to property, plant and equipment	(3,199)	(2,399)
Investment in guaranteed investment certificates	(65,298)	(53,780)
Redemption of guaranteed investment certificates	56,789	49,339
Change in non-cash working capital (note 10)	(281)	(6,403)
	(11,989)	(13,243)
FINANCING ACTIVITIES		
Issuance of common shares (note 7)	114	-
Common share repurchase (note 7)	(843)	(1,094)
	(729)	(1,094)
Foreign exchange gain (loss) on cash and cash equivalents held in foreign currencies	(10)	7
Decrease in cash	(7,606)	(15,292)
Cash and cash equivalents, beginning of period (note 2)	20,043	20,989
Cash and cash equivalents, end of period	12,437	5,697

See accompanying notes

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited – Financial Figures Expressed in thousands of United States Dollars)

March 31, 2010 and 2009

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, 2010 and 2009 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, 2009. 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, 2009 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. CASH AND CASH EQUIVALENTS

Cash and cash equivalents at March 31, 2010 include various short-term deposits of \$6,236 (December 31, 2009 – \$16,664), bearing interest at 0.40% (December 31, 2009 – 0.20% to 0.28%) and maturing on April 16, 2010, and \$6,202 (December 31, 2009 – \$3,379) of cash.

3. GUARANTEED INVESTMENT CERTIFICATES

Guaranteed investment certificates (GICs) with original maturities in excess of 90 days at March 31, 2010 are as follows:

<u>Maturity</u>	<u>Face Value</u>	<u>Interest Rate</u>
May 15, 2010	\$10,999	0.55%
August 7, 2010	\$10,342	0.50%
August 11, 2010	\$1,521	0.25%
August 15, 2010	\$2,833	0.25%
November 6, 2010	\$3,000	0.90%
November 12, 2010	\$2,548	0.90%
March 20, 2011	\$27,628	0.70%

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

4. 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, 2010, \$225 (2009 – \$2,995) was expensed with respect to oil which was sold.

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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited – Financial Figures Expressed in thousands of United States Dollars)

March 31, 2010 and 2009

6. PROPERTY, PLANT AND EQUIPMENT

	March 31, 2010		
	Cost	Accumulated Depletion and Depreciation	Net Book Value
	\$	\$	\$
Canada			
Oil and natural gas properties	129	83	46
Other capital assets	306	160	146
	435	243	192
Yemen			
Oil and natural gas properties	129,029	39,102	89,927
Ethiopia			
Oil and natural gas properties	687	-	687
	130,151	39,345	90,806

	December 31, 2009		
	Cost	Accumulated Depletion and Depreciation	Net Book Value
	\$	\$	\$
Canada			
Oil and natural gas properties	130	80	50
Other capital assets	294	153	141
	424	233	191
Yemen			
Oil and natural gas properties	125,889	36,653	89,236
Ethiopia			
Oil and natural gas properties	639	-	639
	126,952	36,886	90,066

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 five-year extension. The ownership of all assets, tangible and intangible, remains with the Yemen authority.

During the three months ended March 31, 2010, the Company capitalized overhead costs relating to oil and natural gas exploration and development activities of \$477 (2009 – \$409).

Ethiopia

During 2008, the Company signed a Production Sharing Contract (PSC) with the government of the Federal Democratic Republic of Ethiopia on the Metema and Gimbi Blocks covering a total area of 11.5 million acres.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited – Financial Figures Expressed in thousands of United States Dollars)

March 31, 2010 and 2009

6. PROPERTY, PLANT AND EQUIPMENT (Continued)

Costs incurred during 2009 and 2010 related to initial exploration efforts. Costs incurred during 2008 were related to the signing of the PSC. Properties in Ethiopia are unproved and the costs incurred of \$687 (December 31, 2009 – \$639) have been excluded from costs subject to depletion and depreciation.

7. SHARE CAPITAL**a. Common shares****Authorized:**

Unlimited number of Class A Common Voting Shares.

Issued:

Period ended March 31, 2010	Number	Amount (\$)
Class A Common Voting Shares		
Shares outstanding, beginning of period	98,217,984	116,387
Issued on the exercise of options (i)	76,600	114
Contributed surplus reclassified on exercise of options (i)	-	60
Repurchased and cancelled (ii)	(351,792)	(418)
Balance, end of period	97,942,792	116,143

- (i) The Company issued 76,600 Class A Common Voting Shares (2009 – Nil) upon the exercise of options for proceeds of \$114 (2009 - \$Nil). An amount of \$60 (2009 – Nil) related to stock-based compensation expensed in prior periods was reclassified from contributed surplus to share capital in connection with options exercised in 2010.
- (ii) The Company repurchased 351,792 (2009 – 1,148,622) of its common shares pursuant to its Normal Course Issuer Bid at a cost of \$843 (2009 - 1,094). The cost to repurchase common shares at prices in excess of their average book value has been charged to retained earnings.

Year ended December 31, 2009	Number	Amount (\$)
Class A Common Voting Shares		
Shares outstanding, beginning of year	100,265,602	118,243
Issued on the exercise of options (i)	563,300	776
Contributed surplus reclassified on exercise of options (i)	-	452
Repurchased and cancelled (ii)	(2,610,918)	(2,084)
Balance, end of year	98,217,984	116,387

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited – Financial Figures Expressed in thousands of United States Dollars)

March 31, 2010 and 2009

7. SHARE CAPITAL (continued)

- (i) The Company issued 563,300 Class A Common Voting Shares upon the exercise of options for proceeds of \$776. An amount of \$452 related to stock-based compensation expensed in prior years was reclassified from contributed surplus to share capital in connection with options exercised in 2009.
- (ii) The Company repurchased 2,610,918 of its common shares pursuant to its Normal Course Issuer Bid at a cost of \$3,342. The cost to repurchase common shares at prices in excess of their average book value has been charged to retained earnings and contributed surplus. 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 of Directors as they are granted and currently include periods ranging from immediately to evenly over three or five years. The options' maximum term is five years (10 years for options granted prior to October 1, 2001).

At March 31, 2010 a total of 9,794,279 (December 31, 2009 – 9,821,798) shares were 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, 2010		Three months ended March 31, 2009	
	Options (000s)	Weighted Average Exercise Price – C\$	Options (000s)	Weighted Average Exercise Price – C\$
Opening balance	4,095	3.53	4,358	3.29
Granted	-	-	120	1.50
Forfeited / Expired	(15)	1.60	(180)	3.38
Exercised	(77)	1.58	-	-
Ending balance	4,003	3.57	4,298	3.24

Stock options outstanding at March 31, 2010 were as follows:

Number of Options (000s)		Weighted Average Exercise Price – C\$	Year of Expiry
Granted	Exercisable		
805	805	4.08	2010
50	50	0.90	2011
75	75	6.86	2011
260	227	7.01	2012
493	220	1.60	2013
1,475	1,092	4.29	2013
645	157	1.66	2014
200	-	2.22	2014
4,003	2,625	3.57	

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited – Financial Figures Expressed in thousands of United States Dollars)

March 31, 2010 and 2009

7. SHARE CAPITAL (continued)

During the three months ended March 31, 2010, stock-based compensation costs of \$221 (2009 – \$157) were expensed and credited to contributed surplus. The fair value of the options granted during the period was C\$Nil (2009 – C\$72) or C\$Nil per option (2009 – C\$0.60 per option) using the Black-Scholes option pricing model with the following assumptions:

	2010	2009
Risk-free interest rate	NA	1.85%
Expected hold period to exercise	NA	5 years
Volatility in the price of the Company's shares	NA	70% - 71%
Dividend yield	NA	Nil

8. CONTRIBUTED SURPLUS

	Three months ended March 31, 2010 \$	Year ended December 31, 2009 \$
Opening balance	7,146	6,772
Stock-based compensation	221	928
Stock-based compensation associated with exercised options	(60)	(452)
Shares repurchased and cancelled	-	(102)
Closing balance	7,307	7,146

9. CAPITAL DISCLOSURE

The Company defines and computes its capital employed as follows:

	March 31, 2010 \$	December 31, 2009 \$
Shareholders' equity	162,988	160,771
Long-term debt	-	-
Cash and cash equivalents	(12,437)	(20,043)
GICs	(58,892)	(50,383)
Total capital	91,659	90,345

The Company's objectives in 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 debt and therefore has no financial covenants.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited – Financial Figures Expressed in thousands of United States Dollars)

March 31, 2010 and 2009

10. SUPPLEMENTAL CASH FLOW INFORMATION

	Three months ended March 31, 2010 \$	Three months ended March 31, 2009 \$
Changes in non-cash working capital		
Accounts receivable	(186)	991
Due from joint venture partners	2,505	(4,300)
Oil inventory	(78)	(171)
Prepaid expenses	140	1
Accounts payable and accrued liabilities	(2,809)	(2,135)
Deferred revenue	-	(1,602)
	(428)	(7,216)
Changes in non-cash working capital		
Operating activities	(147)	(813)
Investing activities	(281)	(6,403)
	(428)	(7,216)

During the three months ended March 31, 2010, the Company paid \$Nil in interest (2009 – \$Nil) and \$Nil in taxes (2009 – \$Nil). Yemen income taxes are paid to the government through its allocation of oil under the PSA.

11. GEOGRAPHICAL INFORMATION

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

Segmented information is as follows:

Period ended March 31, 2010

	Ethiopia	Yemen	Canada	Total
	\$	\$	\$	\$
Revenue	-	14,520	121	14,641

Period ended March 31, 2009

	Ethiopia	Yemen	Canada	Total
	\$	\$	\$	\$
Revenue	-	6,928	315	7,243

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited – Financial Figures Expressed in thousands of United States Dollars)

March 31, 2010 and 2009

12. PER SHARE AMOUNTS

In calculating basic and diluted earnings per share, the following weighted average numbers of shares were used:

Three months ended March 31	2010	2009
Weighted average number of shares outstanding	98,047	99,867
Dilutive effect of stock options	512	Nil
Weighted average number of diluted shares outstanding	98,559	99,867

A total of 2,615,000 options were not in the money and were excluded from the dilutive calculation for the three months ended March 31, 2010 (2009 – 4,298,000).

13. 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 GICs 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. Accounts payable and accrued liabilities are classified as other financial liabilities and are measured at amortized cost.

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

Classification	Carrying Value (\$)	Fair Value (\$)
Financial assets held for trading	71,329	71,329
Loans and receivables	9,614	9,614
Accounts payable and accrued liabilities	9,390	9,390

Credit Risk

The majority of the accounts receivable are in respect of oil and natural 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 Dated Brent price on the date of shipment adjusted for the official selling price differential posted by the Government of Yemen. At March 31, 2010, \$2,948 (December 31, 2009 – \$2,771) was receivable under the contract and this amount was received subsequent to the end of the period, in April 2010. 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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited – Financial Figures Expressed in thousands of United States Dollars)

March 31, 2010 and 2009

13. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (Continued)Trade and other receivables at March 31, 2010

Neither impaired nor past due	\$9,614
Impaired (net of valuation allowance)	-
Not impaired and past due in the following period:	
Within 30 days	-
31-60 days	-
61-90 days	-
Over 90 days	-

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. A 100-basis-point increase in interest rates during the three months ended March 31, 2010 would have increased net income by approximately \$172 (\$0.00/share).

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 natural 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 natural 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 12 months are accounts payable and accrued liabilities of \$9,390. In addition, the Company has commitments under existing agreements as described in note 14. Given the Company's working capital position, management assesses liquidity risk as being low.

In determining the fair value of financial instruments, the Company maximizes the use of observable inputs and minimizes the use of unobservable inputs. Observable inputs reflect market-driven or market-based information obtained from independent sources, while unobservable inputs reflect the Company's estimate about market data. Based on the observability of significant inputs used, the Company classifies its fair value measurements in accordance with a three-level hierarchy. This hierarchy is based on the quality and reliability of the information used to determine fair value, as follows:

- Level 1: Valuations are based on quoted prices in active markets for identical assets or liabilities. Since the valuations are based on quoted prices that are readily available in an active market, they are not subject to significant measurement uncertainty.
- Level 2: Valuations are based on observable inputs other than quoted prices.
- Level 3: Valuations are based on at least one unobservable input that is supported by little or no market activity and is significant to the fair value measurement.

13. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (Continued)

In assigning financial instruments to the appropriate levels, the Company performs detailed analysis. In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. The level within which the fair value measurement is categorized is based on the lowest-level input that is significant to the fair value measurement in its entirety.

As at March 31, 2010, the Company's fair value measurement of held for trading financial assets was conducted using Level 1 of the hierarchy.

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 in Canada. The Company invests its cash reserves in GICs issued by an Alberta credit union which deposits are guaranteed by the Province of Alberta. Approximately \$1,817 of the \$12,437 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 during 2010 would have been approximately \$79 (\$0.00/share).

14. COMMITMENTS AND CONTINGENCIES

There have been no material changes or developments with respect to the Company's commitments and contingencies as disclosed in the Company's consolidated financial statements for the year ended December 31, 2009.

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.



CALVALLEY PETROLEUM INC.

Head Office

#700, 600 – 6th Ave SW
Calgary, Alberta
Canada T2P 0S5

Sana'a Office

PO Box 7090,
Hadda, Sana'a
Republic of Yemen

www.calvalleypetroleum.com

For further investor information contact

investorrelations@calvalleypetroleum.com

Edmund Shimon, Chairman and CEO

Memet Kont, President and COO

Bill Cummins, CFO

(403) 297-0490