

CALVALLEY PETROLEUM INC.

2011 3rd Quarter Interim Report to Shareholders

**For the three and nine months
ended September 30, 2011**

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ABBREVIATIONS

bbls	barrels
mbbls	thousands of barrels
bopd	barrels of oil per day
mmcf	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 2011 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

- Earnings increased to \$0.10 per share (\$9.4 million) in the third quarter of 2011 up 250 per cent from the \$0.04 per share (\$3.9 million) in the third quarter of 2010. For the nine month period ended September 30, 2011 earnings increased to \$0.11 per share (\$10.9 million) up 22 per cent from the \$0.09 per share (\$8.6 million) for the nine month period in 2010. This record quarterly earnings result can be directly attributed to the increase in crude oil shipments which occurred during the third quarter representing a net sales volume (before royalties and taxes) of 2,887 barrels of oil per day for the period.
- The Company's working interest share of production volumes before royalties and taxes averaged 2,156 barrels per day in the third quarter 2011 being 4 per cent lower than 2,256 barrels per day for the third quarter of 2010. During the third quarter the Company initiated production of heavy crude oil from three wells in the Al Roidhat field. This crude oil was blended with light crude oil from the Hiswah field at the Company's Central Processing Facility ("CPF") prior to trucking to the Company's Truck Offloading Facility ("TOF") which was completed in the second quarter of 2011. In late September, Calvalley initiated sustained production from its Ras Nowmah 2 well. This well is currently producing approximately 2,300 barrels per day and has resulted in gross production from Block 9 increasing to approximately 6,300 barrels per day (net 3,150 bpd). Average gross production volumes for the month of October are estimated to be approximately 6,000 barrels per day.
- Commissioning the TOF has provided access to an export facility through the Masila Export Pipeline System ("MEPS") for crude oil exports. For the third quarter of 2011, the average sale price, based on Dated Brent Crude price, was \$110.90 per barrel, up 46 per cent from the price received in the third quarter of 2010. The product netback in the third quarter of \$46.65 per barrel represents an increase of approximately 60 per cent from \$29.09 per barrel for the same period of 2010.
- Funds flow from operations ("Cash Flow") for the three months ended September 30, 2011 of \$0.12 per share (\$11.6 million) represents an increase of 71 per cent from the \$0.07 per share (\$6.7 million) for the same period of 2010 and is the highest quarterly Cash Flow

per share in the Company history. For the nine months ended September 30, 2011, Cash Flow was \$0.16 per share (\$15.2 million), an increase of 14 per cent from the prior year period.

- The business environment in Yemen has been challenging throughout 2011 with supply chain disruptions and product shortages. 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 its efforts on production optimization activities. Capital expenditures in the current quarter of \$1.8 million are down significantly from \$4.7 million in the comparable quarter of 2010. Year to date capital expenditures are \$12.8 million. Subject to the availability of services, current plans include the drilling of two development wells at Ras Nowmah and an exploration well as soon as conditions permit.
- Subsequent to the end of the quarter, the Company renewed its normal course issuer bid ("NCIB") and received approval to purchase approximately 7.6 million shares through the facilities of the TSX commencing October 12, 2011 and ending October 11, 2012, subject to certain restrictions and limitations. The Company purchased approximately 2.1 million shares at an average price of C\$2.66 per share under the previous NCIB which expired September 15, 2011.
- Calvalley has a healthy balance sheet with approximately \$68 million in working capital at September 30, 2011. The working capital balance increases to over \$70 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 future share repurchases.

Financial information

Significant financial information is included in the table below and is discussed further in the Company's Management Discussion and Analysis.

(in thousands of US dollars except per share amounts)	Three months ended September 30 ⁽¹⁾		Nine months ended September 30 ⁽¹⁾	
	2011	2010	2011	2010
Revenue (Gross)	29,453	19,877	43,865	41,825
Revenue from crude oil sales (net of royalties)	18,331	12,328	27,189	25,813
EBITDA ⁽²⁾	13,299	7,876	17,553	16,242
Operating income ⁽²⁾	11,653	5,936	15,149	12,158
Comprehensive income	9,405	3,931	10,866	8,600
Per share	0.10	0.04	0.11	0.09
Capital expenditures	1,759	4,734	12,838	10,775
Funds flow from operations ⁽²⁾	11,581	6,744	15,194	13,939
Per share	0.12	0.07	0.16	0.14
Cash flow from (used in) operating activities	(3,041)	1,150	1,645	9,729

⁽¹⁾ 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 nine months ended September 30, 2011, including required comparative information, have been prepared in accordance with International Financial Reporting Standards.

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 the IFRS impacts is provided in the Changes in Accounting Policies Section of the Company's Q3 2011 Interim MD&A filed on www.sedar.com

(2) See "Non-IFRS Measures" disclosure in Q3 2011 Interim MD&A filed on www.sedar.com

MANAGEMENT DISCUSSION & ANALYSIS

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 nine month periods ended September 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 November 9, 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 nine months ended September 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

(\$000s unless otherwise noted)	2011				2010				2009 ⁽³⁾		
	Full year	Q3	Q2	Q1	Full year	Q4	Q3	Q2	Q1	Full year	Q4
Avg. production volume – Calvalley share (Bopd)	1,694	2,156	1,157	1,763	2,256	2,167	2,256	2,303	2,299	2,160	2,202
Average sales volume (Bopd)	1,495	2,887	-	1,584	2,186	2,804	2,839	973	2,115	2,440	2,081
Average realized price (\$/bbl)	107.49	110.90	-	101.12	80.03	85.44	76.10	84.70	75.91	57.08	73.83
Oil Sales	43,865	29,453	-	14,412	63,867	22,042	19,877	7,499	14,449	50,839	14,136
Oil Sales, net ⁽¹⁾	27,189	18,331	(82)	8,940	39,494	13,681	12,328	4,564	8,921	31,354	8,742
Cash flow from operating activities	1,645	(3,041)	(1,641)	6,328	21,592	11,863	1,150	3,457	5,122	13,971	9,271
Funds flow from operations ⁽²⁾	15,194	11,581	(1,541)	5,154	21,915	7,976	6,744	1,926	5,269	13,600	4,652
Funds flow from operations per share (\$/share) ⁽²⁾											
- Basic and Diluted	0.16	0.12	(0.02)	0.05	0.22	0.08	0.07	0.02	0.05	0.14	0.05
Comprehensive income (loss)	10,866	9,405	(2,613)	4,074	14,582	5,982	3,931	1,046	3,623	2,951	2,109
Earnings (loss) per share (\$/share)											
- Basic and Diluted	0.11	0.10	(0.03)	0.04	0.15	0.06	0.04	0.01	0.04	0.03	0.02
Working Capital	68,073	68,073	59,643	67,360	69,652	69,652	72,964	72,006	72,088	70,705	70,705
Total Assets	197,943	197,943	190,187	193,317	194,387	194,387	179,633	173,758	173,262	172,991	172,991
Long-term debt	-	-	-	-	-	-	-	-	-	-	-

(1) Revenue net of royalties

(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 nine months ended September 30, 2011 was \$10.9 million versus \$8.6 million for 2010. For the three month period ended September 30, 2011, comprehensive income was \$9.4 million in comparison with comprehensive income of \$3.9 million for the three months ended September 30, 2010. Working capital at September 30, 2011 decreased to \$68.1 million from \$69.7 million at December 31, 2010. Funds flow from operations for the nine month period ended September 30, 2011 increased to \$15.2 million from \$13.9 million for the nine months ended September 30, 2010. For the three month period ended September 30, 2011, funds flow from operations increased to \$11.6 million in comparison with \$6.7 million for the three months ended September 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 Q3	2011 Q2	2011 Q1	2010 Q4	2010 Q3
Dated Brent average oil price (\$/bbl)	113.41	117.05	105.43	86.48	76.86
Calvalley realized price (\$/bbl)	110.90	-	101.12	85.44	76.10
Premium / (Discount) to Dated Brent	(2.51)	N/A	(4.31)	(1.04)	(0.76)

The price of Dated Brent oil averaged \$113.41/bbl in Q3 2011, an increase of 47.6% from the Q3 2010 price of \$76.86/bbl. The price of Dated Brent oil at September 30, 2011 was \$105.25/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

Significant highlights and accomplishments from the third quarter of 2011 are as follows:

- During the third quarter the Company had two product lifts and realized revenues of \$29.5 million (\$16.6 million after of royalties and taxes) through the sale of 265,582 barrels ("bbls") of crude oil (149,988 bbls after of royalties and taxes) at an average price of \$110.90/bbl.
- Reduced inventories of crude oil from 71,217 bbls (after royalties and taxes) at June 30, 2011 to 30,550 bbls (after royalties and taxes) at the end of the third quarter.
- Block 9 gross production ("gross") was increased to approximately 5,900 barrels of crude oil per day ("bopd") at the end of the third quarter. October 2011 average daily production amounted to approximately 6,000 bopd (gross).
- Started production from the Ras Nowmah 2 well.
- Initiated blending of heavy crude oil production from three wells in the Al Roidhat field.
- Total average production for the third quarter was 4,313 bopd (gross).
- For the three months ended September 30, 2011, the Company realized net income of \$9.4 million and funds flow from operations of \$11.6 million.

Increasing production from historical levels of approximately 4,000 bopd (gross) to approximately 5,900 bopd (gross) at the end of the quarter has been a major achievement given the challenging operating environment in Yemen. There are additional wells at Al Roidhat to bring on stream that provide the potential for the Company to further increase production up to approximately 7,000 bopd (gross) and opportunities exist to optimize production from the Hiswah field and from the Ras Nowmah 2 well which is currently producing at a rate of approximately 2,300 bopd (gross).

The Company's plans in Yemen remain contingent on the availability of supplies and services which continue to be affected by both the level of security supplied by the current Government and resolving local disputes.

With the excellent production capability of the Ras Nowmah 2 well the Company is continuing its efforts to ensure the security and safety of personnel in order to advance the drilling of an additional two development wells at Ras Nowmah and an exploration well in the short term.

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. The Company is now proceeding to obtain government approvals for additional water injection wells.

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 have diverted resources to areas outside Yemen and have not been available to provide the necessary services for Calvalley's capital projects. The Company has focused on production optimization activities. Subject to the availability of services, the Company's short term plans include the drilling of two development wells and one exploration well.

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\$46 per bbl at current market prices.

Calvalley has a healthy balance sheet with approximately \$68.1 million in working capital at September 30, 2011. The working capital balance increases to approximately \$70.2 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.

During the third quarter, the Company continued its share repurchase program under a Normal Course Issuer Bid ("NCIB"). A total of 2,129,800 shares were acquired under the NCIB which expired on September 15, 2011 at an average cost of C\$2.66/share. On October 7, 2011, the Company made the necessary filings, and received the necessary approvals, to make a NCIB through the facilities of the TSX commencing October 12, 2011 and ending October 11, 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 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 September 30, 2011, the Company's share of capital costs to be carried forward for recovery against future production was approximately \$49.3 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 September 30, 2011, the Company has incurred \$1.6 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	Q3	Q2	Q1	Year Total	Q4	Q3
Block 9 Oil Production (bopd)	3,387	4,313	2,313	3,527	4,512	4,334	4,512
Company working interest share (bopd)	1,694	2,156	1,157	1,763	2,256	2,167	2,256

Production

Substantially all of Calvalley's crude oil production in the first half of 2011 and all of 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 third quarter, the Company began production from its Al Roidhat and Ras Nowmah fields which are both located within Block 9 in Yemen. Beginning in April 2011, the Company's crude oil production has been trucked to Block 51 for delivery through the Company's recently completed Truck Offloading Facility into the Mesilla Export Pipeline System ("MEPS").

Production during the third quarter of 2011 increased due to the activation of wells in the Al Roidhat and Ras Nowmah fields.

Selected operating information

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

(\$000)	2011				2010		
	Year Total	Q3	Q2	Q1	Year Total	Q4	Q3
Oil sales	43,865	29,453	-	14,412	63,867	22,042	19,877
Royalties (incl. gov't share of profit oil)	(16,676)	(11,122)	(82)	(5,472)	(24,373)	(8,361)	(7,549)
Operating expenses	(6,152)	(4,111)	-	(2,041)	(10,157)	(3,588)	(3,487)
Current taxes	(2,710)	(1,820)	-	(890)	(3,940)	(1,362)	(1,229)
Netback ⁽¹⁾	18,327	12,400	(82)	6,009	25,397	8,731	7,612
Management fees	405	94	131	180	466	146	125
General and administrative expenses	(3,889)	(1,015)	(1,717)	(1,157)	(4,349)	(1,027)	(1,090)
Taxes	2,710	1,820	-	890	3,940	1,362	1,229
EBITDA ⁽¹⁾	17,553	13,299	(1,668)	5,922	25,454	9,212	7,876
Depletion, depreciation and amortization	(2,404)	(1,646)	(10)	(748)	(5,760)	(1,676)	(1,940)
Operating income (loss) ⁽¹⁾	15,149	11,653	(1,678)	5,174	19,694	7,536	5,936
Comprehensive income (loss)	10,866	9,405	(2,613)	4,074	14,582	5,982	3,931
Capital expenditures	12,838	1,759	4,583	6,496	21,077	10,302	4,734
Funds flow (deficiency) from operations ⁽¹⁾	15,194	11,581	(1,541)	5,154	21,915	7,976	6,744
Cash flow (deficiency) from operating activities	1,645	(3,041)	(1,641)	6,328	21,592	11,863	1,150

(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	Q3	Q2	Q1	Year Total	Q4	Q3
Oil sales	107.49	110.90	-	101.12	80.03	85.44	76.10
Royalties (incl. gov't share of profit oil)	(40.92)	(41.92)	-	(38.44)	(30.59)	(32.43)	(28.96)
Operating expenses	(15.07)	(15.48)	-	(14.32)	(12.73)	(13.91)	(13.35)
Current taxes	(6.64)	(6.85)	-	(6.25)	(4.94)	(5.28)	(4.70)
Netback ⁽¹⁾	44.86	46.65	-	42.11	31.77	33.82	29.09

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

Netbacks for the nine months ended September 30, 2011 amounted to \$44.86/bbl in comparison to \$30.78/bbl for the nine months ended September 30, 2010. 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 third quarter of 2011, Calvalley recorded oil revenue of \$29.5 million as compared to \$19.9 million for the three months ended September 30, 2010. The significant increase in sales volume is attributable to a 1.7% increase in sales volume and a 45.7% increase in selling

price. Sales volumes are determined by the timing of lifts which is not directly correlated with production. Production volume in the third quarter amounted to 198,378 bbls (Calvalley share gross of royalties) in comparison to 207,574 bbls produced in the third quarter of 2010.

For the nine months ended September 30, 2011 oil revenues totalled \$43.9 million compared to \$41.8 million for the nine months ended September 30, 2010. The increase in revenue is attributable to a 38.8% increase in the average sales price realized partially offset by a 24.4% decrease in sales volume. The Company recognized revenue on the sale of 408,105 barrels during the nine months ended September 30, 2011 compared with 540,062 barrels during the nine month period ended September 30, 2010. The average selling price realized on barrels sold during the first nine months of 2011 was \$107.49/bbl compared to \$77.44/bbl for the corresponding period in 2010.

Operating Expenses

In the nine months ended September 30, 2010, operating expenses of \$6.2 million (\$15.07/bbl) were recorded in comparison to \$6.6 million (\$12.16/bbl) for the nine months ended September 30, 2010. The cost of oil produced during the second and third 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. The cost of oil produced and stored during the third quarter of 2011 has been allocated to oil inventory.

Operating expenses for the three months ended September 30, 2011 were \$4.1 million (\$15.48/bbl) compared to \$3.5 million (\$13.35/bbl) for the nine month period ended September 30, 2010.

Operating expenses include \$6.30 (2010 – \$5.25) 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 totalled \$1.0 million for the quarter ended September 30, 2011 as compared to \$1.1 million for the quarter ended September 30, 2010. For the nine months ended September 30, 2011, G&A amounted to \$3.9 million compared to \$3.3 million for the nine month period ended September 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 third quarter of 2011, the Company generated a EBITDA of \$13.3 million compared with EBITDA of \$7.9 million during the third quarter of 2010. For the nine months ended September 30, 2011 EBITDA was \$17.6 million compared to \$16.2 million for the corresponding period in 2010.

Depletion, Depreciation and Amortization (DD&A) Expenses

	2011				2010		
	Year Total	Q3	Q2	Q1	Year Total	Q4	Q3
DD&A (\$000)	2,404	1,646	10	748	5,760	1,676	1,940
DD&A (\$/bbl)	5.89	6.20	-	5.25	7.22	6.50	7.43

Calvalley recorded DD&A expenses of \$1.6 million for the quarter ended September 30, 2011 as compared to \$1.9 million for the third quarter of 2010. The DD&A expenses associated with the oil produced and stored during the third quarter was included in the cost of oil inventory on hand at September 30, 2011. For the nine months ended September 30, 2011 DD&A expenses

of \$2.4 million were recorded in comparison to \$4.1 million for the nine month period ended September 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 third quarter of 2011, the Company generated operating income of \$11.7 million compared with operating income of \$5.9 million during the nine months ended September 30, 2010. During the nine months ended September 30, 2011 the Company generated operating income of \$15.1 million in comparison with \$12.2 million during the nine month period ended September 30, 2010.

Income Taxes

Current income tax expense amounted to \$1.8 million (2010 – \$1.2 million) for the third quarter of 2011 and \$2.7 million for the nine months ended September 30, 2011 (2010 - \$2.6 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

(\$000)					2010		
	Year Total	Q3	Q2	Q1	Year Total	Q4	Q3
Funds flow from operations	15,194	11,581	(1,541)	5,154	21,915	7,976	6,744
Change in non-cash working capital	(13,549)	(14,622)	(100)	1,174	(323)	3,887	(5,594)
Cash provided by (used in) operations	1,645	(3,041)	(1,641)	6,328	21,592	11,863	1,150

As at September 30, 2011, the Company held cash and cash equivalents of \$4.2 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 \$44.6 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	Q3	Q2	Q1	Year Total	Q4	Q3
Additions to intangible E&E and to property, plant and equipment	(12,838)	(1,759)	(4,583)	(6,496)	(21,077)	(10,302)	(4,734)
Change in non-cash working capital	(8,738)	(3,899)	489	(5,329)	3,843	6,731	(2,538)
Net investment in GICs	8,863	7,883	8,469	(7,489)	(3,064)	(168)	4,327
Cash provided by (used in) investing activities	(12,713)	2,225	4,375	(19,314)	(20,298)	(3,739)	(2,945)

During the first nine months of 2011, the Company made capital expenditures of \$12.8 million compared with \$10.8 million during the first nine 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 wells at Al-Roidhat and Ras Nowmah 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 \$3.2 million during the first nine months of 2011. Capital expenditures related to the shortfall amounted to \$0.9 million. The Company also redeemed GICs during the nine months ended September 30, 2011.

Financing Activities

(\$000)	2011			2010			
	Year Total	Q3	Q2	Q1	Total Year	Q4	Q3
Issuance of common shares	112	-	45	66	393	183	41
Common share repurchase	(4,379)	(868)	(2,262)	(1,248)	(2,189)	(720)	(626)
	(4,267)	(868)	(2,217)	(1,182)	(1,796)	(537)	(585)

During the nine months ended September 30, 2011 the Company repurchased 1,762,930 Class A Common Voting Shares on the open market pursuant to its normal course issuer bid at an average of \$2.48/share for a total cost of \$4.4 million (C\$2.44/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		
	Q3	Q2	Q1	Q4	Q3	Q2
As at period-end						
Cash and cash equivalents	4,189	5,954	5,441	19,573	11,937	14,316
GICs	44,584	52,467	60,936	53,447	53,279	57,606
Accounts receivable	16,666	34	4,023	4,611	3,910	33
Due from joint interest partners	14,023	12,508	10,917	10,825	12,052	5,825
Oil inventory	1,212	2,983	754	89	1,475	2,303
Prepaid expenses	1,738	1,277	230	371	608	549
Intangible E&E	1,656	1,656	1,235	1,206	746	736
Property and equipment	113,875	113,308	109,781	104,265	95,626	92,390
Total assets	197,943	190,187	193,317	194,387	179,633	173,758

As at September 30, 2011, the Company's total assets were \$197.9 million, an increase of \$3.6 million from December 31, 2010. Cash and cash equivalents amounted to \$4.2 million compared with \$19.6 million at the beginning of the year.

Accounts receivable increased by \$12.1 million to \$16.7 million as at September 30, 2011. The amount due from partners increased from \$10.8 million at the beginning of the year to \$14.0 million as at September 30, 2011.

Oil inventory, valued at cost, increased from \$0.1 million at December 31, 2010 to \$1.2 million at September 30, 2011. Oil inventory results from the timing of lifts and relates to oil production in storage at the end of a period. At September 30, 2011, the Company's oil inventory net of royalties and taxes amounted to 30,550bbls compared to 2,562bbls at December 31, 2010.

Intangible exploration and evaluation assets plus property and equipment increased to \$115.5 million as at September 30, 2011. The movement in property and equipment resulted from capital expenditures of \$12.8 million, which was offset by DD&A expense of \$2.4 million less \$0.4 million in net adjustments to depletion related to oil in inventory.

Liabilities and Shareholders' Equity (\$000) As at period-end	2010					
	Q3	Q2	Q1	Q4	Q3	Q2
Accounts payable and accrued liabilities	14,339	15,580	14,941	19,264	10,297	8,626
Share capital	114,205	114,840	115,893	116,140	116,079	116,227

Accounts payable and accrued liabilities decreased to \$14.3 million as at September 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 \$114.2 million as at September 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 September 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 September 30, 2011, the Company's total assets were \$197.9 million, an increase of \$3.6 million from December 31, 2010. Cash and cash equivalents amounted to \$4.2 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 \$48.8 million at September 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 September 30, 2011 the Company's working capital decreased to \$68.1 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 September 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 September 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 nine months ended September 30, 2011, had these changes occurred on January 1, 2011. These calculations are based on business conditions, production and sales volumes existing during the nine month period ended September 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	2.3	0.02
Crude oil production	1,000 bopd	5.3	0.06
Increase in operating expenses	\$1.00/bbl	(0.4)	(0.004)
Interest rate	1%	0.5	0.005

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 September 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 \$1.2 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 understands of their terms or that if breached, the Company would be able 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 September 30, 2011, the Company had 96,038,683 common shares outstanding. Additionally, there were 5,731,335 options outstanding which were issued pursuant to the Company's stock option plan. As at November 9, 2011, the Company had 95,444,445 common shares outstanding. Additionally, there were 5,731,335 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 September 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 September 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 September 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 September 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 September 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 and nine months ended September 30, 2011. In addition, Note 19 to the Interim Condensed Consolidated Financial Statements for the three and nine months ended September 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 nine months ended September 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, September 30, 2010 - \$746, 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 September 30, 2010, June 30, 2010, March 31, 2010 and the year ended December 31, 2010 resulted in a net increase of \$108, 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, September 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, June 30, 2010, September 30, 2010, and the year ended December 31, 2010 depletion expense decreased by \$884, \$484, 1,295 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.

A total of 2,129,800 shares were acquired under the bid at an average cost of C\$2.66/share.

On October 7, 2011, 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 October 12, 2011 and ending October 11, 2012. 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 7,641,901 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 32,458 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 November 9, 2011, a total of 594,238 shares have been acquired under the bid at an average cost of C\$1.45/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 September 30, 2011, the Company had no take-or-pay revenue and oil inventory was valued at \$1.2 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.

Calvalley Petroleum Inc.

CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
(Unaudited - Expressed in Thousands of United States Dollars)

	September 30, 2011	December 31, 2010
	\$	\$
ASSETS		
Current		
Cash and cash equivalents (note 3)	4,189	19,573
Guaranteed investment certificates (note 4)	44,584	53,447
Accounts receivable	16,666	4,611
Oil inventory (note 5)	1,212	89
Due from joint interest partners (note 6)	14,023	10,825
Prepaid expenses	1,738	371
	82,412	88,916
Intangible exploration and evaluation assets (note 7)	1,656	1,206
Property, plant and equipment (note 8)	113,875	104,265
	115,531	105,471
	197,943	194,387
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current		
Accounts payable and accrued liabilities	14,339	19,264
	14,339	19,264
Commitments and contingencies (note 16)		
Shareholders' equity		
Share capital (notes 9 and 10)	114,205	116,140
Contributed surplus (notes 9 and 10)	10,890	9,056
Retained earnings	58,509	49,927
	183,604	175,123
	197,943	194,387

See accompanying notes

"Edmund Shimoon"

Edmund Shimoon

"Gary Robertson"

Gary Robertson

Calvalley Petroleum Inc.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited - Expressed in thousands of United States Dollars)

	Three months ended September 30		Nine months ended September 30	
	2011 \$	2010 \$	2011 \$	2010 \$
		(note 19)		(note 19)
REVENUE				
Oil sales	29,453	19,877	43,865	41,825
Royalties	(11,122)	(7,549)	(16,676)	(16,012)
	18,331	12,328	27,189	25,813
Management fees	94	125	405	320
Interest	104	94	347	282
	18,529	12,547	27,941	26,415
EXPENSES				
Operating	4,112	3,487	6,153	6,569
General and administrative	1,014	1,090	3,888	3,322
Stock-based compensation (note 10)	460	858	1,882	1,224
Depletion, depreciation and amortization (note 8)	1,646	1,940	2,404	4,084
	7,232	7,375	14,327	15,199
Profit before other items	11,297	5,172	13,614	11,216
Foreign exchange loss	(72)	(12)	(38)	(38)
Profit before income tax	11,225	5,160	13,576	11,178
Income tax	1,820	1,229	2,710	2,578
Profit and comprehensive income	9,405	3,931	10,866	8,600
Earnings per share (note 12)				
Basic	0.10	0.04	0.11	0.09
Diluted	0.10	0.04	0.11	0.09

See accompanying notes

Calvalley Petroleum Inc.
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
(Unaudited – Expressed in Thousands of United States Dollars)

	Issued Capital		Contributed Surplus \$	Retained Earnings \$	Total Equity \$
	Number #	Amount \$			
Balance January 1, 2010	98,217,984	116,387	7,704	36,680	160,771
Stock options exercised	138,100	321	(111)	-	210
Stock-based compensation	-	-	1,224	-	1,224
Shares repurchased and cancelled	(529,528)	(629)	-	(840)	(1,469)
Profit for the period	-	-	-	8,600	8,600
Balance September 30, 2010	97,826,556	116,079	8,817	44,440	169,336
Balance January 1, 2010	98,217,984	116,387	7,704	36,680	160,771
Stock options exercised	214,958	606	(213)	-	393
Stock-based compensation	-	-	1,565	-	1,565
Shares repurchased and cancelled	(718,662)	(853)	-	(1,335)	(2,188)
Profit for the period	-	-	-	14,582	14,582
Balance December 31, 2010	97,714,280	116,140	9,056	49,927	175,123
Balance January 1, 2011	97,714,280	116,140	9,056	49,927	175,123
Stock options exercised	87,333	161	(48)	-	113
Stock-based compensation	-	-	1,882	-	1,882
Shares repurchased and cancelled	(1,762,930)	(2,096)	-	(2,284)	(4,380)
Profit for the period	-	-	-	10,866	10,866
Balance September 30, 2011	96,038,683	114,205	10,890	58,509	183,604

(notes 9 and 10)

See accompanying note

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

	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
	\$	\$	\$	\$
OPERATING ACTIVITIES				
Profit before tax for the period	11,225	5,160	13,576	11,178
Add (deduct) items not affecting cash:				
Stock-based compensation	460	858	1,882	1,224
Depletion, depreciation and amortization	1,646	1,940	2,404	4,084
Income tax paid in kind	(1,820)	(1,229)	(2,710)	(2,578)
Unrealized foreign exchange gain	70	15	42	31
	11,581	6,744	15,194	13,939
Change in non-cash working capital (note 14)	(14,622)	(5,594)	(13,549)	(4,210)
	(3,041)	1,150	1,645	9,729
INVESTING ACTIVITIES				
Additions to intangible exploration and evaluation assets	-	(10)	(450)	(107)
Additions to property, plant and equipment	(1,759)	(4,724)	(12,388)	(10,668)
Investment in guaranteed investment certificates	(3,277)	(33,231)	(31,066)	(144,912)
Redemption of guaranteed investment certificates	11,160	37,558	39,929	142,016
Change in non-cash working capital (note 14)	(3,899)	(2,538)	(8,738)	(2,888)
	2,225	(2,945)	(12,713)	(16,559)
FINANCING ACTIVITIES				
Issuance of common shares (note 9)	-	41	113	210
Common share repurchase (note 9)	(868)	(626)	(4,380)	(1,469)
	(868)	(585)	(4,267)	(1,259)
Foreign exchange gain (loss) on cash and cash equivalents held in foreign currencies	(81)	1	(49)	(17)
Decrease in cash	(1,765)	(2,379)	(15,384)	(8,106)
Cash and cash equivalents, beginning of period	5,954	14,316	19,573	20,043
Cash and cash equivalents, end of period	4,189	11,937	4,189	11,937

See accompanying notes

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited – Financial Figures Expressed in Thousands of United States Dollars)

June 30, 2011 and 2010

1. DESCRIPTION OF BUSINESS

Calvalley Petroleum Inc. ("Calvalley" or the "Company") was incorporated on July 1, 1996 under the Canada Business Corporations Act and is engaged in the exploration, development and production of crude oil and natural gas. The Company's activities are carried out in three geographical segments: Yemen, Ethiopia, and Canada.

Calvalley is a publicly traded company, incorporated and domiciled in Canada. The address of its registered office is 700, 600 – 6th Avenue S.W., Calgary, Alberta, Canada, T2P 0S5.

2. BASIS OF PRESENTATION

The unaudited interim condensed consolidated financial statements include the accounts of Calvalley Petroleum Inc. and its subsidiaries ("Calvalley" or the "Company") as at September 30, 2011 and for the three and nine month periods ended September 30, 2011 and 2010 and have been prepared 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 on the same basis as the unaudited interim condensed consolidated financial statements as at and for the three months ended March 31, 2011. These unaudited interim condensed consolidated financial statements should be read in conjunction with the unaudited interim condensed consolidated financial statements and notes thereto for the three month period ended March 31, 2011 as the disclosures in the financial statements for the periods ended September 30, 2011 do not conform in all respects to the requirements of International Financial Reporting Standards. In these 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.

3. CASH AND CASH EQUIVALENTS

Cash and cash equivalents at September 30, 2011 include various short-term deposits of \$Nil (December 31, 2010 – \$13,403), and \$4,189 (December 31, 2010 – \$6,170) of cash.

4. GUARANTEED INVESTMENT CERTIFICATES

Guaranteed investment certificates (GICs) with original maturities in excess of 90 days at September 30, 2011 are as follows:

Maturity	Face Value \$	Interest Rate %
October 7, 2011	44,188	0.85

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

5. OIL INVENTORY

Inventory sold is expensed through operating and depletion expenses in the period when it is sold. During the nine months ended September 30, 2011, \$89 (2010 - \$225) was expensed with respect to oil which was sold. During the three months ended September 30, 2011, an expense in the amount of \$2,983 (2010 - \$428) was recorded.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited - Financial Figures Expressed in Thousands of United States Dollars)

September 30, 2011 and 2010

6. DUE FROM JOINT INTEREST PARTNERS

Amounts due from joint interest partners are comprised primarily of amounts due for operating costs and capital expenditures.

7. INTANGIBLE EXPLORATION AND EVALUATION ASSETS**Oil and natural gas exploration and evaluation assets**

	Ethiopia
	\$
At January 1, 2010	639
Additions	567
At December 31, 2010	1,206
Additions	450
At September 30, 2011	1,656

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. Costs incurred to date relate to exploration and evaluation efforts in these Blocks.

8. PROPERTY, PLANT AND EQUIPMENT**Oil and natural gas development and production assets**

	Yemen	Canada	Total
	\$	\$	\$
Cost:			
At January 1, 2010	89,235	129	89,364
Additions	20,469	-	20,469
At December 31, 2010	109,704	129	109,833
Additions	12,362	-	12,362
At September 30, 2011	122,066	129	122,195
Depletion and impairment:			
At January 1, 2010	-	81	81
Depletion for the period	5,622	9	5,631
At December 31, 2010	5,622	90	5,712
Depletion for the period	2,745	6	2,751
At September 30, 2011	8,367	96	8,463
Net carrying amount:			
At January 1, 2010	89,235	48	89,283
At December 31, 2010	104,082	39	104,121
At September 30, 2011	113,699	33	113,732

Yemen

The Company has a 50% working interest in the Malik Block 9 Joint Interest Project 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. Depletion of capitalized costs is calculated based on production and is allocated to either oil inventory or expense based on the ratio of sales to production in the period.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited – Financial Figures Expressed in Thousands of United States Dollars)

June 30, 2011 and 2010

8. PROPERTY, PLANT AND EQUIPMENT (Continued)

Other property, plant and equipment

	Canada
	\$
Cost:	
At January 1, 2010	294
Additions	41
At December 31, 2010	335
Additions	27
At September 30, 2011	362
Depreciation and impairment:	
At January 1, 2010	153
Depreciation for the period	38
At December 31, 2010	191
Depreciation for the period	28
At September 30, 2011	219
Net carrying amount:	
At January 1, 2010	141
At December 31, 2010	144
At September 30, 2011	143

Canada

Other property, plant and equipment consist of computer equipment, office equipment and furniture.

Total property, plant and equipment

	Yemen	Canada	Total
	\$	\$	\$
Net carrying amount:			
At January 1, 2010	89,235	192	89,427
At December 31, 2010	104,082	183	104,265
At September 30, 2011	113,699	176	113,875

9. SHARE CAPITAL

Authorized:

The Company is authorized to issue an unlimited number of Class A Common Voting Shares.

Transactions

Nine month period ended September 30, 2011:

The Company issued 87,333 Class A Common Voting Shares (2010 – 138,100) upon the exercise of options for proceeds of \$113 (2010 - \$210). An amount of \$48 (2010 - \$111) related to stock-based compensation expensed in prior periods was reclassified from contributed surplus to share capital in connection with the options exercised.

The Company repurchased 1,762,930 (2010 – 529,528) of its common shares pursuant to its Normal Course Issuer Bid at an average of \$2.48/share (2010 - \$2.78/share) for a cost of \$4,380 (2010 - \$1,469). The cost to repurchase common shares at prices in excess of their average book value has been charged to retained earnings.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited - Financial Figures Expressed in Thousands of United States Dollars)

September 30, 2011 and 2010

9. SHARE CAPITAL (Continued)

Year ended December 31, 2010:

The Company issued 214,985 Class A Common Voting Shares upon the exercise of options for proceeds of \$393. An amount of \$214 related to stock-based compensation expensed in prior years was reclassified from contributed surplus to share capital in connection with the options exercised.

The Company repurchased 718,662 of its common shares pursuant to its Normal Course Issuer Bid at an average of \$3.04/share for a cost of \$2,188. The cost to repurchase common shares at prices in excess of their average book value has been charged to retained earnings.

10. STOCK-BASED COMPENSATION

The Company's restated stock option plan, as approved effective May 11, 2010, 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 September 30, 2011, a total of 9,603,868 (December 31, 2010 – 9,771,428) shares were reserved for issue under this plan. Options which are forfeited are available for re-issue.

The number and weighted average exercise prices of share options for the period are as follows:

	2011		2010	
	Options (000s)	Weighted Average Exercise Price C\$	Options (000s)	Weighted Average Exercise Price C\$
Outstanding at January 1	4,802	3.60	4,095	3.53
Granted	1,847	2.33	1,310	3.57
Forfeited	(80)	2.50	(207)	3.81
Expired	(750)	4.33	(140)	3.56
Exercised	(88)	1.27	(138)	1.58
Outstanding at September 30	5,731	3.28	4,920	3.58
Exercisable at September 30	3,496	3.53	3,055	3.94

No options were exercised during the three months ended September 30, 2011. The weighted average share price at the date of exercise for stock options exercised during the three months ended September 30, 2010 was C\$3.68.

Stock options outstanding at September 30, 2011 were as follows:

Granted (000s)	Exercisable (000s)	Weighted Average Exercise Price C\$	Year of Expiry
160	160	7.61	2012
348	236	1.64	2013
1,420	1,420	4.32	2013
536	397	1.64	2014
180	120	2.20	2014
1,240	613	3.57	2015
1,847	550	2.69	2016
5,731	3,496		

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited – Financial Figures Expressed in Thousands of United States Dollars)

June 30, 2011 and 2010

10. STOCK-BASED COMPENSATION (Continued)

During the nine months ended September 30, 2011, stock-based compensation costs of \$1,882 (2010 – \$1,224) were expensed and credited to contributed surplus. During the three months ended September 30, 2011, stock-based compensation costs amounted to \$460 (2010 - \$858). Contributed surplus is primarily comprised of cumulative stock based compensation provisions. No options were granted during the three months ended September 30, 2011. The fair value of options granted during the third quarter of 2010 was C\$2,533 or C\$2.11 per option using the Black-Scholes option pricing model with the following assumptions:

	<u>2011</u>	<u>2010</u>
Risk-free interest rate	2.00%	2.29 to 2.59%
Expected hold period to exercise	5 years	5 years
Volatility in the price of the Company's shares	66%	66 to 67%
Dividend yield	Nil	Nil

11. CAPITAL DISCLOSURE

The Company defines and computes its capital employed as follows:

	September 30, 2011	December 31, 2010
	\$	\$
Shareholders' equity	183,604	175,123
Long-term debt	-	-
Cash and cash equivalents	(4,189)	(19,573)
GICs	(44,584)	(53,447)
Total capital	134,831	102,103

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 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 THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited - Financial Figures Expressed in Thousands of United States Dollars)
September 30, 2011 and 2010

12. EARNINGS PER SHARE

The calculation of basic and diluted earnings per share is based on the following:

	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Profit attributable to Common shareholders (000s of shares)	\$9,405	\$3,931	\$10,866	\$8,600
Weighted average number of shares outstanding	96,362	97,986	97,047	98,003
Dilutive effect of stock options	75	605	536	573
Weighted average number of diluted shares outstanding	96,437	98,591	97,583	98,576

Excluded from diluted earnings per share for the three months ended September 30, 2011 is the effect of 5,033,667 options (2010 – 3,600,000 options) as the exercise price of these options was greater than the average common share market price for the period. Excluded from diluted earnings per share for the nine months ended September 30, 2011 is the effect of 2,720,000 options (2010 – 3,700,000 options) as the exercise price of these options was greater than the average common share market price for the period.

13. 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. All revenue is earned from external sources.

Segmented information is as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Revenue	\$	\$	\$	\$
Yemen	29,501	19,948	44,092	42,025
Ethiopia	-	-	-	-
Canada	150	148	525	402
Total	29,651	20,096	44,617	42,427

See notes 7 and 8 for additional information regarding geographical segments.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited – Financial Figures Expressed in Thousands of United States Dollars)

June 30, 2011 and 2010

14. SUPPLEMENTAL CASH FLOW INFORMATION

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2011	2010	2011	2010
	\$	\$	\$	\$
Changes in non-cash working capital:				
Accounts receivable	(16,632)	(3,877)	(12,055)	(1,089)
Due from joint interest partners	(1,515)	(6,227)	(3,198)	(2,940)
Oil inventory	1,317	376	(749)	(865)
Prepaid expenses	(461)	(59)	(1,367)	(267)
Accounts payable and accrued liabilities	(1,230)	1,655	(4,918)	(1,937)
	(18,521)	(8,132)	(22,287)	(7,098)
Changes in non-cash working capital:				
Operating activities	(14,622)	(5,594)	(13,549)	(4,210)
Investing activities	(3,899)	(2,538)	(8,738)	(2,888)
	(18,521)	(8,132)	(22,287)	(7,098)
Included within cash flows from operating activities for the period:				
Interest received	42	38	48	274
Interest paid	-	-	-	-

During the nine and three month periods ended September 30, 2011, the Company incurred cash outlays of \$Nil in income taxes (2010 - \$Nil). During the nine month period ended September 30, 2011, Yemen income taxes in the amount of \$2,710 (2010 - \$2,578) were remitted to the government through its allocation of oil under the PSA.

15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Carrying Values and Estimated Fair Values of Financial Assets and Liabilities

The Company has designated its cash and cash equivalents and GICs as assets at fair value through profit or loss, which are measured at fair value with changes being recognized in profit. Accounts receivable and amounts due from joint interest partners are classified as loans and receivables, which are initially measured at fair value and subsequently 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 designated a fair value through profit or loss	48,773	48,773
Loans and receivables	30,689	30,689
Other financial liabilities	14,339	14,339

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:

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September 30, 2011 and 2010

15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (Continued)

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.

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 September 30, 2011, the Company's fair value measurement of financial assets designated at fair value through profit or loss was conducted using Level 1 of the hierarchy.

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 interest 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 recently signed a marketing agreement with a major North American oil and gas company to sell its production. The selling price is based on the quoted Dated Brent price during the month of shipment adjusted for the official selling price differential posted by the Government of Yemen. At September 30, 2011, \$16,634 (December 31, 2010 - \$4,530) was receivable under the contract. The amount receivable at September 30, 2011 was received during October 2011.

The Company funds capital and operating costs and bills joint interest partners for their share of those costs. In the event that a joint interest 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 interest partners' share of proceeds from crude oil sales.

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

Trade and other receivables at September 30, 2011	\$
Neither impaired nor past due	22,431
Impaired (net of valuation allowance)	-
Not impaired and past due in the following period:	
Within 30 days	1,008
31-60 days	816
61-90 days	1,175
Over 90 days	5,258

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 and nine months ended September 30, 2011 would have increased profit by approximately \$130 (\$0.001/share) and \$465 (\$0.005/share) respectively.

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15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (Continued)

Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due. Liquidity describes a company's ability to access cash. Companies operating in the upstream oil and 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 \$14,339. In addition, the Company has commitments under existing agreements as described in note 16. Given the Company's working capital position, management assesses liquidity risk as being low.

Commodity Price Risk Management

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

Foreign Exchange Risk

The Company holds substantially all of its cash and cash 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 \$1,143 of the \$4,189 in cash and cash equivalents is held in Canadian-dollar-denominated accounts. As such, the Company is exposed to foreign currency risk. The impact to profit of a 10% change in the foreign exchange rates between the Canadian and United States dollars at September 30, 2011 would have been approximately \$15 (\$0.000/share).

16. 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, 2010.

17. RELATED PARTY TRANSACTIONS

Transactions with key management personnel

Key management personnel include the Directors and Officers of the Company.

Key management compensation is comprised of the following:

	Three months ended		Nine months ended	
	September 30,		September 30	
	2011	2010	2011	2010
	\$	\$	\$	\$
Salaries and other short-term benefits	269	227	1,066	730
Stock-based compensation (i)	246	686	990	950
	515	913	2,056	1,680

(i) Represents the recognition of stock-based compensation associated with options granted to executive management, as recorded in the consolidated financial statements.

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18. SUBSIDIARIES

The Company has the following significant wholly owned subsidiaries, which principally affected the consolidated profits or net assets:

Name of Company	Business and Area of Operation	Country of Incorporation
Calvalley Energy Ltd.	Intermediate holding company, Yemen and Ethiopia	Cyprus
Calvalley Petroleum (Cyprus) Ltd.*	Exploration, development and production, Yemen	Cyprus
Calvalley Petroleum (Ethiopia) Ltd.*	Exploration, development and production, Ethiopia	Cyprus
Calvalley Petroleum (UK) Ltd.	Holding company	United Kingdom

*Owned indirectly

19. TRANSITION FROM CANADIAN GAAP TO IFRS

These condensed consolidated interim financial statements represent the Company's initial presentation of the financial results of operations and financial position under IFRS for the periods ended September 30, 2011 in conjunction with the Company's annual audited consolidated financial statements to be issued under IFRS as at and for the year ended December 31, 2011.

As a result, these interim condensed consolidated financial statements have been prepared 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 interim and annual consolidated financial statements in accordance with Canadian GAAP.

IFRS 1 requires the presentation of comparative information as at the January 1, 2010 transition date and subsequent comparative periods as well as the consistent and retrospective application of IFRS accounting policies. To assist with the transition, the provisions of IFRS 1 allow for certain mandatory and optional exemptions for first-time adopters to alleviate the retrospective application of all IFRSs.

The following reconciliations present the adjustments made to the Company's CGAAP financial results of operations and financial position to comply with IFRS 1. A summary of the significant accounting policy changes and applicable exemptions are discussed following the reconciliations. Reconciliations include the Company's condensed consolidated statements of comprehensive income (loss) for the three and nine months ended September 30, 2010.

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

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19. TRANSITION FROM CANADIAN GAAP TO IFRS (Continued)

Reconciliation of Assets, Liabilities and Equity

December 31, 2010	Notes	Canadian GAAP \$	Effect of Transition to IFRS \$	IFRS \$
ASSETS				
Current				
Cash and cash equivalents		19,573	-	19,573
Guaranteed investment certificates		53,447	-	53,447
Accounts receivable		4,611	-	4,611
Oil inventory	(d)	120	(31)	89
Due from joint interest partners		10,825	-	10,825
Prepaid expenses		371	-	371
		88,947	(31)	88,916
Intangible exploration and evaluation assets	(a)	-	1,206	1,206
Property, plant and equipment	(a), (d)	101,763	2,502	104,265
		101,763	3,708	105,471
		190,710	3,677	194,387
LIABILITIES AND SHAREHOLDERS' EQUITY				
Current				
Accounts payable and accrued liabilities		19,264	-	19,264
		19,264	-	19,264
Shareholders' equity				
Share capital		116,140	-	116,140
Contributed surplus	(b)	8,462	594	9,056
Accumulated other comprehensive income	(c)	3,963	(3,963)	-
Retained earnings	(b), (c)	42,881	7,046	49,927
		171,446	3,677	175,123
		190,710	3,677	194,387

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited - Financial Figures Expressed in Thousands of United States Dollars)

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19. TRANSITION FROM CANADIAN GAAP TO IFRS (Continued)

Reconciliation of Assets, Liabilities and Equity

September 30, 2010	Notes	Canadian GAAP \$	Effect of Transition to IFRS \$	IFRS \$
ASSETS				
Current				
Cash and cash equivalents		11,937	-	11,937
Guaranteed investment certificates		53,279	-	53,279
Accounts receivable		3,910	-	3,910
Oil inventory	(d)	1,804	(329)	1,475
Due from joint interest partners		12,052	-	12,052
Prepaid expenses		608	-	608
		83,590	(329)	83,261
Intangible exploration and evaluation assets	(a)	-	746	746
Property, plant and equipment	(a), (d)	93,380	2,246	95,626
		93,380	2,992	96,372
		176,970	2,663	179,633
LIABILITIES AND SHAREHOLDERS' EQUITY				
Current				
Accounts payable and accrued liabilities		10,297	-	10,297
		10,297	-	10,297
Shareholders' equity				
Share capital		116,079	-	116,079
Contributed surplus	(b)	8,242	575	8,817
Accumulated other comprehensive income	(c)	3,963	(3,963)	-
Retained earnings	(b), (c)	38,389	6,051	44,440
		166,673	2,663	169,336
		176,970	2,663	179,633

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

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19. TRANSITION FROM CANADIAN GAAP TO IFRS (Continued)

Reconciliation of Comprehensive Income

For the three months ended September 30, 2010	Notes	Canadian GAAP \$	Effect of Transition to IFRS \$	IFRS \$
REVENUE				
Oil sales		19,877	-	19,877
Royalties		(7,549)	-	(7,549)
		12,328	-	12,328
Management fees		125	-	125
Interest		94	-	94
		12,547	-	12,547
EXPENSES				
Operating		3,487	-	3,487
General and administrative, net of recoveries		1,090	-	1,090
Stock-based compensation	(b)	750	108	858
Depletion, depreciation and amortization	(d)	3,235	(1,295)	1,940
		8,562	(1,187)	7,375
Profit before other items		3,985	1,187	5,172
Foreign exchange gain (loss)		(12)	-	(12)
Profit before Income tax		3,973	1,187	5,160
Income tax		1,229	-	1,229
Profit and comprehensive income		2,744	1,187	3,931

Calvalley Petroleum Inc.

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19. TRANSITION FROM CANADIAN GAAP TO IFRS (Continued)

Reconciliation of Comprehensive Income

For the nine months ended September 30, 2010	Notes	Canadian GAAP \$	Effect of Transition to IFRS \$	IFRS \$
REVENUE				
Oil sales		41,825	-	41,825
Royalties		(16,012)	-	(16,012)
		25,813	-	25,813
Management fees		320	-	320
Interest		282	-	282
		26,415	-	26,415
EXPENSES				
Operating		6,569	-	6,569
General and administrative, net of recoveries		3,322	-	3,322
Stock-based compensation	(b)	1,207	17	1,224
Depletion, depreciation and amortization	(d)	6,747	(2,663)	4,084
		17,845	(2,646)	15,199
Profit before other items		8,570	2,646	11,216
Foreign exchange gain (loss)		(38)	-	(38)
Profit before Income tax		8,532	2,646	11,178
Income tax		2,578	-	2,578
Profit and comprehensive income		5,954	2,646	8,600

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19. TRANSITION FROM CANADIAN GAAP TO IFRS (Continued)

Notes to Reconciliation

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, September 30, 2010 - \$746, 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.

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19. TRANSITION FROM CANADIAN GAAP TO IFRS (Continued)*(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 September 30, 2010, June 30, 2010, March 31, 2010 and the year ended December 31, 2010 resulted in a net increase of \$108, 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, September 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, June 30, 2010, September 30, 2010, and the year ended December 31, 2010 depletion expense decreased by \$884, \$484, 1,295 and \$3,677 respectively, which consequently increased the net carrying value of property, plant and equipment and decreased the carrying value of inventory.

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.



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