

**MANAGEMENT'S DISCUSSION AND ANALYSIS
THREE AND SIX MONTHS ENDED JUNE 30, 2011**

Calvalley Petroleum Inc.

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Dated August 11, 2011

References to "Calvalley" or the "Company" refer to Calvalley Petroleum Inc. and its share of consolidated subsidiaries and joint interest projects 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 Company's unaudited condensed consolidated financial statements and related notes for the three and six month periods ended June 30, 2011. 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 "2011", "2010", and "2009" refer to the years ended December 31, 2011, 2010 and 2009, 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 August 11, 2011.

CHANGES IN ACCOUNTING POLICIES

On January 1, 2011, the Company adopted International Financial Reporting Standards ("IFRS") for financial reporting purposes, using a transition date of January 1, 2010. The financial statements for the three and six months ended June 30, 2011, including required comparative information, have been prepared in accordance with International Financial Reporting Standards 1, First-time Adoption of International Financial Reporting Standards, and with International Accounting Standard ("IAS") 34, Interim Financial Reporting, as issued by the International Accounting Standards Board ("IASB"). Previously, the Company prepared its Interim and Annual Consolidated Financial Statements in accordance with Canadian generally accepted accounting principles ("CGAAP").

Unless otherwise noted, 2010 comparative information has been prepared in accordance with IFRS. The adoption of IFRS has not had an impact on the Company's operations, cash flows or strategic decisions. The most significant area of impact was the adoption of the IFRS upstream accounting principles. Further information on impacts is provided in the Changes in Accounting Policies Detail section of this MD&A.

NON-IFRS MEASURES

Funds flow from operations

Funds flow from operations is a measure not recognized under IFRS 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.

EBITDA and Operating income

Earnings before interest, taxes, depreciation and amortization (EBITDA) and Operating income are non-IFRS 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-IFRS 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 provides 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.

Finding and development ("F&D") costs

F&D costs refer to all current year capital expenditures excluding property acquisitions, property dispositions and corporate office expenditures and including changes in future development capital on a proved and proved plus probable basis (as applicable). "Finding and development costs per barrel of oil equivalent" ("F&D \$/Boe") is calculated by dividing finding and development costs by the current year's reserve extensions, discoveries and revisions on a proved or proved plus probable reserve basis (as applicable).

SELECTED QUARTERLY INFORMATION

	2011			2010				2009 ⁽³⁾			
	Full year	Q2	Q1	Full year	Q4	Q3	Q2	Q1	Full year	Q4	Q3
((\$000s unless otherwise noted)											
Avg. production volume – Calvalley share (Bopd)	1,458	1,157	1,763	2,256	2,167	2,256	2,303	2,299	2,160	2,202	2,092
Average sales volume (Bopd)	787	-	1,584	2,186	2,804	2,839	973	2,115	2,440	2,081	2,020
Average realized price (\$/bbl)	101.12	-	101.12	80.03	85.44	76.10	84.70	75.91	57.08	73.83	67.74
Oil Sales	14,412	-	14,412	63,867	22,042	19,877	7,499	14,449	50,839	14,136	12,591
Oil Sales, net ⁽¹⁾	8,858	(82)	8,940	39,494	13,681	12,328	4,564	8,921	31,354	8,742	7,766
Cash flow from operating activities	4,686	(1,641)	6,328	21,592	11,863	1,150	3,457	5,122	13,971	9,271	3,587
Funds flow from operations ⁽²⁾	3,613	(1,541)	5,154	21,915	7,976	6,744	1,926	5,269	13,600	4,652	4,453
Funds flow from operations per share (\$/share) ⁽²⁾											
- Basic and Diluted	0.04	(0.02)	0.05	0.22	0.08	0.07	0.02	0.05	0.14	0.05	0.04
Comprehensive income (loss)	1,461	(2,613)	4,074	14,582	5,982	3,931	1,046	3,623	2,951	2,109	2,122
Earnings (loss) per share (\$/share)											
- Basic and Diluted	0.02	(0.03)	0.04	0.15	0.06	0.04	0.01	0.04	0.03	0.02	0.02
Working Capital	59,643	59,643	67,360	69,652	69,652	72,964	72,006	72,088	70,705	70,705	71,278
Total Assets	190,187	190,187	193,317	194,387	194,387	179,633	173,758	173,262	172,991	172,991	165,178
Long-term debt	-	-	-	-	-	-	-	-	-	-	-

(1) Revenue net of royalties and government share of profit oil

(2) See "Non-GAAP, Non-IFRS Measures". See "Operating Activities" in "Consolidated Cash Flow" section for reconciliation between Funds flow from operations and Cash provided by (used in) operations.

(3) As the Company's IFRS transition date was January 1, 2010, 2009 comparative information has not been restated.

OVERALL PERFORMANCE

Comprehensive income for the six months ended June 30, 2011 was \$1.5 million versus \$4.7 million for 2010. For the three month period ended June 30, 2011, comprehensive loss was \$2.6 million in comparison with comprehensive income of \$1.0 for the three months ended June 30, 2010. The loss during the second quarter of 2011 is primarily attributable to the fact that there were no oil sales recorded during the quarter. Oil produced during the quarter was stored and is held in inventory at June 30, 2011. Working capital at June 30, 2011 decreased to \$59.6 million from \$69.7 million at December 31, 2010. Funds flow from operations for the six month period ended June 30, 2011 decreased to \$3.6 million from \$7.2 million for the six months ended June 30, 2010.

BUSINESS ENVIRONMENT

Calvalley produces high quality crude oil sold at world prices. As such, 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 five most recent quarters:

	2011 Q2	2011 Q1	2010 Q4	2010 Q3	2010 Q2
Dated Brent average oil price (\$/bbl)	117.05	105.43	86.48	76.86	78.24
Calvalley realized price (\$/bbl)	-	101.12	85.44	76.10	84.70
Premium / (Discount) to Dated Brent	N/A	(4.31)	(1.04)	(0.76)	6.46

The price of Dated Brent oil averaged \$117.05/bbl in Q2 2011, an increase of 50% from the Q2 2010 price of \$78.24/bbl. The price of Dated Brent oil at June 30, 2011 was \$111.51/bbl.

Recent political unrest in numerous countries in the Middle East and North Africa has caused uncertainty with respect to the general business environment in the region. While Calvalley monitors the situation on a daily basis, the Company's operations are managed accordingly. Furthermore, Calvalley, with no debt, strong cash generation from operations, and the availability of cash and cash equivalents, remains well-positioned to manage through the periods of uncertainty.

HIGHLIGHTS AND OUTLOOK

During the second quarter of 2011, the Company maintained production operations notwithstanding that the Company's normal product delivery system, westward to the Ras Isa export terminal, was impacted by a pipeline rupture. Calvalley's share of production in the quarter of 1,157 bopd was restricted, initially due to the pipeline disruption, and subsequently to accommodate additional crude oil reprocessing activities at the Company's Central Processing Facility ("CPF").

The Company established access to alternative crude oil marketing facilities to the east of Block 9 by completing the Company's Truck Offloading Facility ("TOF"). The TOF provides the Company an alternative marketing outlet and higher netbacks on its blended crude oil production by accessing the Masila Export Pipeline System ("MEPS") for crude oil exports.

Subsequent to the end of the quarter, the Company finalized a crude oil marketing agreement with a third party on behalf of the working interest owners in Block 9. Exports of crude oil will resume in the third quarter.

No sales of crude oil occurred in the quarter as product exports at the Ras Isa terminal were curtailed due to the pipeline disruption and access to other marketing outlets were not available to facilitate exports via the MEPS. The Company accumulated inventory both at the CPF as well as at the Masila export terminal.

Reported cash flow from operating activities for the six months ended June 2011 of US\$4.7 million includes a negative cash flow for the second quarter of 2011 of US\$1.6mm (as a result of no crude oil exports in the period) which includes one-time general and administrative charges of US\$0.5 million. The deferred cash flow available from the crude oil inventory at the end of the second quarter is approximately US\$4.9 million at current market prices.

At Qarn Qaymah, the Company has finalized the assessment of the fractured basement and has identified a program for remedial action which has been prepared and submitted for regulatory approval.

At Hiswah, results to date indicate a positive response to the pressure maintenance program initiated in 2010. The Company is now proceeding to obtain government approvals for additional water injection wells.

At Ras Nowmah, subsequent to the end of the quarter, the Company brought the Ras Nowmah 2 well on production at a restricted production rate of 1,500 bopd.

At Al Roidhat, subsequent to the end of the quarter, the Company has initiated production from two wells and is planning to put additional wells on production during the third quarter. Crude oil from this field is 15 degree API and is being blended with the light crude oil from the Hiswah and Ras Nowmah fields.

The business environment in Yemen has been challenging throughout 2011 with supply chain disruptions and product shortages. The effect on Company operations has been mitigated by commissioning the eastern export infrastructure. During the political turmoil several service companies diverted resources to areas outside Yemen and were not available to provide the necessary services for Calvalley's capital projects. The Company has focused on production optimization activities with the Company's share of production volumes in July 2011 averaging approximately 1,900 bopd and in the period August-to-date

averaging approximately 2,400 bopd. Subject to the availability of services, the Company plans to drill two development wells and one exploration well before the end of the year.

The Company receives a price for its crude oil which is comparable to Dated Brent Crude Price ("Brent"). The price differential between the West Texas Intermediate Price ("WTI") and Brent has grown significantly over the last year with Brent commanding a premium of more than US\$20 per barrel over WTI. This premium is providing a significant boost to the Company's netbacks which approximate US\$40 per barrel at current market prices.

Calvalley has a healthy balance sheet with approximately \$60 million in working capital at June 30, 2011. The working capital balance increases to approximately \$65 million with inventory of crude oil valued at current market value rather than cost. As the Company expands its production base in Yemen, cash flow will continue to support increased investment activities and share repurchases.

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 Interest (JI) project 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 JI project's allocation of profit oil under the PSA.

Production Sharing Agreement

Oil and natural gas production from Block 9 is allocated between the JI partners 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 JI partners and the Government of Yemen. The JI partners are 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 JI partners as follows:

- 39.23% of total profit oil to the JI (before deducting 35% income tax on JI partners' 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 Joint Interest partners' share of profit oil).

Provided that total recoverable costs do not exceed 45% of gross production, the JI partners 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 June 30, 2011, the Company's share of capital costs to be carried forward for recovery against future production was approximately \$54.1 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 JI partners. 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 (PSC) 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 period 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 initial work obligations under the PSC, to be incurred 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. As at June 30, 2011, the Company has incurred \$1.7 million in exploration expenditures in fulfillment of these obligations.

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 information

	2011			2010			
	Year Total	Q2	Q1	Year Total	Q4	Q3	Q2
Block 9 Oil Production (bopd)	2,917	2,313	3,527	4,512	4,334	4,512	4,606
Company working interest share (bopd)	1,458	1,157	1,763	2,256	2,167	2,256	2,303

Production

Substantially all of Calvalley's crude oil production in 2011 and 2010 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. During the second quarter of 2011, the Company's crude oil production was trucked to Block 51 for delivery through the Company's recently completed Truck Offloading Facility into the Masila Export Pipeline System ("MEPS"). During the three months ended June 30, 2011, the Company's working interest oil production averaged 1,157 barrels of oil per day (bopd) (2010 – 2,303 bopd).

Production during the second quarter of 2011 decreased due to various logistical matters associated with commissioning the newly constructed Truck Offloading Facility at Block 51. In particular, oil salt content levels exceeded limits required by the MEPS. In response, the Company has implemented interim procedures using existing facilities at the CPF to remove salt from its produced oil. The Company is also proceeding with construction of new desalting facilities which will be required on a long-term basis. Production was also curtailed in early April 2011 as a result of an interruption to export facilities at the Ras Isa terminal prior to completion of the Company's Truck Offloading Facility at Block 51.

Selected operating information

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

(\$000)	2011			2010			
	Year Total	Q2	Q1	Year Total	Q4	Q3	Q2
Oil sales	14,412	-	14,412	63,867	22,042	19,877	7,499
Royalties (incl. gov't share of profit oil)	(5,554)	(82)	(5,472)	(24,373)	(8,361)	(7,549)	(2,935)
Operating expenses	(2,041)	-	(2,041)	(10,157)	(3,588)	(3,487)	(1,194)
Current taxes	(890)	-	(890)	(3,940)	(1,362)	(1,229)	(463)
Netback ⁽¹⁾	5,927	(82)	6,009	25,397	8,731	7,612	2,907
Management fees	311	131	180	466	146	125	94
General and administrative expenses	(2,874)	(1,717)	(1,157)	(4,349)	(1,027)	(1,090)	(1,169)
Taxes	890	-	890	3,940	1,362	1,229	463
EBITDA ⁽¹⁾	4,254	(1,668)	5,922	25,454	9,212	7,876	2,295
Depletion, depreciation and amortization	(758)	(10)	(748)	(5,760)	(1,676)	(1,940)	(694)
Operating income (loss) ⁽¹⁾	3,496	(1,678)	5,174	19,694	7,536	5,936	1,601
Comprehensive income (loss)	1,461	(2,613)	4,074	14,582	5,982	3,931	1,046
Capital expenditures	11,079	4,583	6,496	21,077	10,302	4,734	2,842
Funds flow (deficiency) from operations ⁽¹⁾	3,613	(1,541)	5,154	21,915	7,976	6,744	1,926
Cash flow (deficiency) from operating activities	4,686	(1,641)	6,328	21,592	11,863	1,150	3,457

(1) See "Non-GAAP, Non-IFRS Measures".

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

Netbacks

(\$/bbl)	2011			2010			
	Year Total	Q2	Q1	Year Total	Q4	Q3	Q2
Oil sales	101.12	-	101.12	80.03	85.44	76.10	84.70
Royalties (incl. gov't share of profit oil)	(39.07)	-	(38.44)	(30.59)	(32.43)	(28.96)	(33.25)
Operating expenses	(14.32)	-	(14.32)	(12.73)	(13.91)	(13.35)	(13.49)
Current taxes	(6.25)	-	(6.25)	(4.94)	(5.28)	(4.70)	(5.23)
Netback ⁽¹⁾	41.48	-	42.11	31.77	33.82	29.09	32.73

(1) See "Non-GAAP, Non-IFRS Measures".

As there were no oil lifts during the second quarter of 2011, netback for the period is not an applicable measure. Netbacks for the six months ended June 30, 2011 amounted to \$41.48/bbl in comparison to \$32.38/bbl for the six months ended June 30, 2011. Fluctuations in netbacks are normally primarily attributable to changes in the prevailing price of crude oil. Netbacks are also impacted by fluctuations in operating costs as discussed below.

Revenue

During the second quarter of 2011, Calvalley had no product liftings and did not record oil sales as compared to \$7.5 million (88,535bbbls) for the three months ended June 30, 2010. The decrease in sales volume is attributable to the timing of lifts which is not directly correlated with production. Production

volume in the second quarter of 105,248 bbls in 2011 was restricted due to a pipeline disruption and products quality issues related to the new sales point and is down from 209,588 bbls produced in the second quarter of 2010.

For the six months ended June 30, 2011 oil revenues totalled \$14.4 million compared to \$21.9 million for the six months ended June 30, 2010. The decrease in revenue is attributable to a 48.9% decrease in sales volume which was partially offset by a 28.5% increase in the average selling price realized. The Company recognized revenue on the sale of 142,523 barrels during the six months ended June 30, 2011 compared with 278,884 barrels during the six month period ended June 30, 2010. The average selling price realized on barrels sold during the first half of 2011 was \$101.12/bbl compared to \$78.70/bbl for the corresponding period in 2010.

Other Revenue

Other revenue amounted to \$0.3 million for the quarter ended June 30, 2011 (2010 - \$0.2 million). Interest revenue resulted from maintaining significant cash reserves and guaranteed investment certificates (GICs) throughout the period. Interest rates on interest-bearing deposits declined throughout 2008 and 2009, and have remained depressed as central banks attempt to stimulate their economies by reducing borrowing rates.

Operating Expenses

Due to the fact that no sales were realized during the second quarter of 2011, operating expenses have been allocated to product inventory. In the three months ended June 30, 2010, operating expenses of \$1.2 million (\$13.91/bbl) were recorded. The cost of oil produced and stored during the second quarter of 2011 in the amount of \$1.9 million (\$18.00/bbl) has been allocated to oil inventory and to property, plant and equipment for the portion of oil volumes allocated to line fill in the MEPS. The cost of oil produced during the second quarter was higher than historical norms due to costs associated with transitioning to the new delivery point at Block 51, and to a temporary increase in costs of reprocessing to satisfy crude oil quality standards at the export facility.

Operating expenses for the six months ended June 30, 2011 were \$2.0 million (\$14.32/bbl) compared to \$3.1 million (\$11.05/bbl) for the six month period ended June 30, 2010.

During the first quarter of 2011, the operator of the processing facility at Block 18 charged the Company \$0.2 million for facilities usage adjustments for 2010 deliveries. The charge accounts for \$1.56/bbl of the \$14.32/bbl recorded as operating expenditures during the first quarter of 2011. Operating costs on a per barrel basis were also higher during the second quarter of 2011 due to the disruptions in production noted in the Production section of this MD&A.

Operating expenses include \$6.27 (2010 – \$5.24) per gross barrel for trucking costs, third-party processing costs, and tariffs for use of pipeline and marine terminal facilities.

General and Administrative Expenses (G&A)

G&A, including one time charges relating to legal and other costs of \$0.5 million, totalled \$1.7 million for the quarter ended June 30, 2011 as compared to \$1.2 million for the quarter ended June 30, 2010. For the six months ended June 30, 2011, G&A amounted to \$2.9 million compared to \$2.2 million for the six month period ended June 30, 2010. G&A costs directly associated with Block 9 operations become recoverable costs and will be recovered from revenue associated with cost oil under the terms of the PSA.

EBITDA

During the second quarter of 2011, as a result of no crude oil product lifings, the Company generated a loss before interest, tax, depreciation and amortization of \$1.7 million compared with EBITDA of \$2.3 million during the second quarter of 2010. For the six months ended June 30, 2011 EBITDA was \$4.3 million compared to \$8.4 million for the corresponding period in 2010.

Depletion, Depreciation and Amortization (DD&A) Expenses

	2011			2010			
	Year Total	Q2	Q1	Year Total	Q4	Q3	Q2
DD&A (\$000)	758	10	748	5,760	1,676	1,940	694
DD&A (\$/bbl)	5.32	-	5.25	7.22	6.50	7.43	7.84

Calvalley recorded DD&A expenses of \$Nil million for the quarter ended June 30, 2011 as compared to \$0.7 million for the second quarter of 2010. The DD&A expenses associated with the oil produced during the second quarter of \$0.9 million was included in the cost of oil inventory on hand at June 30, 2011. For the six months ended June 30, 2011 DD&A expenses of \$0.8 million were recorded in comparison to \$2.1 million for the six month period ended June 30, 2010. The changes in the 2011 versus 2010 annual DD&A rates per barrel are primarily related to adjustments as reflected in the Company's December 31, 2010 reserve report. The DD&A provision is also impacted by the amount included in inventory at each period end.

Operating Income

During the second quarter of 2011, the Company generated operating loss of \$1.7 million compared with operating income of \$1.6 million during the three months ended June 30, 2010. During the six months ended June 30, 2011 the Company generated operating income of \$3.5 million in comparison with \$6.2 million during the six month period ended June 30, 2010. Operating income was impacted by the same factors as those affecting netbacks and EBITDA.

Income Taxes

Current income tax expense amounted to \$Nil (2010 – \$0.5 million) for the second quarter of 2011 and \$0.9 million for the six months ended June 30, 2011 (2010 - \$1.3 million). The charge 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

	2011			2010			
	Year Total	Q2	Q1	Year Total	Q4	Q3	Q2
(\$000)							
Funds flow from operations	3,613	(1,541)	5,154	21,915	7,976	6,744	1,926
Change in non-cash working capital	1,073	(100)	1,174	(323)	3,887	(5,594)	1,531
Cash provided by (used in) operations	4,686	(1,641)	6,328	21,592	11,863	1,150	3,457

As at June 30, 2011, the Company held cash and cash equivalents of \$6.0 million compared with \$19.6 million at the end of 2010. Additionally, the Company held GICs with an initial term greater than 90 days in the amount of \$52.5 million (December 31, 2010 – \$53.4 million). The Company invests its cash in GICs issued by an Alberta credit union in which deposits are guaranteed by the Province of Alberta.

Investing Activities

(\$000)	2011			2010			
	Year Total	Q2	Q1	Year Total	Q4	Q3	Q2
Additions to intangible E&E and to property, plant and equipment	(11,079)	(4,583)	(6,496)	(21,077)	(10,302)	(4,734)	(2,842)
Change in non-cash working capital	(4,839)	489	(5,329)	3,843	6,731	(2,538)	(69)
Net investment in GICs	980	8,469	(7,489)	(3,064)	(168)	4,327	1,286
Cash provided by (used in) investing activities	(14,938)	4,375	(19,314)	(20,298)	(3,739)	(2,945)	(1,625)

During the first half of 2011, the Company made capital expenditures of \$11.1 million compared with \$6.0 million during the first six months of 2010. The Company invested in the water and gas injection facilities, as well as the installations required for blending crude oil. The Company completed construction of its truck offloading facility at Block 51. Expenditures were also incurred to prepare and complete the Al-Roidhat wells for production, drill an injector well in the Hiswah field, and to drill exploration and appraisal wells in the Ras Nowmah East and Qarn Qaymah areas. The Company's funding of expenditures on behalf of its partners exceeded payments received from the Company's partners in the amount of \$1.7 million during the first half of 2011. Capital expenditures related to the shortfall amounted to \$0.1 million. The Company also invested in GICs during the three months ended June 30, 2011.

Financing Activities

(\$000)	2011			2010			
	Year Total	Q2	Q1	Total Year	Q4	Q3	Q2
Issuance of common shares	112	45	66	393	183	41	55
Common share repurchase	(3,511)	(2,262)	(1,248)	(2,189)	(720)	(626)	-
	(3,399)	(2,217)	(1,182)	(1,796)	(537)	(585)	55

During the six months ended June 30, 2011 the Company repurchased 1,229,462 Class A Common Voting Shares on the open market pursuant to its normal course issuer bids at an average of \$2.86/share for a total cost of \$3.5 million (C\$2.80/share). Proceeds from the issuance of Class A Common Voting Shares during the year were related solely to the exercise of stock options and totalled \$112,000.

CONSOLIDATED FINANCIAL POSITION

Assets (\$000)	2011		2010			
	Q2	Q1	Q4	Q3	Q2	Q1
As at period-end						
Cash and cash equivalents	5,954	5,441	19,573	11,937	14,316	12,437
GICs	52,467	60,936	53,447	53,279	57,606	58,892
Accounts receivable	34	4,023	4,611	3,910	33	3,007
Due from joint interest partners	12,508	10,917	10,825	12,052	5,825	6,607
Oil inventory	2,983	754	89	1,475	2,303	334
Prepaid expenses	1,277	230	371	608	549	201
Intangible E&E	1,656	1,235	1,206	746	736	686
Property and equipment	113,308	109,781	104,265	95,626	92,390	91,098
Total assets	190,187	193,317	194,387	179,633	173,758	173,262

As at June 30, 2011, the Company's total assets were \$190.2 million, a decrease of \$4.2 million from December 31, 2010. Cash and cash equivalents amounted to \$6.0 million compared with \$19.6 million at the beginning of the year.

Accounts receivable decreased by \$4.6 million to \$0.03 million as at June 30, 2011. The amount due from partners increased from \$10.8 million at the beginning of the year to \$12.5 million as at June 30, 2011.

Oil inventory increased from \$0.1 million at December 31, 2010 to \$3.0 million at June 30, 2011. Oil inventory results from the timing of lifts and relates to oil production in storage at the end of a period, valued at average cost. At June 30, 2011, the Company's oil inventory net of royalties and taxes amounted to 78,159bbls compared to 2,562bbls at December 31, 2010.

Intangible exploration and evaluation assets plus property and equipment increased to \$115.0 million as at June 30, 2011. The movement in property and equipment resulted from capital expenditures of \$11.1 million, which was offset by DD&A expense of \$0.8 million plus \$0.8 million in net adjustments to depletion related to oil in inventory.

	2011		2010			
	Q2	Q1	Q4	Q3	Q2	Q1
Liabilities and Shareholders' Equity (\$000)						
As at period-end						
Accounts payable and accrued liabilities	15,580	14,941	19,264	10,297	8,626	9,390
Share capital	114,840	115,893	116,140	116,079	116,227	116,143

Accounts payable and accrued liabilities decreased to \$15.6 million as at June 30, 2011, from \$19.3 million as at December 31, 2010. The primary reason for this decrease is the change in capital spending profile and the timing of payments made to suppliers and contractors.

Share capital decreased to \$114.8 million as at June 30, 2011 from \$116.1 million as at the end of 2010 as a result of the repurchase of common shares through the Company's normal course issuer bids. 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 2011 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 June 30, 2011. 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 and funds flow from operations.

As at June 30, 2011, the Company's total assets were \$190.2 million, a decrease of \$4.2 million from December 31, 2010. Cash and cash equivalents amounted to \$6.0 million compared with \$19.6 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 decreased from \$73.0 million at December 31, 2010 to \$58.4 million at June 30, 2011.

Interest rates on interest-bearing deposits have remained depressed over the past year as central banks attempt to stimulate their economies 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 June 30, 2011 the Company's working capital decreased to \$59.6 million as compared to \$69.7 million as at December 31, 2010.

At December 31, 2010 the Company had Canadian tax pools of approximately \$34.2 million, of which \$16.8 million were non-capital losses, \$7.1 million were Canadian resource tax pools, and \$10.3 million were undepreciated capital cost allowance. 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 each of 2011, 2012, and 2013. 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 \$450,000 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 PSC with the government of the Federal Democratic Republic of Ethiopia. Pursuant to the PSC, the Company has certain commitments to spend approximately \$8.5 million during the first four years of its work program. As at June 30, 2011, the Company has incurred \$1.7 million in exploration expenditures in fulfillment of these obligations.

Calvalley had no off-balance-sheet arrangements as at June 30, 2011 or December 31, 2010.

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 six months ended June 30, 2011, had these changes occurred on January 1, 2011. These calculations are based on business conditions, production and sales volumes existing during the six month period ended June 30, 2011. 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	0.8	0.01
Crude oil production	1,000 bopd	3.3	0.03
Increase in operating expenses	\$1.00/bbl	(0.1)	(0.001)
Interest rate	1%	0.3	0.003

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.

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

The Company has entered into a crude oil marketing agreement under which the Company sells all of its crude oil production to a single purchaser. The purchaser's parent has been assigned credit ratings of Baa3 and Negative Outlook by Moody's and BBB- Stable Outlook by S&P.

Credit risk also relates to the risk that joint interest 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 JI 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 hazards 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 years this issue has been before 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 and the Company is exploring both judicial, and extra judicial, resolutions. No amounts have been accrued in the consolidated financial statements for the periods ended June 30, 2011 as the ultimate resolution is uncertain. The Company

will record any amounts due, if any, once the outcome of the contingency is likely and reasonably estimated.

Between 2004 and 2007, the Company billed its Block 9 joint interest partners (JI Partners) for fees in accordance with the terms of the PSA which governs the joint interest operating activities on Block 9. The JI Partners contend that certain of these fees are not billable under the terms of the JOA between the Company and the JI Partners. Pending resolution of this matter, the Company has not charged the JI Partners for the fees in question during 2008 and 2009. The Company and its JI Partners have now agreed to enter into a binding expert determination in London, England to interpret the terms of the JOA and to obtain a ruling 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 \$1.0 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 \$1.1 million.

In the normal course of operations, the Company may be subject to litigation and claims. In the opinion of management, other than as disclosed above, no such litigation or claim, individually or in aggregate, would result in a liability that would have a significant adverse effect on the financial position or results of operations of the Company.

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.

Political Risks

Beyond the risk inherent in the oil and gas industry, the Company is subject to additional risks resulting from the current unrest in the Middle East. These risks can involve matters arising out of the evolving laws and policies, the imposition of special taxes or similar charges, oil export or pipeline restrictions, foreign currency controls, the unenforceability of contractual rights, restrictions on the use of expatriates in the operations and other matters.

There can be no assurance that agreements entered into with various parties are enforceable or binding in accordance with the Company's understanding of their terms or that if breached, the Company would be able to obtain favourable remedies. The Company bears the risk that political change could occur and that such change could have a further impact on the Company's operations.

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. Furthermore, 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 impairment 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 interest 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 interest audits are recorded in the period of settlement with joint interest partners.

ADDITIONAL INFORMATION

As at June 30, 2011, the Company had 96,572,151 common shares outstanding. Additionally, there were 5,846,335 options outstanding which were issued pursuant to the Company's stock option plan. As at August 11, 2011, the Company had 96,572,151 common shares outstanding. Additionally, there were 5,846,335 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 June 30, 2011, 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 June 30, 2011 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 annual 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 IFRS. 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 June 30, 2011, 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 June 30, 2011 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 IFRS.

CHANGES IN ACCOUNTING POLICIES DETAIL

Adoption of International Financial Reporting Standards (IFRS)

The Company has prepared its June 30, 2011 Interim Condensed Consolidated Financial Statements in accordance with IFRS 1, First-time Adoption of International Financial Reporting Standards, and with IAS 34, Interim Financial Reporting, as issued by the IASB. Previously, the Company prepared its financial statements in accordance with Canadian GAAP (CGAAP). The adoption of IFRS has not had a material impact on the Company's operations, strategic decisions, cash flows and capital expenditures.

The Company's IFRS accounting policies are provided in Note 2 to the Interim Condensed Consolidated Financial Statements as at and for the three months ended March 31, 2011 and are referenced in Note 2 to the Interim Condensed Consolidated Financial Statements as at and for the three months ended June 30, 2011. In addition, Note 18 to the Interim Condensed Consolidated Financial Statements for the three months ended June 30, 2011 presents reconciliations between the Company's 2010 CGAAP results and

the 2010 IFRS results. The reconciliations include the Assets, Liabilities, and Equity as at December 31, 2010, and Consolidated Statements of Comprehensive Income for the three and six months ended June 30, 2010.

The following summary provides reconciliations of Calvalley's 2010 CGAAP and IFRS results, along with a discussion of the significant IFRS accounting policy changes.

(\$000)	2010				
	Annual	Q4	Q3	Q2	Q1
Net Earnings – CGAAP	10,941	4,987	2,744	485	2,725
Depletion, depreciation and amortization	3,677	1,014	1,295	484	884
Stock based compensation	(36)	(19)	(108)	77	14
	3,641	995	1,187	561	898
Profit and Comprehensive Income – IFRS	14,582	5,982	3,931	1,046	3,623

IFRS is applied retrospectively at the transition date with all adjustments to assets and liabilities as stated under CGAAP taken to retained earnings unless certain exceptions and exemptions are applied.

IFRS 1, "First-Time Adoption of International Financial Reporting Standards", permits first time adopters of IFRS a number of exemptions. The Company has elected to utilize the following exemptions for first-time adoption of IFRS:

- i. IFRS 3, Business Combinations, which allows for an implementation of the IFRS business combination rules on a prospective basis, therefore, business combinations entered into prior to January 1, 2010 have not been retrospectively restated;
- ii. IFRS 1, First-Time Adoption of International Financial Reporting Standards, whereby foreign currency translation adjustments classified in accumulated other comprehensive income are deemed to be zero and are reclassified to retained earnings on January 1, 2010, and the retrospective restatement of foreign currency translation under IFRS is not performed;
- iii. IFRS 2, Share-based payments, whereby stock options that vested prior to January 1, 2010 are not required to be retrospectively restated. Therefore, IFRS requirements apply only to those options that were unvested at the date of transition;
- iv. IFRS 1, First-Time Adoption of International Financial Reporting Standards, whereby the petroleum asset balance as determined under the Company's previous accounting framework (CGAAP) is allocated to the IFRS categories of exploration and evaluation assets and development and production properties. Under the exemption, for assets in the development or production phases, the amount is allocated to the underlying IFRS transitional assets on a pro-rata basis using reserve values as of the IFRS transition date.
- v. IFRS 23, Borrowing Costs, whereby borrowing cost disclosures relating to qualifying assets are applied prospectively from the IFRS transition date.

The impact to the Company of applicable exceptions and exemptions on transition to IFRS, and of changes in accounting policies under IFRS are as follows:

(a) *Oil and natural gas assets:*

The Company elected to apply the IFRS 1 deemed cost exemption whereby, subject to an impairment test, the CGAAP full cost pool was recharacterized upon transition to IFRS as follows:

- (i) exploration and evaluation assets were reclassified from the full cost pool to intangible exploration and evaluation assets at the amount that was recorded under CGAAP; and
- (ii) the remaining full cost pool was allocated to oil and natural gas development and production assets.

The CGAAP full cost pool was not impaired, and allocation of the pool as at January 1, 2010 resulted in a \$639 (March 31, 2010 - \$686, June 30, 2010 - \$736, and December 31, 2010 -

\$1,206) increase in intangible exploration and evaluation assets relating to exploration costs incurred in Ethiopia, with a corresponding decrease in property, plant and equipment.

(b) Stock-based compensation:

Under Canadian GAAP, the Company recognized stock-based compensation expense related to stock options on a straight-line basis through the date of full vesting, and accounted for forfeitures as they occurred. Under IFRS 2, "Share-based Payment", the Company is required to recognize stock-based compensation expense over the individual vesting periods for the graded vesting options, and to incorporate a forfeiture rate for the estimated number of options expected to vest.

In accordance with the IFRS 1 exemption for share-based payments the Company has retrospectively applied IFRS 2 to those stock options issued after November 7, 2002, that had not vested as at January 1, 2010. This resulted in an increase in contributed surplus of \$558, with a corresponding decrease in retained earnings for additional share-based compensation expense as at January 1, 2010. Application of IFRS 2 during the three month periods ended June 30, 2010, March 31, 2010 and the year ended December 31, 2010 resulted in a net decrease of \$77, \$14 and a net increase of \$36, respectively, in contributed surplus and in stock-based compensation expense.

(c) Cumulative translation differences:

The Company elected to apply the IFRS 1 exemption for cumulative translation differences that arose from investments in foreign operations. Accordingly, total cumulative translation differences of \$3,963, which were included in other comprehensive income, have been eliminated as at January 1, 2010, March 31, 2010, June 30, 2010 and December 31, 2010 with a corresponding increase in retained earnings.

(d) Depletion and depreciation:

On transition to IFRS the Company adopted a policy to deplete oil and natural gas development and production properties based on proved plus probable reserves, including a provision for future costs to develop proved plus probable reserves. Under Canadian GAAP the Company depleted its full cost pool on a proved reserves basis.

This difference had no impact on the transition statement of financial position as at January 1, 2010 as a result of the IFRS 1 deemed cost election discussed above. For the three month periods ended March 31, 2010 and June 30, 2010 and the year ended December 31, 2010 depletion expense decreased by \$884, \$484 and \$3,677 respectively, which consequently increased the net carrying value of property, plant and equipment and decreased the carrying value of inventory.

NORMAL COURSE ISSUER BIDS

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. A copy of the notice filed with the TSX 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") were authorized to be acquired under the bid, representing 5% of the 98,960,580 Common Shares outstanding as of April 15, 2009. Calvalley was to acquire Common Shares under the bid at the market price at the time of purchase, and all Common Shares acquired were to be cancelled. Unless Calvalley utilized a Block Purchase Exemption as permitted by the TSX, purchases were subject to a daily purchase restriction equal to 25% of the average daily trading volume of the Common Shares over the preceding 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 were, 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.

On September 14, 2010, the Company made the necessary filings, and received the necessary approvals, to make a normal course issuer bid through the facilities of the TSX commencing September 16, 2010 and ending September 15, 2011. A copy of the notice filed with the TSX can be obtained by any shareholder of the Company, without charge, by contacting the Company.

A total of 7,841,792 Class A Common Shares (the "Common Shares") were authorized to be acquired under the bid, representing 10% of the public float of Common Shares of the Company. Calvalley may acquire Common Shares under the bid at the market price at the time of purchase, and all Common Shares acquired are to be cancelled. Unless Calvalley utilizes 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 preceding six calendar months, or a maximum of 32,134 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 expenditure prudently incurred by Calvalley to increase shareholder value.

As of August 11, 2011, a total of 1,596,332 shares have been acquired under the bid at an average cost of C\$3.02/share.

COMPARABILITY WITH PRIOR PERIODS

Revenue may fluctuate from period to period due to the timing of shipments of oil. 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 June 30, 2011, the Company had no take-or-pay revenue and oil inventory was valued at \$3.0 million.

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.