PAINTED PONY PETROLEUM LTD.

Born to run

2009 ANNUAL REPORT TO SHAREHOLDERS

Painted Pony Petroleum Ltd. was recognized as a TSX Venture 50® company in 2010. TSX Venture 50 is a trade-mark of TSX Inc. and is used under license.

CORPORATE PROFILE

Painted Pony Petroleum Ltd. ("Painted Pony" or the "Company") is a public junior oil and gas exploration company based in Calgary, Alberta, Canada. The Company closed its initial public offering and commenced trading on the TSX Venture Exchange in May 2007. Painted Pony's corporate philosophy is to grow through exploration and development drilling complemented by strategic corporate and asset acquisitions. The Company's long term target is to maintain a balanced crude oil and natural gas portfolio in resource-type plays.

ANNUAL GENERAL AND SPECIAL MEETING

Painted Pony Petroleum Ltd. invites shareholders and interested parties to attend its Annual General and Special Meeting to be held in the McMurray Room at the Calgary Petroleum Club, 319 5th Avenue S.W., Calgary, Alberta on Wednesday, May 26th, 2010 at 3:00 p.m. (Calgary time). Shareholders not attending the meeting are encouraged to complete the form of proxy and deliver it in accordance with the instructions therein at their earliest convenience.

GLOSSARY

ARC	asset retirement costs
ARO	asset retirement obligations
/d	per day
boe	barrels of oil equivalent (6 mcf of natural gas = 1 barrel of oil equivalent)
bbls	barrels
GOR	gross overriding royalties
mboe	thousand barrels of oil equivalent
mbbl	thousand barrels
mcf	thousand cubic feet
mmcf	million cubic feet
NGL	natural gas liquids
NI 51-101	National Instrument 51-101
WTI	West Texas Intermediate, a benchmark crude oil used for pricing comparison

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Cover painting "Born to Run" by Paul Van Ginkel (www.paulvanginkel.com)

Financial and Operating Highlights

		2009		2008
FINANCIAL *(000s except per share and shares outstanding)*				
Petroleum and natural gas revenue (before royalties)	**$**	**28,895**	$	20,635
Funds flow from operations[1]	**$**	**15,210**	$	12,758
Per share - basic[2]	**$**	**0.44**	$	0.38
Per share - diluted[2]	**$**	**0.44**	$	0.38
Cash flow from operating activities	**$**	**12,460**	$	13,599
Net earnings (loss)	**$**	**(3,656)**	$	5,453
Per share - basic and diluted[2]	**$**	**(0.10)**	$	0.16
Capital expenditures[3]	**$**	**56,003**	$	72,714
Net working capital	**$**	**40,679**	$	11,835
Total assets	**$**	**164,907**	$	97,194
Shares outstanding				
Class A		**44,081,700**		28,222,700
Class B		**1,173,600**		1,173,600
OPERATIONAL				
Daily sales volumes				
Oil *(bbls/d)*		**893**		386
Condensate *(bbls/d)*		**24**		12
NGL's *(bbls/d)*		**17**		5
Gas *(mcf/d)*		**3,712**		2,149
Total *(boe/d)*		**1,552**		761
Realized prices				
Oil *($/bbl)*	**$**	**69.15**	$	94.50
Gas *($/mcf)*	**$**	**4.20**	$	8.59
Field operating netbacks				
Oil *($/bbl)*	**$**	**47.49**	$	65.89
Gas and associated liquids *($/boe)*	**$**	**8.41**	$	26.41
Company combined *($/boe)*	**$**	**30.89**	$	46.45
Net developed and undeveloped land				
Saskatchewan *(acres)*		**60,145**		54,010
British Columbia *(acres)*		**104,066**		93,867
Total *(acres)*		**164,211**		147,877
Total proved and probable reserves *(mboe, 6:1)*		**6,491.0**		4,360.2
Wells drilled[4]				
Gross		**20**		50
Net		**17.0**		21.3
Net success rate		**98%**		86%

1. *This table contains the term "funds flow from operations", which should not be considered an alternative to, or more meaningful than "cash flow from operating activities" as determined in accordance with Canadian generally accepted accounting principles ("GAAP") as an indicator of the Company's performance. Funds flow from operations and funds flow from operations per share (basic and diluted) does not have any standardized meaning prescribed by GAAP and may not be comparable with the calculation of similar measures for other entities. Management uses funds flow from operations to analyze operating performance and leverage and considers funds flow from operations to be a key measure as it demonstrates the Company's ability to generate the cash necessary to fund future capital investment. The reconciliation between funds flow from operations and cash flow from operating activities can be found in "Management's Discussion and Analysis". Funds flow from operations per share is calculated using the basic and diluted weighted average number of shares for the period, and after the deemed conversion of the Class B shares to Class A shares, consistent with the calculations of earnings per share.*

2. *Class B shares are converted into Class A shares at $10 divided by the greater of $1.00 and the Current Trading Price, defined as the weighted average trading price of the Class A shares for the last 30 consecutive trading days.*

3. *Including Asset Retirement Costs and Stock-Based Compensation.*

4. *"Gross and net wells drilled" in 2008 excludes a salt water disposal well and includes a stratigraphic well. "Net wells drilled" refers to net revenue interest. "Net success rate" in 2008 excludes a stratigraphic well. Gross and net wells drilled in 2008 exclude 2 (1.0 net) gas wells drilled between acquisition effective and close date.*

To Our Shareholders

THE YEAR IN REVIEW

The global economic meltdown, which started in the summer of 2008, continued during the first half of 2009. The North American economy suffered dramatically, with adversity affecting many sectors. Companies found access to capital very limited and obtaining credit increasingly difficult. Add to this softening commodity prices - drilling operations ground to the lowest levels in many years in many organizations, as capital resources were carefully preserved. Oil and gas explorers with operations focused on Western Canada found changes to the Alberta provincial royalty regulations resulted in many organizations redirecting their scarce capital into Saskatchewan and British Columbia. Painted Pony, with focused operations in south-east Saskatchewan and north-east British Columbia, found competition levels increasing dramatically.

In response to this economic environment, and as commodity prices declined in the second half of 2008, Painted Pony revised its drilling program to minimize risk and optimize cash flow. Painted Pony entered into 2009 with a scaled-back development drilling program focused on oil in the Bakken, as dictated by its conservative financial mandate. By mid-year, as oil prices strengthened and capital markets began to improve, Painted Pony began to expand its drilling operations focused on light oil.

In 2009, Painted Pony:

- *grew daily production rates to average 1,552 boe/d in 2009, up 104% over 2008. Fourth quarter production in 2009 averaged 2,006 boe/d (weighted 73% oil and liquids and 27% gas);*
- *exited 2009 with positive working capital of $41 million and undrawn available credit facilities of $40 million;*
- *raised $20 million and $52 million in two bought-deal financings through the issuance of Class A shares at $2.85 per share in June and $5.88 per share in November of 2009, respectively;*
- *enjoyed 2009 field netbacks of $47.49 per bbl for light oil on sales prices averaging $69.15 per bbl;*
- *closed four acquisitions of undeveloped land and light oil production costing an aggregate of $13.6 million primarily in the Company's core Midale/Huntoon area in south-east Saskatchewan;*
- *continued to grow its land to a total of 164,211 net acres of developed and undeveloped land in Saskatchewan and British Columbia, with undeveloped land valued at $93.2 million;*
- *increased proved and probable reserves from 4,360 mboe to 6,491.0 mboe, replacing 2009 production by 476%; and*
- *drilled 20 (17.0 net) wells at a 98% net success rate.*

PLANS FOR 2010

Painted Pony plans to conduct an active drilling program during 2010, with approximately 30 net wells planned in Saskatchewan, primarily targeting the Bakken oil formation. In British Columbia, the Company will drill for conventional and unconventional gas. The Montney formation will be targeted through operated wells and on a carried basis from lands farmed out. Drilling operations during 2010 are expected to also include conventional Bluesky and Cadomin locations, as well as exploratory wells for the Buckinghorse shale formation.

To Our Shareholders

BORN TO RUN

Painted Pony's high quality assets and conservative financial management allowed the Company to continue building the foundation for future growth through these very challenging times. The hard work invested by the team since the inception of the Company almost three years ago has created an organization uniquely positioned amongst junior oil and gas players. One of the few junior public companies focused in Canada's most exciting resource plays - the Bakken oil in Saskatchewan, the Montney unconventional gas play and an emerging resource play in the Buckinghorse shale gas in British Columbia. 2010 should be another year of exciting growth with the drilling of the Company's first operated Montney and Buckinghorse gas wells in northeast British Columbia, and exploration and development drilling for Bakken oil. As a junior resource company with existing land positions in resource plays dominated by significantly larger organizations, Painted Pony was ***"Born to Run"***.

We thank you for your support.

On Behalf of the Board of Directors,

Patrick R. Ward
President and Chief Executive Officer
March 24, 2010

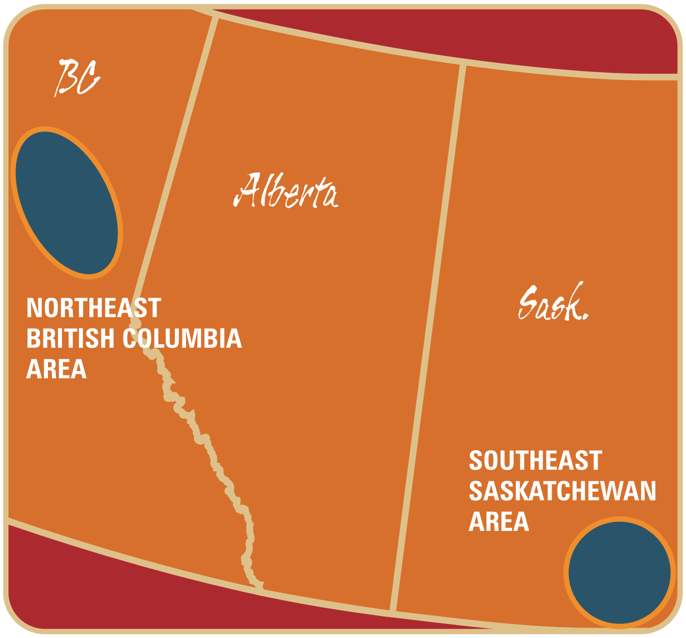
The future belongs to those who see possibilities...

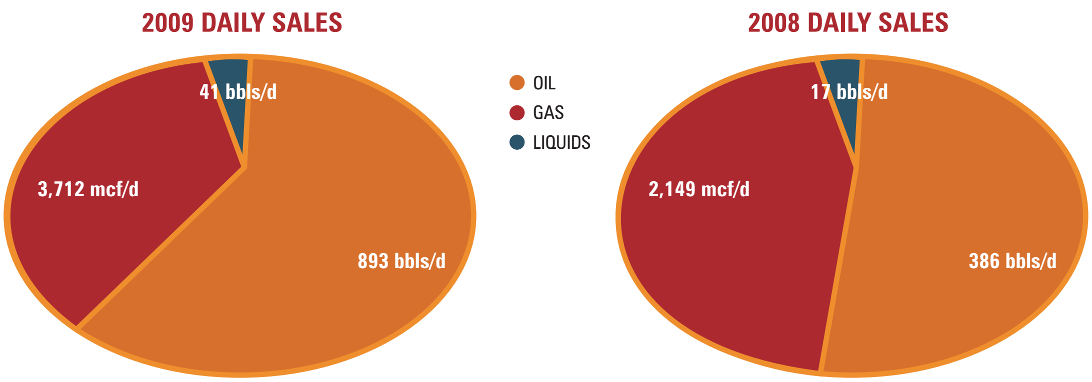
...before they become obvious.

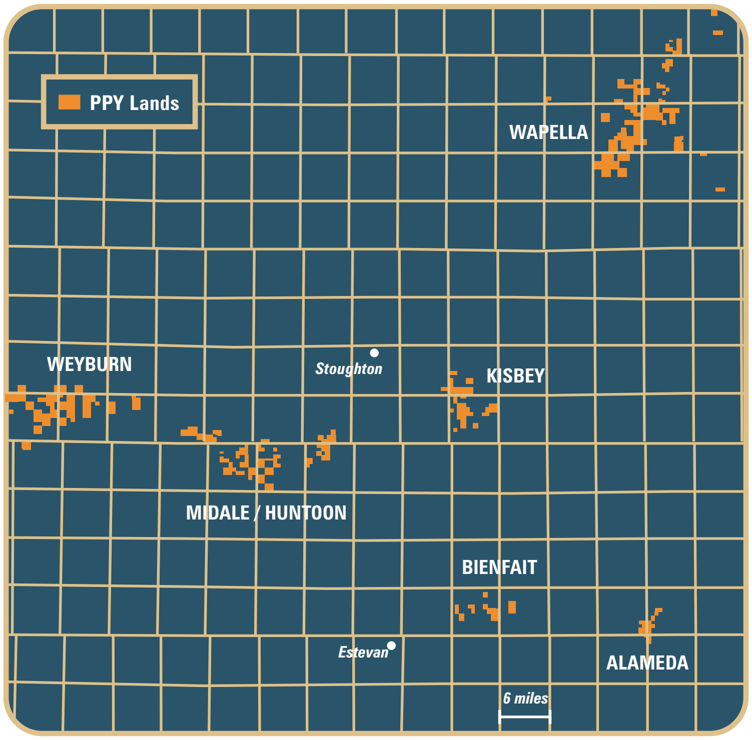
- John Sculley

Review of Operations

Painted Pony's operations are concentrated in southeast Saskatchewan and in northeast British Columbia. In Saskatchewan, the Company targets light oil from the Bakken formation and sweet gas in British Columbia from three geological formations; the conventional Bluesky/Gething and the unconventional Montney/Doig and Buckinghorse shale formations. Production volumes averaged 1,552 boe/d in 2009, up 104% over 2008. Fourth quarter production in 2009 averaged 2,006 boe/d (weighted 73% oil and liquids and 27% gas)







TARGETING BAKKEN OIL IN SASKATCHEWAN

Painted Pony's operations in Saskatchewan are primarily located north of Estevan in the general areas east and west of the town of Stoughton. The Company targets high netback, light sweet oil primarily from the Bakken formation, plus the Midale, Frobisher and Alida zones. The combination of technological advances, such as horizontal drilling and multi stage fracture stimulation techniques, and provincial royalty incentive programs for horizontal drilling have encouraged the oil development in this resource play to be pursued.

Review of Operations

DRILLING OPERATIONS

In mid 2007 when Painted Pony commenced operations, the business plan called for drilling exploration wells to earn land through two farm-in agreements. In 2008, the Company extended the boundaries of the Bakken pool through drilling to delineate the "sweet spots" within core areas. During the first half of 2009, the objective was to preserve capital and to invest in only the very lowest-risk capital projects.

Painted Pony's conservative fiscal stewardship meant it had resources available to execute accretive acquisitions at a time when access to capital was very tight. In the second half of the year in 2009, commodity prices gradually strengthened, bringing improved economics and access to capital to many oil weighted resource companies. By the end of the third quarter of 2009, the Company had closed four acquisitions of undeveloped land and Bakken production at a cost of $13.6 million (before adjustments), primarily in the Company's core Midale/Huntoon area.

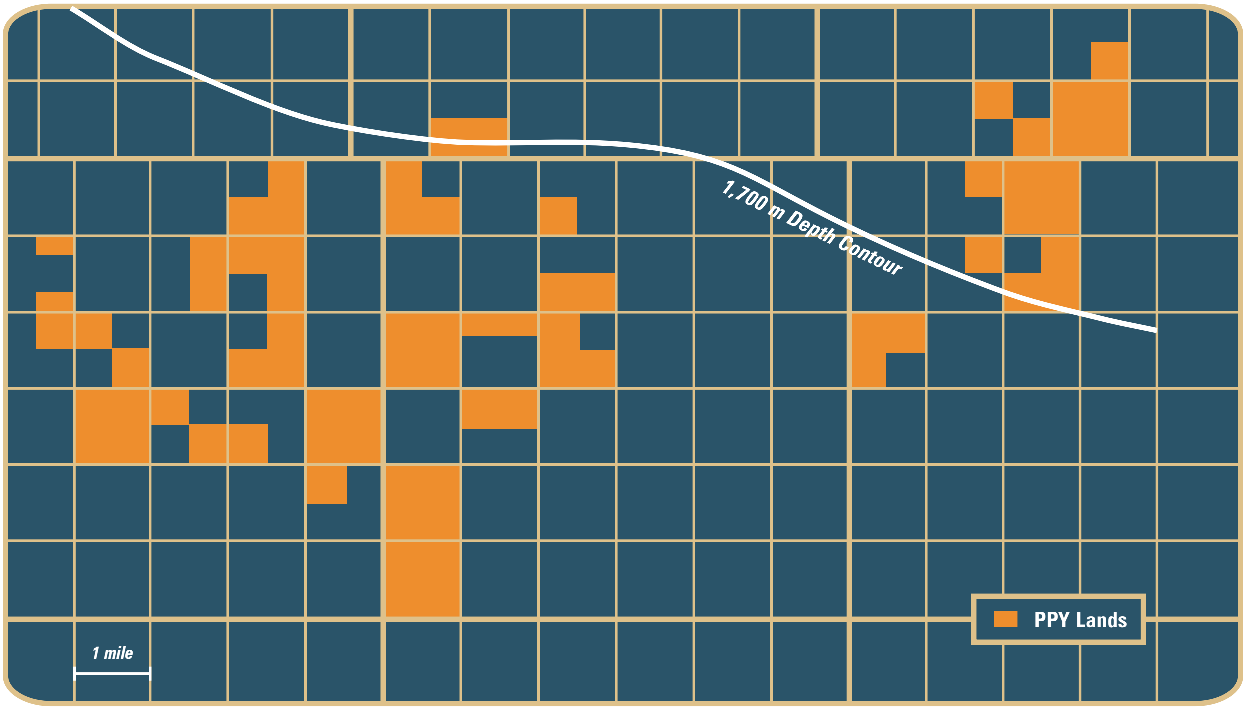
Armed with a drilling inventory of approximately 100 locations and a strong balance sheet, Painted Pony then embarked on an enhanced capital program targeting lower risk developmental locations for the Bakken formation. By the end of 2009, Painted Pony had drilled 19 (16.5 net) wells at a 98% success rate within the fiscal year. Daily production rates began to increase; sales averaged 1,456 boe/d (weighted 99% oil and liquids) in the fourth quarter of 2009, an increase of 135% compared to the fourth quarter of 2008. In comparison, sales in 2008 averaged 386 bbls/d and 620 bbls/d in the fourth quarter of 2008.

The Company continued to grow its land holdings. At December 31, 2009, Painted Pony had 60,145 net acres of land in Saskatchewan, of which 97% is undeveloped. Utilizing this land inventory, in 2010, Painted Pony has budgeted to drill approximately 30 net wells in Saskatchewan, primarily in the Midale and Huntoon development areas, targeting the Bakken formation. During the first quarter of 2010, the Company has drilled 10 (9.3 net) horizontal oil wells, primarily targeting Bakken light oil.

FRACTURE STIMULATION

In 2009, Painted Pony's operated wells were primarily drilled as "shorties", meaning the wellbores' horizontal leg were approximately half the length of conventional Bakken wells with a similar number of fracture treatments as traditionally found in the longer wells, thereby effectively "down-spacing" the fractures. This technique has several advantages: drilling and completions are simplified, fracture spacing is tighter than traditional full-length wells, reservoir drawdown during production is improved and additional royalty relief results in competitive economics. Individual well performance is monitored continually. As technology continues to evolve, industry competitors have been evaluating economic results using different methodologies, including drilling dual lateral legs and using a long cemented liner. Painted Pony will continue to evaluate alternative drilling and completion techniques in designing programs to obtain optimal economics.

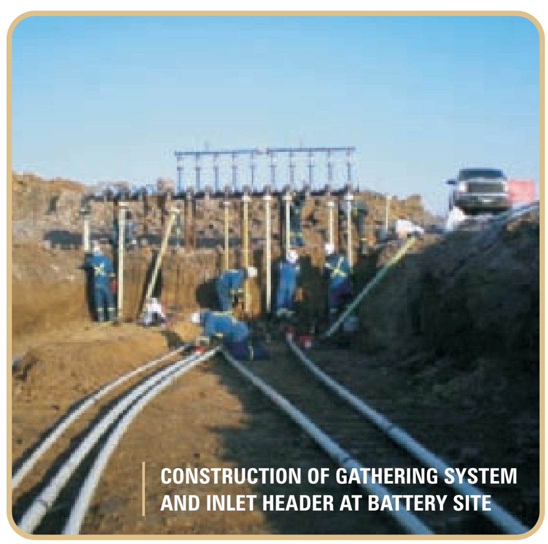
Review of Operations



Midale/Huntoon Area, Saskatchewan

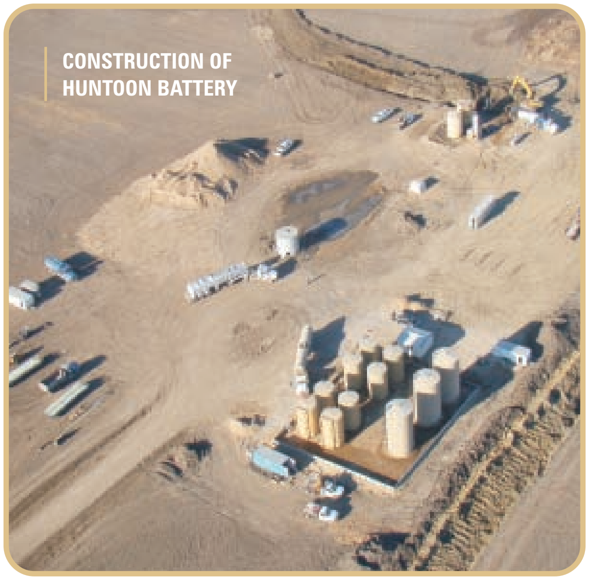
The Midale/Huntoon area is located southwest of the town of Stoughton and produces 43 degree API light oil from the Bakken formation. Painted Pony acquired its initial interests in the area through a 2007 farm-in agreement. In 2008, the Company executed other farm-in agreements providing access to additional prospective lands in the Midale and Huntoon areas. In the third quarter of 2009, four acquisitions of undeveloped land and Bakken production at a cost of $13.6 million (before adjustments) were completed, primarily in this area. As at December 31, 2009, Painted Pony had 10,061 net acres of developed and undeveloped land in the Midale/Huntoon area, of which 88% is undeveloped.

During 2009, Painted Pony operated the drilling of 16 (15.7 net) wells in the Midale/Huntoon area. In 2010, the Company currently anticipates drilling 27 (24.0 net) wells on these lands. In 2008, oil sales averaged 171 bbls/d. By 2009, the combination of the successful drilling program since inception combined with the acquisitions increased sales to an average 644 boe/d, with production during the fourth quarter averaging 1,211 boe/d.



CONSTRUCTION OF GATHERING SYSTEM AND INLET HEADER AT BATTERY SITE

Review of Operations



Kisbey Area, Saskatchewan

The Kisbey area is located further east of the Huntoon area and also produces 43 degree API light oil from the Bakken formation. Painted Pony acquired its interests in the area through a January 2007 farm-in agreement. Although initially the operator of the Kisbey area, Painted Pony relinquished operatorship to the highest working interest partner mid-year 2008.

In 2009, the Company participated in the drilling of 2 (0.45 net) wells in the Kisbey area and 2 (0.6 net) wells are planned for in 2010. Painted Pony's developed and undeveloped land at December 31, 2009 was 1,573 net acres, of which 86% is undeveloped. During the first quarter of 2009, a number of wells within the Kisbey area were tied in to a partner operated gas plant, enabling the sale of solution gas and associated liquids. Sales in 2009 from the Kisbey area averaged 174 boe/d, weighted 95% oil and liquids.

Weyburn Area, Saskatchewan

Painted Pony's team spearheaded the extension west of the Bakken-pool in 2008 into the Weyburn exploration area, located west of the Midale area. By the end of 2009, the Company have aggregated 18,084 net acres of developed and undeveloped land, 99% undeveloped, through land sales, farm-in wells and freehold leasing. In 2009, Painted Pony drilled 1 (0.3 net) well in the area. As part of the exploration component of the 2010 drilling program, the Company may drill up to 4 (3.3 net) wells on these lands, depending on results. Sales in 2009 from the Weyburn area averaged 78 bbls/d, weighted 99% oil and liquids.

Wapella Area, Saskatchewan

Northeast of the Company's Kisbey operations lies Painted Pony's Wapella exploration area. Quiet accumulation of lands through freehold leasing and land sales allowed Painted Pony to aggregate 25,402 net acres by the end of 2009. In 2010, the Company is planning to drill up to 2 (2.0 net) wells to begin to evaluate the prospectivity of these lands for Bakken oil.

Other Areas, Saskatchewan

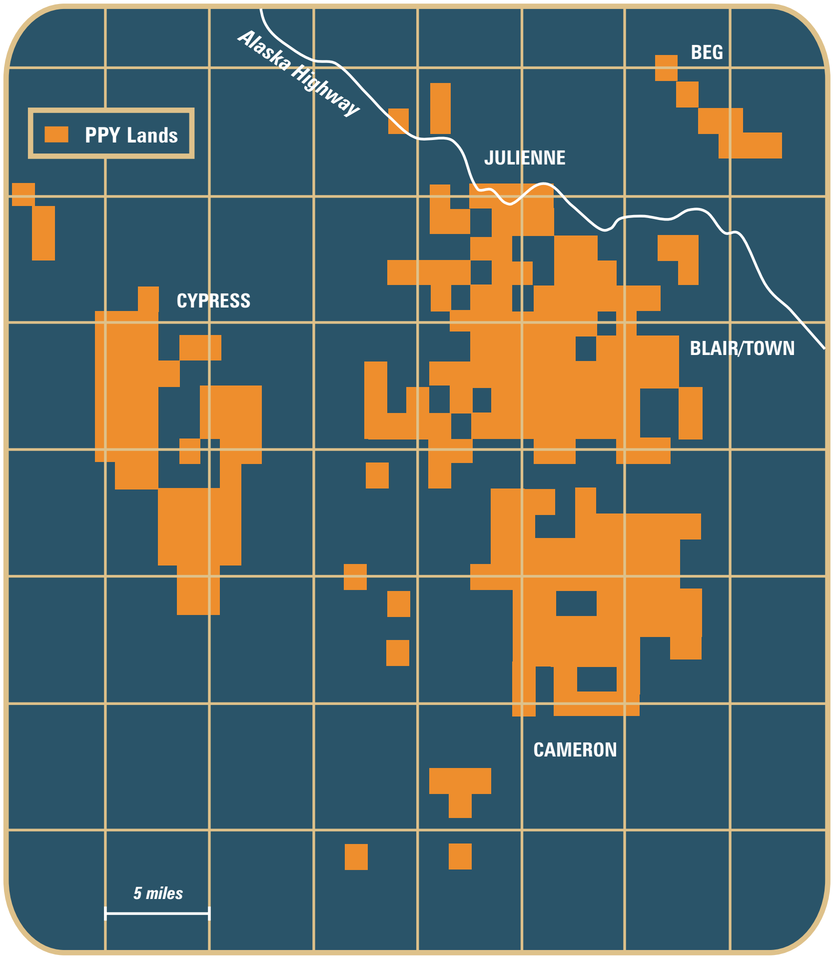
Painted Pony has 5,025 net acres of lands in other areas of southeast Saskatchewan. In the first quarter of 2010, the Company drilled one 100% successful working interest well in the Alameda area targeting the Frobisher zone.

Review of Operations

NORTHEAST BRITISH COLUMBIA OPERATIONS

Painted Pony's activity within British Columbia was initially limited to accessing a large seismic data base. In March of 2008, the Company entered into northeast British Columbia through the acquisition of 89,600 net acres of developed and undeveloped land and producing conventional gas assets. Painted Pony then proceeded to examine the geological potential of these lands; two potential resource-style plays emerged the Montney and the Buckinghorse. To initially evaluate the Montney potential on these lands with minimal capital exposure, two farm-out agreements were negotiated late in 2008.

Painted Pony's assets in northeast British Columbia have year round-access (excluding break-up), under-utilized pipelines and gas plants. Play economics have been enhanced by improvements to the British Columbia provincial royalty incentive programs.



Targeting Conventional and Unconventional Gas in British Columbia

Painted Pony's is focused on evaluating and developing three plays; conventional gas, unconventional Montney gas and Buckinghorse shale gas. Production averaged 3,654 mcf/d for the 2009 calendar year; 3,127 mcf/d in the fourth quarter, plus 30 bbl/d of liquids in each period.

Review of Operations

Unconventional Gas - the Montney Formation

The Montney formation is a silty-shale resource play that has been developed to the south and east of the Company's Cameron/Blair properties. Industry competitors are now drilling wells targeting the Montney on lands directly offsetting Company lands. In the Blair/Cameron area, the Montney contains sweet gas, approximately 300 meters thick, over-pressured and gas-charged. Painted Pony's Montney interests are being evaluated on three fronts; this year through company-operated drilling on the Blair/Town lands and through two farm-out agreements within the Cameron and Cypress areas.

Blair/Town lands

On the Blair/Town block, Painted Pony conducted two 100% drilling operations targeting the Montney gas formation in the first quarter of 2010. An existing vertical well bore was re-entered and deepened into the Montney and a horizontal well was drilled. Both wells are expected to be completed in March 2010. One additional horizontal well (30% working interest) targeting Montney gas is currently drilling and is should be completed after spring breakup.

FIRST HORIZONTAL MONTNEY WELL IN BLAIR AREA

Under the two farm-out agreements, a senior oil and gas company has farmed-in on portions of Montney/Doig rights held by the Company within the Cypress and Cameron areas of British Columbia. The initial conditions of both farm-out agreements have been satisfied. Both agreements contain rolling option provisions whereby additional lands can be earned through conducting additional activities on the farm-out lands.

Cameron lands

On the Cameron block, under the terms of an on-going farm-out agreement, two vertical wells drilled in 2009 targeting the Montney have been completed. One of the wells has been tied-in and is now production testing; the other is awaiting tie-in. In addition, three horizontal wells commenced drilling in the first quarter of 2010. Of these, two wells have been rig released and are waiting on completion, and the third well is currently drilling. All three of these wells are expected to be completed after spring breakup. Painted Pony will retain a 20% working interest in the wells after paying 20% of only the equipping and tie-in costs.

Cypress lands

Under the terms of this farm-out agreement, Painted Pony retained a 6% working interest in the initial horizontal well drilled primarily during the first quarter of 2009 targeting the Montney formations. The Company is obligated to pay 6% of the equipping and tie-in costs. This well was initially completed mid-year 2009 in the lower Montney. Early in the first quarter of 2010 it was re-completed in the upper Montney and Doig formations. This well is now on production. Painted Pony has farmed out 9,300 net acres for the Montney/Doig formations.

Review of Operations

Buckinghorse Shale Formation

The Buckinghorse shale formation is over-pressured, gas-charged, encountered between 400 and 1,200 meters in depth. Painted Pony holds over 70,000 net acres of land on the trend.

Late in 2008, Painted Pony participated in the experimental re-completion of two vertical wells in the Buckinghorse formation in the Blair area. Both wells were completed throughout the 800 meter thick interval and placed on production at modest rates. In the third quarter of 2010, Painted Pony is planning to air drill two wells targeting the Buckinghorse shale formation, each at a 50% working interest. Air drilling is expected to aid in establishing commercial flow rates from the formation.

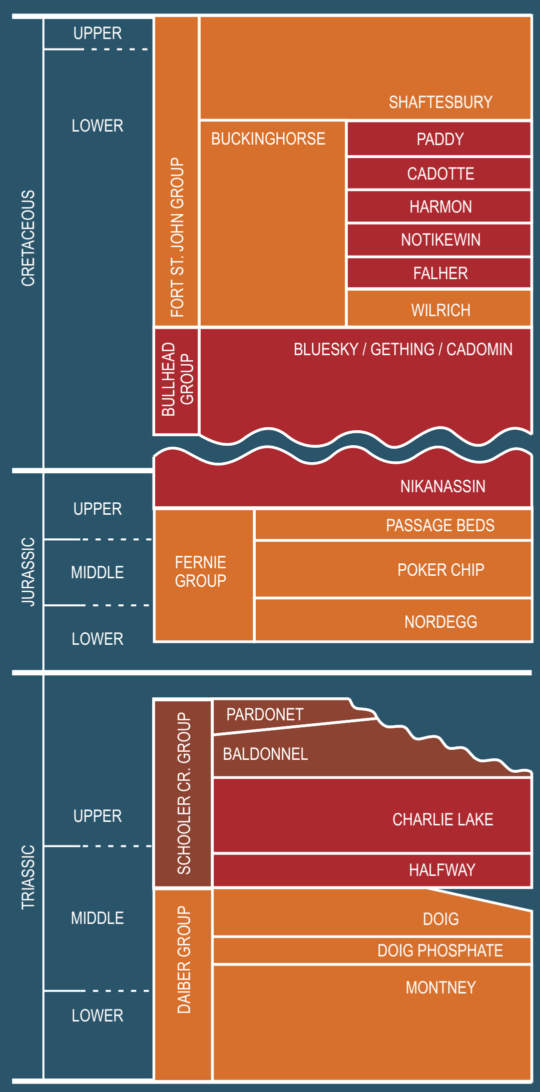
Conventional Gas Plays

Painted Pony's gas production in northeast British Columbia is primarily from the Bluesky/Gething zones in the Blair and Cameron areas. Wells in the Cypress area were shut-in mid-year 2009 due to low gas prices. Gas and NGL sales averaged 639 boe/d in 2009 and 550 boe/d in the fourth quarter of 2009.

In 2009, Painted Pony participated in the drilling of 1 (0.5 net) well targeting the Bluesky formation and re-completed one 100% Bluesky well in the Blair area. In the first quarter of 2010, the Company participated in drilling 2 (1.0 net) wells targeting the Bluesky and Cadomin zones. Both wells were completed successfully. One well has been tied-in and is producing and the other is expected to be tied in later this year.

Early in 2010, Painted Pony and its partners have been granted Good Engineering Practice ("GEP") downspacing for a portion of the Cameron area in order to further develop the Bluesky zone , allowing continued development drilling in 2010.

Northeast British Columbia Generalized Stratigraphy



Review of Operations

LAND HOLDINGS

Painted Pony focuses on identifying potentially prospective new areas where the Company can aggregate an acreage position on a cost effective basis. When Painted Pony commenced operations in May of 2007, the Company held no land, and had access to two large blocks of land in Saskatchewan through farm-in agreements. By the end of 2007, Painted Pony had 6,605 net acres of developed and undeveloped land in Saskatchewan. In 2008, the Company grew its net land position in Saskatchewan by earning land through executing on farm in arrangements, freehold leasing and participating in crown land sales. In March of 2008, Painted Pony acquired 89,600 net acres of developed and undeveloped land in northeast British Columbia in conjunction with a purchase of producing properties. By the end of 2008, Painted Pony had 147,877 net acres of developed and undeveloped lands, of which 54,010 net acres were in Saskatchewan and 93,867 net acres were in British Columbia.

With this solid land position in place, in 2009 Painted Pony focused on purchasing selective parcels complementary to existing company owned lands. By December 31, 2009, the Company had 104,066 net acres of developed and undeveloped lands in British Columbia, of which 80% were undeveloped and 60,145 net acres in Saskatchewan, 97% undeveloped. During 2008 and 2009, competition for land in both Saskatchewan and British Columbia from other larger industry competitors intensified, and in many areas prices escalated. The Company continues to proactively address expiries. A number of applications were made during 2009 to address continuation of lands in British Columbia; the Company expects these lands to be continued through execution of a work program.

As at December 31, 2009, Painted Pony's Land Property Report sets out the following:

Summary of Land *(acres)*

	Undeveloped		Developed		Total	
	Gross	Net	Gross	Net	Gross	Net
Saskatchewan						
Wapella	25,242	25,242	160	160	25,402	25,402
Weyburn	18,326	17,923	241	161	18,567	18,084
Midale	11,188	8,814	1,365	1,247	12,553	10,061
Kisbey	5,595	1,357	924	216	6,519	1,573
Other	6,432	4,924	200	101	6,632	5,025
	66,783	58,260	2,890	1,885	69,673	60,145
British Columbia						
Blair/Town	49,803	33,051	27,929	13,549	77,732	46,600
Cameron	61,595	31,428	4,433	2,190	66,028	33,618
Cypress	33,117	8,827	8,867	3,438	41,984	12,265
Other	12,516	9,564	5,444	2,019	17,960	11,583
	157,031	82,870	46,673	21,196	203,704	104,066
Total	223,814	141,130	49,563	23,081	273,377	164,211

As at December 31, 2009, in a report prepared by Seaton-Jordan & Associates Ltd. ("Seaton-Jordan"), the Company's undeveloped land in Saskatchewan and British Columbia was valued at $93.2 million. Seaton-Jordan's assessment of the Company's lands was prepared in accordance with National Instrument 51-101 - Standards of Disclosure for Oil and Gas Activities ("NI 51-101").

Reserves

The Reserves Sub Committee is comprised of independent board members appointed by the Board of Directors of Painted Pony. In accordance with its mandate, this committee has reviewed the reserves report (the "Sproule Report") dated effective December 31, 2009, which was prepared by Sproule Associates Limited ("Sproule") and dated March 11, 2010 using forecast prices and costs.The Sproule Report was prepared in accordance with National Instrument 51-101 ("NI 51-101"). This instrument adopted by the Canadian Securities Administrators, sets out standards of disclosure for oil and gas activities and mandates the application of evaluation standards defined in the Canadian Oil and Gas Evaluation Handbook (COGEH). The information that follows has been derived from the Sproule Report.

The estimates of reserves are subject to revisions as additional reservoir and performance information becomes available, and contains judgments of future events for which the actual results may vary materially. The reader is referred to the Company's Statement of Reserves Data and Other Oil and Gas Information Form, which it is anticipated will be filed before the end of April 2010 on the Company's website and on www.sedar.com. This Annual Report contains extracts of Painted Pony's reserves only.

At December 31, 2009 the Company's proved plus probable working interest reserves were 6,491.0 mboe (weighted 66% oil and natural gas liquids) compared to 4,360.2 mboe (weighted 52% oil and natural gas liquids) as at December 31, 2008. At December 31, 2009, Painted Pony's total proved working interest reserves were 3,944.1 mboe, an increase of 44% compared to 2,747.5 mboe at December 31, 2008.

Summary of Company Gross Oil and Gas Working Interest Reserves[(1),(2)]
Forecast Prices and Costs

	As at Dec 31, 2009				As at Dec 31, 2008
	Natural gas [(3)] *(mmcf)*	Light and medium oil *(mbbl)*	Natural gas liquids *(mbbl)*	Total *(mboe[(4)], 6:1)*	Total *(mboe[(4)], 6:1)*
Proved					
Developed producing	**6,695**	**1,435.4**	**161.6**	**2,712.8**	1,798.1
Developed non-producing	**348**	**3.2**	**2.8**	**64.0**	335.6
Undeveloped	**771**	**971.2**	**67.5**	**1,167.3**	613.8
Total proved	**7,814**	**2,409.9**	**231.8**	**3,944.1**	2,747.5
Probable	**5,524**	**1,478.0**	**148.3**	**2,546.9**	1,612.7
Total proved plus probable	**13,338**	**3,887.9**	**380.1**	**6,491.0**	4,360.2

(1) Company Gross, being Painted Pony's total working interest reserves before royalties owned by others.
(2) Numbers in this table are subject to rounding error.
(3) Includes non-associated, associated gas and solution gas.
(4) Natural gas is converted to barrels of oil equivalent ("boe") at a ratio of six thousand standard cubic feet to one barrel of oil.

"Gross" reserves (being working interest reserves, excluding royalty interest reserves, before deduction of royalty burdens payable) is disclosed. The reserve report was prepared utilizing definitions as set out under NI 51-101.

Reserves

NET PRESENT VALUE OF FUTURE NET REVENUE

The forecast prices used in the Sproule Report effective December 31, 2009 were Sproule's published Forecast Prices and Costs as at December 31, 2009. The estimated future net revenues are stated before deducting future estimated site restoration costs and reduced for estimated future well abandonment costs, the Saskatchewan Capital Tax and estimated capital for future development associated with the reserves.

In the reserve report, the net total future capital required to bring undeveloped proved plus probable reserves onto production is estimated to be $46,728,000, an increase of $24,533,000 from 2008, over the life of the reserves.

Summary of Net Present Values of Future Net Revenue (1),(2),(3),(4),(5)
Forecast Prices and Costs *($000s)*
Before Income Taxes

	As at Dec 31, 2009					As at Dec 31, 2008	
	0%	5%	10%	15%	20%	0%	10%
Proved							
Developed producing	**101,965**	**85,257**	**73,733**	**65,374**	**59,056**	59,234	38,389
Developed non-producing	**315**	**268**	**227**	**192**	**161**	9,081	5,176
Undeveloped	**38,659**	**29,750**	**23,465**	**18,837**	**15,311**	19,967	8,577
Total proved	**140,939**	**115,276**	**97,426**	**84,403**	**74,528**	88,282	52,142
Probable	**99,542**	**66,086**	**47,269**	**35,611**	**27,827**	66,041	25,912
Total proved plus probable	**240,481**	**181,361**	**144,695**	**120,014**	**102,356**	154,324	78,054

(1) Numbers in this table are subject to rounding error.
(2) Values are net of abandonment liabilities.
(3) The net present values of future net revenue do not represent fair market value.
(4) Sproule price deck dated December 31, 2009.
The estimated future net revenues are stated before deducting future estimated site restoration costs, and reduced for estimated future well abandonment costs, the Saskatchewan Capital Tax and estimated capital for future development associated with the reserves.

Summary of Pricing and Inflation Rate Assumptions
Forecast Prices and Costs
As at December 31, 2009

	WTI Cushing Oklahoma *($US/bbl)*	Edmonton Par price 40° API *($Cdn/bbl)*	Inflation rates *(%/year)*	Henry Hub price *($US/mmbtu)*	AECO-C Spot *($Cdn/mmbtu)*	Exchange rate *($US/$Cdn)*
2010	79.17	84.25	2.0	5.70	5.36	0.920
2011	84.46	89.99	2.0	6.48	6.21	0.920
2012	86.89	92.61	2.0	6.70	6.44	0.920
2013	90.20	96.19	2.0	7.43	7.23	0.920
2014	92.01	98.13	2.0	8.12	7.98	0.920
2015	93.85	100.11	2.0	8.28	8.16	0.920
2016	95.72	102.13	2.0	8.45	8.34	0.920
2017	97.64	104.19	2.0	8.62	8.52	0.920
2018	99.59	106.30	2.0	8.79	8.71	0.920
2019	101.58	108.44	2.0	8.96	8.90	0.920
2020	103.61	110.63	2.0	9.14	9.10	0.920
Thereafter	+2%/yr	+2%/yr	2.0	+2%/yr	+2%/yr	0.920

Reserves

RESERVE LIFE INDEX

The reserve life index is calculated by dividing reserves as at the effective date of the Sproule Report (December 31, 2009) by the production during the applicable period, and represents a measure of the amount of time production could be sustained at the production rates based on the reserves at the applicable point in time. Based upon the year-end reserve volumes and the average fourth quarter 2009 production rate for Painted Pony, sufficient reserves exist to continue production at the current rate for approximately nine years based on proved plus probable reserves, and over five years based on proved reserves.

Reserve Life

Years	Proved	Proved and probable
Natural gas	6.6	11.3
Crude oil and NGLs	3.2	5.2
Total boe	5.3	8.8

PRODUCTION REPLACEMENT RATIO

The production replacement ratio measures the number of times the fourth quarter's annualized production has been replaced by net reserve additions. Painted Pony's production replacement ratio reflects the Company's lower risk drilling operations undertaken in 2009 where capital resources were utilized to exploit some of the existing opportunity inventory, primarily in the Saskatchewan operations.

	2009	2008
Proved basis	**2.4 x**	6.5 x
Proved plus probable basis	**3.7 x**	9.5 x

Net present value of future net revenue does not represent fair market value of the reserves. There is no assurance that the forecast prices and cost assumptions will be attained and variances could be material.

Management's Discussion and Analysis

The following Management's Discussion and Analysis ("MD&A") of the consolidated financial results as provided by the management of Painted Pony Petroleum Ltd. ("Painted Pony" or the "Company") should be read in conjunction with the consolidated financial statements and related notes for the year ended December 31, 2009. This commentary is dated March 24, 2010. The financial data presented is in accordance with Canadian generally accepted accounting principles ("GAAP") in Canadian dollars, except where indicated otherwise. These documents, including the Annual Information Form, and additional information about Painted Pony are available on SEDAR at www.sedar.com.

DESCRIPTION OF COMPANY

Painted Pony is a Calgary-based exploration and development company focused on oil in southeast Saskatchewan and natural gas in northeast British Columbia. The Class A and Class B shares of Painted Pony trade on the TSX Venture Exchange under the symbols "PPY.A" and "PPY.B", respectively.

Painted Pony commenced commercial operations on April 3, 2007 upon completion of a financial reorganization as part of an overall restructuring of the Company. On May 23, 2007, subsequent to completion of an initial public offering on May 17, 2007, the Class A shares and Class B shares of Painted Pony Petroleum Ltd. began trading on the TSX Venture Exchange. Painted Pony then commenced an actively operated exploration program.

NON-GAAP MEASURES

Management's Discussion and Analysis contains the term "funds flow from operations", which should not be considered an alternative to, or more meaningful than cash flow from operating activities as determined in accordance with GAAP as an indicator of the Company's performance. Funds flow from operations and funds flow from operations per share (basic and diluted) do not have any standardized meaning prescribed by GAAP and may not be comparable with the calculation of similar measures for other entities. Management uses funds flow from operations to analyze operating performance and considers funds flow from operations to be a key measure as it demonstrates the Company's ability to generate the cash necessary to fund future capital investment and to repay debt. Funds flow from operations per share is calculated using the basic and diluted weighted average number of shares for the period, and after deemed conversion of Class B shares into Class A, consistent with the calculations of earnings per share. The Company reconciles funds flow from operations to cash flow from operating activities, which is the most directly comparable measure calculated in accordance with GAAP, as follows:

($000s)

Years ended December 31,	**2009**	**2008**
Cash flow from operating activities	**$ 12,460**	$ 13,599
Changes in non-cash working capital	**2,700**	(972)
Asset retirement expenditures	**50**	131
Funds flow from operations	**$ 15,210**	$ 12,758

Management's Discussion and Analysis also contains other industry benchmarks and terms, such as net working capital position (calculated as current assets less current liabilities) and operating netbacks (calculated on a per unit basis as oil, gas and natural gas liquids revenues less royalties, transportation, and operating costs), which are not recognized measures under GAAP. Management believes these measures are useful supplemental measures of, firstly, the total net position of current assets and current liabilities the Company has and, secondly, the profitability relative to commodity prices. Readers are cautioned, however, that these measures should not be construed as alternatives to other terms such as current and long-term debt or net income determined in accordance with GAAP as measures of performance. Painted Pony's method of calculating these measures may differ from other companies, and accordingly, may not be comparable to similar measures used by other companies.

Management's Discussion and Analysis

FORWARD-LOOKING INFORMATION

This MD&A contains forward-looking statements relating to future events. Forward-looking information is information that does not relate strictly to historical or current facts, and can be identified by words such as "anticipate", "continue", "estimate", "expect", "forecast", "may", "will", "project", "should", "believe", "intend", or similar expressions. These statements represent management's reasonable projections, expectations, and estimates as of the date of this document, but undue reliance should not be placed upon them as they are derived from numerous assumptions. These assumptions are subject to known and unknown risks and uncertainties, including the business risks discussed in the MD&A, which may cause actual performance and financial results to differ materially from any projections of future performance or results expressed or implied by such forward-looking statements.

The forward looking information in this document is subject to significant risks and uncertainties and is based on a number of material factors and assumptions which may prove to be incorrect; including but not limited to the following:

a) volumes in 2010 will be weighted approximately 30% towards gas sales, and success in the planned drilling targeting the Montney formation in British Columbia will add incremental volumes;

b) the average oil price in 2010 will be approximately 3% less than the Edmonton par reference price and the natural gas price received will be a premium to the AECO daily spot price;

c) overall royalties in 2010 will approximate 14% of total revenues;

d) expected economic benefits from the multi-well oil battery facility and water disposal facility in the Huntoon area include reducing production disruptions caused by adverse weather, cost-effective water handling and disposal, reducing trucking costs and eliminating the capital investment of oil storage tanks at each well location;

e) sales of solution gas and associated liquids from the Huntoon area are expected to occur during mid-year 2010;

f) per unit transportation costs in British Columbia are anticipated to decrease in the last two months of 2010 when a firm-service contract term expires;

g) oil operating costs will be reduced in future months as the benefits of the investments made in the various batteries and gathering systems begin to be realized;

h) net general and administrative costs per barrel of oil equivalent when compared to the average costs in 2009 will be higher during the first half of 2010 and less in the second half, reflecting the timing of costs associated with statutory annual shareholder and security reporting for year ending 2009 and expected production volume increases throughout 2010;

i) as gross oil sales increase in 2010, capital taxes are expected to correspondingly increase;

j) certain lands approaching expiry in British Columbia will be continued through execution of a work program, as a result of a number of continuation applications submitted in 2009;

k) the work programs forming the basis of continuation applications for lands in British Columbia will be completed;

l) the tax pools for which tax assets have been recorded will be utilized;

m) available credit facilities may be utilized on a periodic basis in 2010;

n) the risk of accounts receivables becoming uncollectible is mitigated by the financial position of the applicable entities; and

o) the Company has sufficient financial resources with which to conduct its capital program; further, this is subject to the additional assumption that the drilling rigs, field service providers, completion and tie in equipment will be available as required and that the costs of securing such services and equipment will not materially exceed expectations.

Management's Discussion and Analysis

While we anticipate that subsequent events and developments may cause our views to change, we do not have an intention to update this forward-looking information, except as required by applicable securities laws. This forward-looking information represents our views as of the date of this document and such information should not be relied upon as representing our views as of any date subsequent to the date of this document. We have attempted to identify important factors that could cause actual results, performance or achievements to vary from those current expectations or estimates expressed or implied by the forward-looking information. However, there may be other factors that cause results, performance or achievements not to be as expected or estimated and that could cause actual results, performance or achievements to differ materially from current expectations. Other risks and uncertainties include, but are not limited to, the following:

a) normal risks common to the oil and natural gas industry, including various operational risks in the carrying out of exploration, development and production operations;

b) risks and uncertainty of oil and gas geological deposits;

c) revisions, amendments or changes to capital expenditure plans including exploration, development and exploitation projects;

d) risks as to the availability and pricing of appropriate financing alternatives on acceptable terms;

e) potential changes in income tax regulations, governmental policies, rules, practices or approval process changes, or delays, or enhancements; and

f) the Company's ability to attract and retain qualified professional employees.

Statements relating to "reserves" or "resources" are by their nature deemed to be forward-looking statements, as they involve the implied assessment based on certain estimates and assumptions that the resources and reserves described can be profitably produced in the future.

The reader is further cautioned that the preparation of consolidated financial statements in accordance with GAAP requires management to make certain judgments and estimates that affect the reported amounts of assets, liabilities, revenues and expenses. Estimating reserves is also critical to several accounting estimates and requires judgments and decisions based upon available geological, geophysical, engineering and economic data. These estimates may change, having either a negative or positive effect on net earnings as further information becomes available, and as the economic environment changes.

There can be no assurance that forward-looking information will prove to be accurate, as results and future events could differ materially from those expected or estimated in such statements. Accordingly, readers should not place undue reliance on forward-looking information. From time to time, Painted Pony's management makes estimates and forms opinions on which the forward-looking statements are based. The Company assumes no obligation to update forward-looking statements if circumstances, management's estimates, or opinions change, unless prescribed by securities laws.

BOE PRESENTATION

Barrels of oil equivalent ("boe") may be misleading, particularly if used in isolation. A boe conversion ratio of six thousand cubic feet of gas ("mcf") to one barrel of oil ("bbl") (6 mcf: 1 bbl) is used as an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. All boe conversions in this report are derived by converting natural gas to oil in the ratio of six mcf of gas to one barrel of oil. Readers should be aware that historical results are not necessarily indicative of future performance.

Management's Discussion and Analysis

NET EARNINGS AND FUNDS FLOW FROM OPERATIONS

Painted Pony generated funds flow from operations of $15.2 million for the year ended December 31, 2009, compared to $12.8 million for the year ended December 31, 2008. On a basic and diluted per share basis, funds flow from operations for 2009 was $0.44 compared to $0.38 in 2008.

Cash flow from operating activities was $12.5 million for the year ended December 31, 2009, compared to $13.6 million for 2008.

Painted Pony incurred a net loss of $3.7 million in the year ended December 31, 2009, compared to net earnings of $5.5 million for the year ended December 31, 2008. Non-cash stock-based compensation expenses for 2009 totaled $3.5 million, of which $1.1 million was for share options surrendered for cancellation in the third quarter of 2009. In 2008, the Company recorded a $5.5 million future income tax reduction, primarily from the income tax effect of recognizing an offsetting, previously recorded liability for flow-through shares issued. In 2009, the Company recorded a future income tax reduction of $1.4 million to recognize the future income tax assets that are expected to be utilized. The 2009 net loss was $0.10 per basic and diluted share compared to net earnings of $0.16 per basic and diluted share in 2008.

SALES VOLUMES

During the year ended December 31, 2009, Painted Pony's sales volumes averaged 1,552 boe per day compared to 761 boe per day for 2008, an increase of 104%. All of Painted Pony's light oil sales originate from the Saskatchewan operations while sales of gas, condensate, and NGL's are primarily from the northeast British Columbia assets. Increased oil sales were from the Company's drilling program and third quarter asset acquisitions. Sales volumes in 2009 were weighted 58% towards oil, reflecting the focus of the year's capital program towards oil, as compared to the 51% oil weighting in 2008.

Average Daily Sales Volumes

Years ended December 31,	2009	2008
Oil *(bbls/d)*	**893**	386
Condensate *(bbls/d)*	**24**	12
NGL's *(bbls/d)*	**17**	5
Gas *(mcf/d)*	**3,712**	2,149
Total *(boe/d)*	**1,552**	761

Daily oil sales volumes in 2009 increased 131% compared to 2008. Crude oil sales for the year 2009 were from 65 (40.6 net) wells in the Midale, Kisbey, Weyburn and Alameda areas, compared to 45 (18.4 net) wells during 2008.

Natural gas daily sales volumes increased by 73% in 2009 compared to 2008, as the first quarter 2009 drilling and re-completion program was partially offset by the Company voluntary shutting in lower netback gas wells in the Cypress area mid-year. Furthermore, 2008 sales volumes are representative of only three quarters of a year, from the date of the British Columbia asset acquisition. Gas, condensate and liquids sales during the year ended December 31, 2009 were primarily from 30 (14.1 net) wells in the Blair, Cypress and Cameron areas, compared to sales from 26 (12.3 net) wells during 2008. Minor quantities of gas and NGL products were produced in 2009 in Saskatchewan, as gas conservation began in the first quarter from the Kisbey area and in the third quarter from the Weyburn area.

The Company anticipates sales volumes in 2010 to be weighted approximately 30% towards gas sales, although success in the planned drilling targeting the Montney formation in British Columbia would add incremental volumes.*

**This paragraph contains forward-looking information. Please refer to "Forward-looking Information" and "Business Risks, Uncertainties and Forward-looking Information" for a discussion of the risks and uncertainties related to such information.*

Management's Discussion and Analysis

REVENUES

Petroleum and natural gas sales increased 40% to $28.9 million in the year ending December 31, 2009, compared to $20.6 million for 2008. In 2009, oil sales revenues were 78% of total sales dollars compared to 65% in 2008, while oil volumes were 58% and 51% in 2009 and 2008, respectively. In both years, oil sales have contributed disproportionately more to total sales dollars compared to volumes reflecting the relative strength of crude oil prices to gas prices.

Sales by Product *($000s)*

Years ended December 31,	2009	2008
Oil	**$ 22,534**	$ 13,356
Gas	**5,688**	6,757
Condensate	**517**	425
NGL and sulphur	**156**	97
Total	**$ 28,895**	$ 20,635

Crude oil revenue in 2009 was $22.5 million compared to $13.4 million during 2008. Oil revenues increased 69% year over year. Daily oil production volumes for 2009 increased by 131% over 2008, while the Company's average 2009 oil price was only 73% of the average 2008 oil price. Commodity prices weakened considerably during 2009 over the prior year; oil prices averaged $69.15 per bbl during 2009 compared to $94.50 per bbl in 2008. Painted Pony received an average crude oil price approximately the same as the Edmonton light oil reference price throughout 2009. Painted Pony's light oil is a premium light crude with low sulphur content.

Revenue from gas, condensate, NGL and sulphur sales totaled $6.4 million during 2009, compared to $7.3 million received during 2008. The Company received an average gas price of $4.20 per mcf in the year ended December 31, 2009, a premium to the AECO daily spot average gas reference price of $3.99 per mcf. In 2008, the Company received an average gas price of $8.59 per mcf.

To date, Painted Pony has not undertaken any risk management contracts or commodity price contracts.

While the Company historically tended to receive an average oil price which slightly exceeded or approximated the Edmonton par reference price, expectations for 2010 are for an average oil price approximately 3% less than the reference price reflecting the prices currently paid for crude where the Company tends to deliver the bulk of the oil in Saskatchewan. The Company continues monthly to expect to receive a natural gas price at a premium to the AECO daily spot price. The average prices reported for Painted Pony's sales is the weighted net price, which is reflective of month to month price and sales volume changes.*

**This paragraph contains forward-looking information. Please refer to "Forward-looking Information" and "Business Risks, Uncertainties and Forward-looking Information" for a discussion of the risks and uncertainties related to such information.*

Average Benchmark Prices

Years ended December 31,	2009	2008
Exchange rate *(US$/Cdn$)*	**0.881**	0.943
Oil - WTI *(US$/bbl)*	**62.09**	99.59
- Edmonton par - light oil *($/bbl)*	**66.46**	102.85
Gas - AECO, daily spot *($/mcf)*	**3.99**	8.15

Management's Discussion and Analysis

Painted Pony's Realized Prices

Years ended December 31,	2009	2008
Oil *($/bbl)*	**69.15**	94.50
Gas *($/mcf)*	**4.20**	8.59
Condensate *($/bbl)*	**58.84**	101.37
NGL *($/bbl)*	**24.22**	44.06

ROYALTIES

Royalties for the year ended December 31, 2009 are lower on a percentage of sales and on a per boe basis in comparison to 2008 due to lower commodity prices and prior period royalty amendments and adjustments proposed by the government. In 2009, total royalties were $3.4 million, or approximately 11.9% of total revenue. For the year ended December 31, 2008, total royalties were $3.3 million, or approximately 16.0% of revenue. In 2009, oil royalties averaged 14.1% of sales, while gas and associated product royalties averaged 4.2%. In 2010, the Company anticipates overall royalty rates to continue at similar levels.*

**This paragraph contains forward-looking information. Please refer to "Forward-looking Information" and "Business Risks, Uncertainties and Forward-looking Information" for a discussion of the risks and uncertainties related to such information.*

Painted Pony's producing properties in British Columbia are on crown lands, and in Saskatchewan are primarily on freehold lands. Crown royalties during the year ended December 31, 2009 were primarily from the sales of crude oil, although royalties for both commodities were reduced by various credits in the first half of the year. Freehold royalties were from the sale of oil, gas, and liquids in Saskatchewan. Gross overriding royalties were mainly from oil sales on lands earned through farm-ins.

Royalties as a % of Revenue

Years ended December 31,	2009	2008
Crown	**1.6**	5.2
Freehold	**7.3**	7.5
GOR	**3.0**	3.3
	11.9	16.0

Royalties by Type *($000s)*

Years ended December 31,	2009	2008
Crown	**$ 459**	$ 1,077
Freehold	**2,125**	1,550
GOR	**857**	671
	$ 3,441	$ 3,298
Per boe *(6 mcf:1 bbl)*	**$ 6.07**	$ 11.84

TRANSPORTATION COSTS

Transportation costs for the year ended December 31, 2009 were $3.0 million, compared to $1.9 million for the year ended December 31, 2008.

Management's Discussion and Analysis

***Transportation by Commodity** ($000s)*

Years ended December 31,	2009	2008
Light oil	**$ 613**	$ 486
Gas and associated liquids	**2,402**	1,387
Net	**$ 3,015**	$ 1,873

In Saskatchewan, in 2009 and 2008, transportation costs were 2.7% and 3.6%, respectively, of gross oil revenues. These charges reflect the cost to truck oil to various sales points, including related costs of addressing occasional capacity issues. During the third quarter of 2009, per unit transportation costs began to decline as savings from the newly installed gathering systems and facilities began to be realized.

In the first quarter of 2009, additional wells were added to the Kisbey area gathering system. In the summer of 2009, construction of a multi-well oil battery and gathering system in the Midale area was completed and placed on-stream and a multi-well oil battery complete with a gas conservation facility was placed on-stream in the Weyburn area. In the latter half of 2009, construction commenced on a multi-well oil battery facility and water disposal facility in the Huntoon area that was placed on-stream in the first quarter of 2010. The Company continues the installation of electricity to numerous wells previously powered by gas engines. Expected economic benefits include reducing production disruptions caused by adverse weather, cost-effective water handling and disposal, reduced trucking costs and eliminating the capital investment of oil storage tanks at each well location. Solution gas and liquids conservation facilities are currently under construction in this area. Sales of solution gas and associated liquids are expected to occur by mid-year 2010.*

**This paragraph contains forward-looking information. Please refer to "Forward-looking Information" and "Business Risks, Uncertainties and Forward-looking Information" for a discussion of the risks and uncertainties related to such information.*

In British Columbia, gas gathering, processing and transmission services are generally provided by mid-stream processing companies. These services allow the Company to avoid allocating capital resources for facilities, on a firm-service or interruptible basis. The all-in charges for these services are included in transportation costs. The Company is committed to a firm-service contract for the processing costs associated with the physical delivery of five mmcf per day of natural gas to the end of October 2010. The cost for transporting the gas and field products primarily from the British Columbia properties, averaged $9.98 per boe in the year ended December 31, 2009 and $10.11 per boe during 2008, including costs for excess capacity under the firm service contract. In 2010, with the firm-service contract ending, the Company expects the per unit transportation costs to decrease in the last two months of the year.*

**This paragraph contains forward-looking information. Please refer to "Forward-looking Information" and "Business Risks, Uncertainties and Forward-looking Information" for a discussion of the risks and uncertainties related to such information.*

OPERATING COSTS

Operating costs for the year ended December 31, 2009 were $4.9 million or $8.72 per boe. This compares to $2.5 million or $9.08 per boe for 2008.

***Operating Costs** ($000s, except per unit)*

Years ended December 31,	2009	2008
Oil	**$ 3,270**	$ 1,294
Gas and associated liquids	**1,669**	1,236
Production expenses	**$ 4,939**	$ 2,530
Oil *($/bbl)*	**$ 10.04**	$ 9.15
Gas and associated liquids *($/boe)*	**6.93**	9.01
Operating cost *($/boe)*	**$ 8.72**	$ 9.08

Management's Discussion and Analysis

While overall per unit operating costs decreased in 2009 compared to 2008, the increased per unit oil production costs were more than offset by the reduced gas and liquids charges.

For the Company's oil producing properties, operating costs are primarily salt water disposal and hauling fees, equipment rentals for gas engines to run the pump jacks if not electrified, fuel and power expenditures, and contract operator fees. Throughout 2009, Painted Pony frequently rented rig mats to allow access to well sites experiencing wet road conditions, helping minimize production disruptions. The rig mat rentals made up approximately $0.70 per bbl of oil operating costs during the year. The Company anticipates reduced oil operating costs in future months as the benefits of the investments made in the various batteries and gathering systems begin to be realized and costs such as renting rig mats are not incurred.*

**This paragraph contains forward-looking information. Please refer to "Forward-looking Information" and "Business Risks, Uncertainties and Forward-looking Information" for a discussion of the risks and uncertainties related to such information.*

Operating costs for gas and associated liquids properties are mainly compression fees, contract operating fees, salt water hauling and disposal costs, equipment rentals, glycol and methanol costs, and routine repairs and maintenance expenditures on more mature properties. Per unit gas operating costs were lower in 2009 compared to 2008, primarily due to higher production volumes, credits from a multi-period re-negotiated compression fee and the impact of voluntarily shutting in some high-operating cost wells.

OPERATING NETBACKS

For the year ended December 31, 2009, field operating netbacks averaged $30.89 per boe, compared to field operating netbacks of $46.45 per boe during the year ended December 31, 2008.

Combined Field Operating Netback ($/boe)

Years ended December 31,	2009	2008
Sales	**$ 51.00**	$ 74.10
Transportation	**(5.32)**	(6.73)
Royalties	**(6.07)**	(11.84)
Operating costs	**(8.72)**	(9.08)
Field operating netback	**$ 30.89**	$ 46.45

Netbacks by Commodity

Years ended December 31,	2009	2008
Crude oil *($/bbl)*	**$ 47.49**	$ 65.89
Gas and associated products *($/boe)*	**$ 8.41**	$ 26.41

During 2009, Painted Pony's per unit netback for crude oil was 69% of the gross sales price, compared to 32% for gas and related products, or 61% overall.

Netbacks from crude oil production in Saskatchewan were $47.49 per bbl for the year ended December 31, 2009, compared to $65.89 per bbl in 2008. The decreased netback for crude oil during 2009, primarily due to prices being 73% of the 2008 price, was somewhat offset by lower royalties and transportation costs.

The Company monitors netbacks for gas inclusive of associated products. Approximately 75% of associated liquids volumes are from British Columbia properties, which primarily produce gas. Gas and associated product netbacks averaged $8.41 per boe in 2009, compared to $26.41 per boe in 2008. The Company had no gas or associated product sales in the first quarter of 2008. In comparison to the prior year, gas and associated product netbacks in 2009 have decreased primarily as a result of lower commodity prices, somewhat offset by lower transportation costs and lower royalties resulting from several prior period royalty amendments.

Management's Discussion and Analysis

GENERAL AND ADMINISTRATIVE

Net general and administrative expenses during the year ended December 31, 2009 were $2.0 million, compared to $1.0 million in 2008, or $3.60 per boe and $3.76 per boe, respectively.

General and Administrative Costs *($000s, except per boe)*

Years ended December 31,	2009	2008
Gross costs	**$ 3,578**	$ 2,534
Capitalized	**(954)**	(626)
Recoveries	**(582)**	(861)
Net costs	**$ 2,042**	$ 1,047
Net G&A, per boe	**$ 3.60**	$ 3.76

Gross general and administrative costs in 2009 were 41% greater than in 2008. Expanded operations required incremental personnel and their direct and indirect charges such as rent and office overhead costs and associated fees for professional services, computer maintenance and software. At year end 2009, the Company had sixteen full time personnel compared to thirteen people in the end of 2008, plus part time consultants in both years.

The Company's policy of allocating and capitalizing costs associated with new capital projects was unchanged in 2009 compared to 2008. During 2009, the Company allocated $0.6 million of administrative costs to capital projects and operating costs, compared to $0.9 million during 2008. The portion allocated to capital projects was in accordance with common industry practice whereby an operator calculates and allocates overhead to each working interest partner in proportion to their ownership interest, based on 100% of the capital expenditures. Reduced cost allocations in 2009 reflect the reduced operated capital expenditure levels, compared to the prior year. General and administrative costs capitalized in the year ended December 31, 2009, was $1.0 million, compared to $0.6 million during 2008, directly reflecting increased exploration staff.

In 2010, net general and administrative costs per boe compared to the average 2009 cost are expected to be higher in the first half then less in the second half of 2010, reflecting the timing of shareholder-reporting related costs and expected production volume increases.*

**This paragraph contains forward-looking information. Please refer to "Forward-looking Information" and "Business Risks, Uncertainties and Forward-looking Information" for a discussion of the risks and uncertainties related to such information.*

CAPITAL AND OTHER TAXES

Capital and other taxes for 2009 were $0.4 million, compared to $0.3 million incurred during 2008. Saskatchewan capital taxes were $0.4 million and $0.2 million, respectively, for 2009 and 2008. The Part XII.6 tax of $0.1 million in 2008 was pursuant to expenditures incurred and tax pools renounced for shares issued on a "look-back" basis. The Company satisfied its flow-through obligations in 2008 and thus, has no Part XII.6 tax expense in 2009. As the gross oil sales increase in 2010, capital taxes are expected to correspondingly increase.*

**This paragraph contains forward-looking information. Please refer to "Forward-looking Information" and "Business Risks, Uncertainties and Forward-looking Information" for a discussion of the risks and uncertainties related to such information.*

Capital and Other Taxes *($000s)*

Years ended December 31,	2009	2008
Capital tax	**$ 382**	$ 227
Part XII.6 tax	**-**	105
	$ 382	$ 332

Management's Discussion and Analysis

INTEREST AND OTHER INCOME

Painted Pony invests cash in short-term term deposits and interest-bearing deposit accounts, generating interest income. Reduced interest income in 2009 reflects the significantly lower interest rates compared to 2008.

Other income was primarily from processing, salt water disposal fees and rentals of tubular pipe for Company-operated fracs. In 2009, the increased Company working interest in operated capital expenditures has resulted in minimal related tubular pipe rentals to partners.

Interest and Other Income *($000s)*

Years ended December 31,	2009	2008
Interest income	**$ 72**	$ 834
Other income	**62**	369
	$ 134	$ 1,203

DEPLETION, DEPRECIATION AND ACCRETION

Depletion, depreciation and accretion expense in 2009 totaled $16.7 million and $8.3 million in 2008. On a per boe basis, the charge remained essentially unchanged. In 2009, Painted Pony excluded $16.4 million (2008: $11.6 million) of undeveloped land and $0.8 million (2008: $nil) of seismic costs from the depletion calculation.

Depletion, Depreciation and Accretion Costs *($000s, except per boe)*

Years ended December 31,	2009	2008
Depletion	**$ 16,506**	$ 8,123
Depreciation	**38**	29
Accretion	**165**	113
Total	**$ 16,709**	$ 8,265
Per boe	**$ 29.49**	$ 29.68

Depletion rates reflect the all-in combined effect of land purchases, the asset acquisitions, investments in facilities and gathering system plus drilling operations. Depreciation expense was recognized for office equipment, computer hardware and software, and office furniture being depreciated on a 20% per annum declining balance basis. Increased accretion costs reflect the higher future retirement liabilities expected to be incurred from the incremental wells added through drilling activities and property acquisitions.

STOCK-BASED COMPENSATION

Stock-based compensation costs were $4.5 million in 2009 and $6.1 million in 2008. The Company capitalized $0.9 million during the year ended December 31, 2009 and $1.6 million during 2008. The remainder of $3.5 million for 2009 and $4.5 million for 2008 was expensed. The stock-based compensation expense is a non-cash calculation, utilizing the Black-Scholes model, of the estimated cost associated with options granted to purchase Class A shares. This expense may not represent actual cash compensation realized by the recipients of the options upon the eventual exercise and disposition of these options.

Management's Discussion and Analysis

In 2009, 1,389,000 options at a weighted average price of $6.15 per share were surrendered by various employees, consultants, officers and directors, and subsequently cancelled. The exercise prices associated with those options were significantly in excess of the trading price of the shares at that time. The decision to surrender the options was entirely voluntarily and no agreements or commitments were made to holders with respect to new options. In accordance with GAAP, all of the unamortized stock-based compensation relating to the options held by employees and directors that would have been recorded over the remaining vesting period was recorded in the period of cancellation. The effect of this cancellation required the recognition of $1.1 million of additional expense in 2009.

CAPITAL EXPENDITURES

In 2009, Painted Pony carried out an active drilling program with the drilling of 20 (17.0 net) wells. The Company participated in the drilling of 19 (16.5 net) horizontal Bakken oil wells in the Huntoon, Midale, Kisbey, and Weyburn areas of Saskatchewan and 1 (0.5 net) conventional Bluesky gas well in the Cameron area of British Columbia, at an overall net success rate of 98%. Non-acquisition exploration and development capital expenditures totaled $40.5 million in 2009 compared to $47.5 million in 2008.

During the third quarter of 2009, the Company completed four separate acquisitions of primarily Bakken producing properties and undeveloped land, primarily in the Company's core Midale/Huntoon area of Saskatchewan, for estimated total cost of $13.6 million, including closing costs and adjustments. In the first quarter of 2008, Painted Pony closed an acquisition of natural gas properties in British Columbia for a total cost of $21.1 million, including closing costs and adjustments.

Capital Expenditures *($000s)*

Years ended December 31,	2009	2008[1]
Lease acquisitions and retention	**$ 6,349**	$ 8,076
Seismic	**804**	353
Drilling and completions	**23,943**	33,067
Facilities and equipment	**9,411**	5,955
Exploration and development	**40,507**	47,451
Property acquisitions	**13,588**	21,091
Abandonment expenditures	**50**	131
	54,145	68,673
Head office expenditures	**56**	138
	54,201	68,811
Stock-based compensation costs including tax effect	**1,294**	2,343
Asset retirement costs	**508**	1,560
Total expenditures	**$ 56,003**	$ 72,714

(1) For comparative purposes, 2008 data has been summarized to correspond to 2009 data.

Late in 2008, Painted Pony entered into two farm-out agreements with a senior oil and gas exploration and production company for portions of the Company's Montney rights within the Cypress and Cameron areas of British Columbia.

On the Cypress lands, under the terms of the farm-out agreement, Painted Pony retained a 6% working interest in the initial horizontal well drilled primarily during the first quarter of 2009 targeting the Montney formation, and may elect to pay 6% of the equipping and tie-in costs. This well was initially completed mid-year 2009 and early in the first quarter of 2010 was re-completed in up-hole Montney and Doig formations. This well has flowed gas and is anticipated to be placed on production after break-up. The farmee has an option to elect to drill additional wells under the rolling option provisions of the farm-out agreement.

Management's Discussion and Analysis

Under the terms of the Cameron farm-out agreement, two vertical wells which were drilled in the first quarter of 2010 targeting the Montney, have been completed. One of the wells has been tied-in and is now production testing; the other is awaiting tie-in. In addition, three horizontal wells commenced drilling in the first quarter of 2010, targeting the Montney formation. Painted Pony will retain a 20% working interest in the wells after electing to pay 20% of the equipping and tie-in costs.

The Company built its land position through farm-in agreements, freehold leasing, and acquisitions. At December 31, 2009, the Company owned 60,145 net acres of land (97% undeveloped) in Saskatchewan and 104,066 net acres of land (80% undeveloped) in British Columbia. Applications were made during 2009 to address continuation of land in British Columbia, and the Company expects these lands to be continued through execution of a work program.*

*****This paragraph contains forward-looking information. Please refer to "Forward-looking Information" and "Business Risks, Uncertainties and Forward-looking Information" for a discussion of the risks and uncertainties related to such information.*

CEILING TEST

The Company calculates a ceiling test annually whereby the carrying amount of petroleum and natural gas properties is compared to estimated future cash flows from the production of proved reserves. In 2009, the ceiling test was performed in accordance with the requirements of the CICA AcG-16 "Oil and Gas Accounting - Full Cost".

The Company performed a ceiling test calculation at December 31, 2009, resulting in undiscounted future cash flows from proved reserves and unproved properties exceeding the carrying amount of oil and gas assets. Consequently, no impairment in oil and gas assets was identified.

At December 31, 2009, the Company calculated the ceiling test using weighted Canadian-dollar average prices of $96.06 per bbl for light gravity crude oil, $7.15 per mcf for natural gas, $93.40 per bbl for condensate, and $58.83 per bbl for NGL's.

CAPITAL RESOURCES

At December 31, 2009, Painted Pony had a $33 million demand revolving credit facility and a $7 million demand non-revolving acquisition/development facility with a Canadian chartered bank.

Interest is payable at a floating rate, determined as the lender's prime rate, plus between 0.25% and 2.5%, depending on the Company's debt to cash flow ratio, as defined by the lender, on the demand revolving facility and at the lender's prime rate plus between 0.75% and 3.0%, depending on the floating rate, on the demand non-revolving facility. A standby fee is charged on one quarter of one percent (0.25%) to one half of one percent (0.50%) on the undrawn portion of the credit facilities, depending on the Company's cash flow ratio, as defined by the lender. Security is provided by a first fixed and floating charge debenture of $100 million on all of the Company's assets. Painted Pony has provided a negative pledge and undertaking to provide fixed charges over major petroleum and natural gas reserves in certain circumstances.

The availability under the demand revolving credit facilities is subject to an interim review on or before March 31, 2010. At March 24, 2010, Painted Pony has no debt under either credit facility. To date, the Company has not drawn on either facility. There can be no assurance that the amount of the available demand credit facilities will not be decreased.

On November 17, 2009, the Company completed a bought deal financing of 8,800,000 Class A Shares at a price of $5.88 per share for total gross proceeds of $51.7 million.

On June 30, 2009, the Company completed a bought deal financing of 7,000,000 Class A Shares at a price of $2.85 per share for total gross proceeds of $20 million.

Management's Discussion and Analysis

LIQUIDITY

As at December 31, 2009, Painted Pony had current assets of $52.1 million and current liabilities of $11.4 million, resulting in a net working capital position of $40.7 million. Available cash has been, and is currently, on deposit in a major Canadian financial institution or invested in term deposits. Management has received confirmation from the financial institution that these funds are available on demand.

Management anticipates that the Company will continue to have adequate liquidity to fund future working capital requirements and capital expenditures through a combination of cash flows, the availability of credit facilities and investment capital. As a result of the global economic slowdown, there exists uncertainty in the commodity, credit and capital markets, which the Company continues to monitor in conjunction with its financing alternatives. The capital program will be reviewed, and adjusted if believed necessary based on commodity prices, perceived credit and investment capital availability and share price levels to support the Company's objectives of maintaining a net debt to funds flow from operations ratio of one times or less.*

**This paragraph contains forward-looking information. Please refer to "Forward-looking Information" and "Business Risks, Uncertainties and Forward-looking Information" for a discussion of the risks and uncertainties related to such information.*

Painted Pony has two bank credit facilities totaling $40.0 million, on which no balance was owed at either December 31, 2009 or currently. In 2010, the Company may utilize available credit facilities on a periodic basis.*

**This paragraph contains forward-looking information. Please refer to "Forward-looking Information" and "Business Risks, Uncertainties and Forward-looking Information" for a discussion of the risks and uncertainties related to such information.*

COMMITMENTS

At December 31, 2009, the Company is committed to the processing costs associated with the physical delivery of five mmcf per day of natural gas until October 31, 2010. The estimated remaining cost of the commitment is $0.6 million.

At December 31, 2009, the Company is further committed to minimum tolls for transportation of oil through a major carrier system beginning in 2010 and ending in 2014. The total minimum cost of the commitment is estimated to be $2.3 million.

At December 31, 2009, the Company was committed to future payments totaling $1.3 million for office space rental and a proportionate share of operating costs through 2013.

SHARE CAPITAL

In 2008 and 2009, the Company has issued the following shares:

- *On March 31, 2008, the Company issued 4,110,000 Class A shares at a deemed price of $4.33 per share as partial consideration for the acquisition of gas properties located in northeast British Columbia.*
- *On April 30, 2008, the Company completed a bought deal private placement of 8,800,000 Class A shares at a price of $4.35 per share for total gross proceeds of $38 million.*
- *On June 30, 2009, the Company completed a bought deal financing of 7,000,000 Class A shares at a price of $2.85 per share for total gross proceeds of $20 million.*
- *On November 17, 2009, the Company completed a bought deal financing of 8,800,000 Class A shares at a price of $5.88 per share for total gross proceeds of $51.7 million.*

Management's Discussion and Analysis

As at December 31, 2009, 44,081,700 Class A shares and 1,173,600 Class B shares were issued and outstanding. As at March 24, 2010, 44,136,700 Class A shares and 1,173,600 Class B shares were issued and outstanding.

The Company is authorized to issue an unlimited number of Preferred Shares, issuable in series. As at December 31, 2009 and March 24, 2010, no Preferred Shares were outstanding.

The Company has a Stock Option Plan (the "Plan") whereby options to purchase Class A Shares may be granted by the Board of Directors to directors, officers, and employees of, and consultants to, the Company. The Plan has reserved for issuance a number of Class A Shares equal to ten percent of the aggregate number of Class A Shares and Class B Shares issued and outstanding from time to time. In 2009, a total of 1,448,000 options were cancelled or forfeited, 59,000 options were exercised and an additional 1,422,000 options were granted. The options are exercisable over a five year period at a weighted-average price of $3.53 per share with generally one-third vesting immediately, one-third vesting one year from the date of grant, and one-third vesting two years from the date of grant. As at December 31, 2009, 2,755,000 options were issued and outstanding.

As at March 24, 2010, 3,389,000 options were issued and outstanding at an average exercise price of $4.00.

INCOME TAXES

The Company recognized a future tax asset of $0.9 million in the fourth quarter of 2008 for a portion of the estimated future value of its tax pools. In the fourth quarter of 2009, the Company recognized an additional future tax asset, bringing the total asset to $3.1 million, as the Company believes that it met and continues to meet the criteria of these pools being utilized as being more likely than not.*

**This paragraph contains forward-looking information. Please refer to "Forward-looking Information" and "Business Risks, Uncertainties and Forward-looking Information" for a discussion of the risks and uncertainties related to such information.*

In the first quarter of 2008, the Company recognized in the consolidated financial statements the tax effect of tax benefits renounced to subscribers pursuant to shares issued on a flow-through basis in 2007. The future income tax reduction of $5.5 million relates primarily to the recognition of the income tax effect of the $12.0 million renounced in February 2008 pursuant to the May 2007 flow-through share issuance.

SUBSEQUENT EVENTS

On January 5, 2010, the Company issued 689,000 options to purchase Class A shares at a price of $5.88 per share. One-third of the options vested immediately, and the remainder vest one-third, one year after date of grant and one-third, two years after date of grant. The options expire five years from grant date.

DIVIDENDS

The Company has not declared or paid any dividends. Any decision to pay dividends on any of its shares will be made by the Board of Directors on the basis of earnings, financial requirements and other conditions existing at such future time.

FOURTH QUARTER PERFORMANCE AND COMPARISON TO PRIOR GUIDANCE

Readers are reminded that forward looking information in this document is subject to significant risks and uncertainties and is based on a number of material factors and assumptions which may prove to be incorrect. A comparison of fourth quarter 2009 performance and a comparison to previously announced guidance by the Company follows.

Management's Discussion and Analysis

NET EARNINGS AND FUNDS FLOW FROM OPERATIONS

Funds flow from operations during the fourth quarter of 2009 was $7.0 million, an increase of 141% over the comparable quarter in 2008 when funds flow from operations was $2.9 million.

In the fourth quarter of 2009, cash flow from operating activities was $6.2 million, compared to 2008 fourth quarter cash flow of $3.6 million. The Company reconciles funds flow from operations to cash flow from operating activities, which is the most directly comparable measure calculated in accordance with GAAP, as follows:

($000s)

Three months ended December 31,	2009	2008
Cash flow from operating activities	**$ 6,157**	$ 3,579
Changes in non-cash working capital	**823**	(818)
Asset retirement expenditures	**1**	131
Funds flow from operations	**$ 6,981**	$ 2,892

In the last quarter of 2009, the Company recorded net earnings of $2.0 million, the combination of the incremental oil production volumes and recognition of an additional future income tax asset, compared to fourth quarter 2008 net earnings of $0.3 million.

SALES VOLUMES

Sales volumes for the three months ended December 31, 2009 averaged 2,006 boe per day, weighted 71% light oil and 29% natural gas and associated products. In comparison, in the fourth quarter of 2008, Painted Pony's sales averaged 1,173 boe per day, weighted 53% light oil and 47% natural gas and associated products. The 2009 drilling program focused on Bakken oil and the third quarter property acquisitions contributed to this increase in sales volumes.

Average Daily Sales Volumes

Three months ended December 31,	2009	2008
Oil *(bbls/d)*	**1,427**	620
Condensate *(bbls/d)*	**23**	17
NGL's *(bbls/d)*	**21**	5
Gas *(mcf/d)*	**3,211**	3,188
Total *(boe/d)*	**2,006**	1,173

The Company guided that it expected oil sales in the last quarter of 2009 to increase compared to the prior quarter, as the fourth quarter drilling program targeting Bakken oil was placed on production. Oil sales in the fourth quarter of 2009 averaged 1,427 bbls per day, an increase of 42% compared to the third quarter 2009 average oil sales of 1,008 bbls per day.

As guided by the Company, seasonal weather did cause some production disruptions in 2009. In the first week of October 2009, the Company experienced a temporary reduction of approximately a quarter of the daily oil sales volumes due to excessively wet surface conditions.

The Company guided that it expected oil sales to average approximately 70% of total average sales volumes in the fourth quarter of 2009. With actual sales in the fourth quarter at 2,006 boe per day, oil sales represented 71% of total volumes in the period.

Management's Discussion and Analysis

REALIZED PRICES

For the three months ending December 31, 2009, Painted Pony received an average crude oil price of $75.63 per bbl, 26% higher than the average price of $60.01 per bbl received during the comparable 2008 period. The Edmonton par reference price for light oil during the fourth quarter of 2009 and 2008 respectively was $77.17 per bbl and $63.75 per bbl. In the fourth quarter of 2009, the Company received an average price of $4.94 per mcf compared to $7.26 per mcf received in the fourth quarter of 2008. The AECO daily spot price for the fourth quarter of 2009 was $4.59 per mcf compared to $6.72 per mcf for the fourth quarter of 2008.

Average Benchmark Prices

Three months ended December 31,	2009	2008
Oil - Edmonton par - light oil *($/bbl)*	**77.17**	63.75
Gas - AECO, daily spot *($/mcf)*	**4.59**	6.72

Painted Pony's Realized Prices

Three months ended December 31,	2009	2008
Oil *($/bbl)*	**75.63**	60.01
Gas *($/mcf)*	**4.94**	7.26

The Company guided that it expected to receive an average oil price which slightly exceeds or approximates the Edmonton par reference price and a natural gas price at a premium to the AECO daily spot price. During the last quarter of 2009, Painted Pony received an average oil price of $75.63 per bbl, or 2% less than the Edmonton reference price of $77.17 per bbl for this period.

The average natural gas price the Company received in the fourth quarter of 2009 was $4.94 per mcf, a premium price compared to the AECO daily spot price of $4.59 per mcf.

REVENUES

During the fourth quarter of 2009, total revenues were $11.6 million, 105% higher than the last quarter 2008 revenues of $5.7 million. Oil revenues in the last quarter of 2009 grew by 190% compared to the same quarter in 2008, reflecting the 130% increase in oil sales volumes and the 26% increase in the average per unit oil sales price. Gas revenues declined in the fourth quarter of 2009 in comparison to 2008 by 31%, reflecting relatively flat volumes combined with a 32% decrease in the per unit gas sales price. In 2009, the Company commenced sales of gas and natural gas liquids from the Weyburn area subsequent to the completion of a battery and gas conservation facility in July.

Sales by Product *($000s)*

Three months ended December 31,	2009	2008
Oil	**$ 9,931**	$ 3,424
Gas	**1,461**	2,129
Condensate, NGL and sulphur	**220**	103
Total	**$ 11,612**	$ 5,656

Management's Discussion and Analysis

ROYALTIES

In the fourth quarter of 2009, the Company paid $1.6 million in royalties, up 93% from the $0.8 million of royalties in the comparable quarter of 2008. Royalties were 13.5% of sales during the fourth quarter of 2009, compared to 14.4% in the last quarter of 2008. Painted Pony had guided royalties in the fourth quarter of 2009 were expected to approximate 14% of total sales.

TRANSPORTATION COSTS

Transportation costs were $0.7 million for the fourth quarters of 2009 and 2008.

Transportation by Commodity *($000s)*

Three months ended December 31,	2009	2008
Light oil	**$ 207**	$ 151
Gas and associated liquids	**541**	510
Net	**$ 748**	$ 661

Transportation costs per unit in Saskatchewan began to decline in the second half of 2009, averaging $1.57 per bbl in the fourth quarter of 2009, compared to $2.66 per bbl in the same period of 2008. As guided, the investments in flow-lines in Saskatchewan helped reduce trucking costs.

In British Columbia, in the third quarter of 2009, transportation costs averaged $9.40 per boe. The Company guided per unit costs in the fourth quarter to be similar. As a result of lower production volumes, however, actual costs per boe in the fourth quarter averaged $10.16 per boe, similar to the $10.02 per boe charge in 2008.

OPERATING COSTS

In the fourth quarter of 2009, operating costs totaled $1.7 million ($9.25 per boe), compared to $1.1 million ($10.34 per bbl) in the last quarter of 2008. Fourth quarter per unit costs for both oil and gas properties have decreased in 2009 compared to the prior year, reflecting cost reductions in Saskatchewan from new batteries and gathering systems, the voluntary shutting in of higher operating cost gas wells in British Columbia and an increased production base for both commodities. The Company's expectation of lower per unit operating costs in Saskatchewan from reduced trucking and water disposal fees was not yet realized. While costs in Saskatchewan declined slightly in the fourth quarter compared to the prior periods, the start-up of the Company-owned water disposal facility for the Midale/Huntoon area did not commence until the first quarter of 2010.

OPERATING NETBACKS

During the fourth quarter of 2009, Painted Pony generated field operating netbacks of $41.10 per boe, compared to $28.39 per boe in the same quarter of 2008.

Combined Field Operating Netback *($/boe)*

Three months ended December 31,	2009	2008
Sales	**$ 62.90**	$ 52.40
Transportation	**(4.05)**	(6.13)
Royalties	**(8.50)**	(7.54)
Operating costs	**(9.25)**	(10.34)
Field operating netback	**$ 41.10**	$ 28.39

Management's Discussion and Analysis

Netbacks by Commodity

Three months ended December 31,	2009	2008
Crude oil *($/bbl)*	$ 52.86	$ 36.08
Gas and associated products *($/boe)*	$ 12.14	$ 19.77

GENERAL AND ADMINISTRATIVE

In the fourth quarter of 2009, the net general and administrative costs were $0.5 million ($2.49 per boe) compared to $0.4 million ($3.49 per boe) in the fourth quarter of 2008. Painted Pony indicated that the active operated capital program during the fourth quarter of 2009 could result in lower net general and administrative costs due to additional costs being allocated to capital projects. Actual general and administration expenses were marginally lower than the third quarter cost when a bonus of approximately $200,000 was paid as net cost allocations remained relatively constant. On a per unit of production basis, net general and administrative costs were significantly lower in the fourth quarter compared to the third quarter of 2009 cost of $3.35 per boe, the effect the bonus paid during the third quarter and production volume growth in the fourth quarter.

General and Administrative Costs ($000s)

Three months ended December 31,	2009	2008
Gross costs	$ 865	$ 701
Capitalized	(209)	(186)
Recoveries	(195)	(138)
Net costs	$ 461	$ 377
Net G&A, per boe	$ 2.49	$ 3.49

During the fourth quarter of 2009, Painted Pony invested $17.0 million on capital projects. In the comparable 2008 quarter, the Company invested $12.5 million. The Company spent $5.4 million on land assets in the fourth quarter of 2009, primarily at British Columbia land sales. As guided, Painted Pony's applications to continue lands in British Columbia were approved, subject to completion of the work program as submitted. The Company had guided it anticipated to participate in drilling 1 (0.13 net) non-operated well during the fourth quarter of 2009, in addition to the 8 (6.2 net) successful horizontal oil wells targeting the Bakken drilled. This well has not yet been drilled.

OTHER ITEMS

Depletion, depreciation, and accretion expense in the fourth quarter of 2009 was $5.7 million ($31.06 per boe) compared to $2.8 million ($26.39 per boe) in the fourth quarter of 2008, and $30.16 per boe in the third quarter of 2009, reflecting the investments in facilities and gathering systems throughout 2009.

Consistent with the guidance given, in the fourth quarter of 2009, capital tax cost increased by $0.2 million, reflecting increased oil sales revenues in Saskatchewan.

As guided, interest income was earned in the fourth quarter of 2009 subsequent to the issuance of shares in November as the additional funds were invested.

Fourth quarter 2009 expense for stock-based compensation was expected to be $0.5 million. Actual costs were $0.4 million.

Painted Pony guided that it expected to exit 2009 with no debt. As at December 31, 2009, Painted Pony had a positive working capital position and was not drawn on either of the credit facilities.

Management's Discussion and Analysis

OFF BALANCE SHEET ARRANGEMENTS

No off balance sheet arrangements existed as at December 31, 2009.

RELATED PARTY TRANSACTIONS

The Company utilizes the services of a law firm in which the Corporate Secretary is a Partner. During the year ended December 31, 2009, the Company remitted $264,000, of which $198,000 was for services obtained from the firm and $66,000 was to reimburse various filing fees. During 2008, the Company incurred $151,000.

All related party transactions are in the normal course of business and have been measured at the agreed to terms and exchange values, being the consideration established and agreed to by the parties.

FINANCIAL INSTRUMENTS AND OTHER INSTRUMENTS

The fair values of the Company's cash and cash equivalents, accounts receivables, accounts payables and accrued liabilities approximate their carrying amounts due to the short-term nature of these financial instruments.

The Company's accounts receivables are primarily with industry partners and are subject to normal industry credit risks. The Company extends unsecured credit to these entities, and therefore, the collection of any receivables may be affected by changes in the economic environment or other conditions. Management believes the risk is mitigated by the financial position of the entities.*

**This paragraph contains forward-looking information. Please refer to "Forward-looking Information" and "Business Risks, Uncertainties and Forward-looking Information" for a discussion of the risks and uncertainties related to such information.*

To date, the Company has not participated in any risk management contracts or commodity price contracts.

CHANGE IN ACCOUNTING POLICY

Goodwill and Intangible Assets

On January 1, 2009, the Company adopted the new accounting standard, Section 3064, "Goodwill and Intangible Assets". This section provides guidance on the recognition, measurement, presentation and disclosure for goodwill and intangible assets, other than the initial recognition of goodwill or intangible assets acquired in a business combination. Retroactive application to prior-period financial statements is required. There was no impact of this new standard on the Company's financial statements.

Financial Instruments Disclosures

In May 2009, the CICA amended Section 3862, Financial Instruments - Disclosures, to improve disclosure requirements about fair value measurement for financial instruments and liquidity risk disclosures. These amendments require a three-level hierarchy that reflects the significance of the inputs used in making the fair value measurements. Fair values of assets and liabilities included in Level 1 are determined by reference to quoted prices in active markets for identical assets and liabilities. Assets and liabilities in Level 2 include valuations using inputs other than quoted prices for which all significant outputs are observable, either directly or indirectly. Level 3 valuations are based on inputs that are unobservable and significant to the overall fair value measurement. The amendments to Section 3862 apply for annual financial statements relating to fiscal years ending after September 30, 2009.

Management's Discussion and Analysis

FUTURE ACCOUNTING POLICY CHANGES

Business Combinations

In January 2009, the CICA Accounting Standards Board (AcSB) issued Section 1582, Business Combinations. Section 1582 replaces Section 1581, Business Combinations and harmonizes the Canadian standards with International Financial Reporting Standards (IFRS). Section 1582 establishes principles and requirements of the acquisition method for business combinations and related disclosures. This section is effective January 1, 2011, and applies prospectively to business combinations for which the acquisition date is on or after the first reporting period of the Corporation beginning on or after January 1, 2011. Early adoption is permitted. The Corporation expects to adopt Section 1582 effective January 1, 2011. The newly issued Sections 1600 and 1601, Consolidated Financial Statements are required to be adopted at the same time as Section 1582.

International Financial Reporting Standards

On February 13, 2008, the CICA Accounting Standards Board (AcSB) confirmed that the changeover to IFRS from Canadian GAAP will be required for publicly accountable enterprises for interim and annual financial statements effective for fiscal years beginning on or after January 1, 2011, including comparatives for 2010. The objective is to improve financial reporting by having one single set of accounting standards that are comparable with other entities on an international basis.

The Company commenced its IFRS conversion project during 2009 and purchased a software tool designed to guide junior oil and gas companies through the planning, decision-making, and implementation processes. Furthermore, the Company established that the Audit Committee would essentially serve as the IFRS Steering Committee, to monitor the progress and critical decisions in the transition to IFRS. An external advisor is available to work with the conversion project team to advise on decision-making and the conversion process. Additionally, the external auditors will review accounting policy determinations as they are assessed by the project team. Regular reporting is provided to the Board of Directors.

The Company has established an IFRS transition plan that includes a timetable for assessing the impact on systems, internal controls over financial reporting (ICFR) and business activities. The Company's IFRS conversion project consists of three phases: Planning, Analysis and Decision-Making, and Implementation. The Company has completed the Planning phase, which involved a high-level preliminary assessment of the differences between Canadian GAAP and IFRS and the potential effects of IFRS to accounting and reporting processes, information systems, business processes and external disclosures. This assessment has provided insight as to the most significant areas of difference applicable to the Company.

The second phase, Analysis and Decision-Making, is underway, and has involved an in-depth analysis and evaluation of the financial impacts of various alternatives provided for under IFRS, selection of accounting policies, identification of effects on operational and business processes, analysis of disclosure requirements, an analysis of the optional exemptions and mandatory exceptions of IFRS 1, First-Time Adoption of International Financial Reporting Standards (IFRS 1) for full retrospective application upon transition to IFRS; and development of solutions to address the issues identified.

Phase three, Implementation, has also commenced and involves reviewing information systems changes to ensure that the changes address the Company's needs, determining business process changes required and establishing a framework for enacting those changes, conducting training programs across the Finance Department and other affected areas of the business, and preparing opening IFRS balances for January 1, 2010. This phase also involves the compilation of financial information necessary to assemble comparative IFRS financial statements and reconciliations for 2011 for approval by the Audit Committee and initiating IFRS internal business processes.

Given the progress of the project and outcomes identified, the Company may revise its intentions between the time of communicating these key milestones and the changeover date. Further, changes in regulation or economic conditions at the date of the changeover or throughout the project could result in changes to the transition plan being communicated here.

Management's Discussion and Analysis

The transition from Canadian GAAP to IFRS is a significant undertaking that may materially affect our reported financial position and results of operations. The Company continues to monitor standards development as issued by the International Accounting Standards Board ("IASB") and the AcSB, as well as regulatory developments as issued by the Canadian Securities Administrators ("CSA"), which may affect the timing, nature or disclosure of the adoption of IFRS.

The Company is still determining the full effects of adopting IFRS. The preliminary assessment of the impacts of adopting IFRS based on the current standards has identified the following areas as having the most significant potential impact to the consolidated financial statements. This should not be regarded as a complete list of changes that will result from the transition to IFRS, but rather, is intended to highlight the areas believed to be the most significant. As the Company moves through the Implementation phase, the Company is working to confirm additional changes. These assessments are based on available information and expectations as of the date hereof and thus, are subject to change for new facts and circumstances. Additionally, an analysis of changes is still in progress and not all decisions have been made where choices of accounting policies are available. At this stage, the Company has not completed quantification of the impacts expected on the consolidated financial statements for these differences.

IFRS 1 provides entities adopting IFRS for the first time with a number of optional exemptions and mandatory exceptions, in certain areas, to the general requirement of full retrospective application of IFRS. Most adjustments required on transition to IFRS will be made retrospectively against opening retained earnings in the first comparative balance sheet.

The major differences between Canadian GAAP and IFRS applicable to the Company are as follows:

(a) Exploration and evaluation of mineral resources ("E&E") - IFRS 6: IFRS 6 is the only specific standard that applies to extractive industries. This standard refers to a very clear and definitive segregation of capital expenditures into three main categories - pre-exploration, Exploration and Evaluation ("E&E), and post-exploration or development and production expenditures. Under IFRS, all pre-license costs are expensed, while under Canadian GAAP, these costs may be capitalized. E&E costs under IFRS may either be expensed or capitalized. The Company has determined that it will capitalize E&E expenditures. Under IFRS, the E&E expenditures must be assessed for impairment when the facts suggest that the carrying amount of an asset exceeds its recoverable amount. Furthermore, when an E&E asset is transferred to post-exploration, an impairment test must be conducted.

(b) Componentization: Under IFRS, the full cost pool under Canadian GAAP must be broken down into economic components and then depleted on a component basis. IFRS allows depletion to be calculated using either proven reserves or using proven and probable reserves. The Company anticipates that it will calculate and record depletion using proven plus probable reserves. The IASB has implemented an amendment to IFRS 1 that will permit the Company to apply IFRS prospectively by utilizing its current reserves at the transition date to allocate the Company's full cost pool, with the provision that an impairment test, under IFRS standards, be conducted at the transition date.

(c) Impairment of property and equipment: The full cost pool under Canadian GAAP must be broken down into cash generating units ("CGU's"), which are the smallest group of assets capable of generating independent cash inflows. The Company anticipates that, at the year ended December 31, 2009, it has two to four CGU's. The cash generating units must be tested for impairment on at least an annual basis. The impairment test can be based on either "value in use" or "fair value less costs to sell." The Company expects to use "fair value less costs to sell" as the basis for the impairment test under IFRS.

Management's Discussion and Analysis

(d) Provisions and contingent assets and liabilities: IAS 37, Provisions, Contingent Liabilities and Contingent Assets requires a provision to be recognized when there is a present obligation as a result of a past transaction or event; it is probable that an outflow of resources will be required to settle the obligation; and a reliable estimate can be made of the obligation. The threshold for recognition of a provision under Canadian GAAP is higher than under IFRS (70% vs. 50%). Therefore, it is possible that some contingent liabilities not recognized under Canadian GAAP may meet the recognition criteria under IFRS. Furthermore, IFRS requires the use of best estimates, mid-points, or probabilistic weighted averages as the measurement method. Under Canadian GAAP, the discount rate used in determining the value of asset retirement obligations is the credit adjusted risk-free rate applicable to the Company. Under IFRS, the discount rate used must reflect the risks specific to the obligation or liability. It is expected that the discount rate used for asset retirement obligations under IFRS will be a higher rate than that used under Canadian GAAP, thereby reducing the liability. Finally, unwinding of the discount under IFRS is interest expense (finance costs), as opposed to accretion expense (operating expense). The Company is currently identifying contingent assets and liabilities requiring recognition under IFRS.

(e) Income taxes: IAS 12, Income Taxes, prescribes that an entity account for the tax consequences of transactions and other events in the same way that it accounts for the transactions and other events themselves. Therefore, where transactions and other events are recognized in earnings, the recognition of deferred tax assets or liabilities which arise from those transactions should also be recorded in earnings. For transactions that are recognized outside of the statement of earnings, either in other comprehensive income or directly in equity, any related tax effects should also be recognized outside the statement of earnings. The Company is still analyzing the implications of this standard, and expects to comment on the impact by the end of 2010.

(f) Share-based payments: Under IFRS 2, Share-Based Payment, awards will continue to be measured at fair value, with compensation expense under our plans recognized over the service period. For the Company's plan which is equity-settled, the Company will continue to recognize a corresponding increase in equity. Unlike Canadian GAAP, the service period under IFRS may commence prior to the date of grant and end on the vesting date. This represents a difference in timing and ultimately does not impact the overall expense.

(g) Disclosures: IFRS requires significant disclosures for accounting policies, use of IFRS 1 mandatory exemptions, and use of IFRS 1 elective exemptions. It is expected that the IFRS disclosures for the Company will be substantial, as the basis of substance over form reflected in IFRS will require much more detailed disclosures than Canadian GAAP requires.

CRITICAL ACCOUNTING ESTIMATES

The reader is cautioned that the preparation of financial statements in accordance with GAAP requires management to make certain judgments and estimates that affect the reported amounts of assets, liabilities, revenues and expenses. Estimating reserves is also critical to several accounting estimates and requires judgments and decisions based upon available geological, geophysical, engineering and economic data. Estimated reserves are also utilized by Painted Pony's bank in determining credit facilities. Reserves affect net income through depletion, site restoration and abandonment estimates and the ceiling test calculation. Estimating reserves is very complex, requiring many judgments based on available geological, geophysical, engineering and economic data. Changes in these judgments could have a material impact on the estimated reserves. These estimates may change, having either a negative or positive effect on net earnings as further information becomes available, and as the economic environment changes. Changes in these judgments and estimates could have a material impact on the financial results and financial condition of the Company. The MD&A outlines the accounting policies and practices that are critical to determining Painted Pony's financial results.In following the liability method of accounting for income taxes, related assets and liabilities are recognized for the estimated tax consequences between amounts included in the financial statements and their tax base, using substantively enacted future income tax rates. Timing of future revenue streams and future capital spending changes can affect the timing of any temporary differences, and accordingly affect the amount of the future income tax liability calculated at a point in time. These differences could materially impact earnings.

Management's Discussion and Analysis

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

With the above risks and uncertainties, the reader is cautioned that future events and results may vary substantially from that which the Company currently foresees.

BUSINESS RISKS, UNCERTAINTIES AND FORWARD-LOOKING INFORMATION*

Statements in this document may contain forward-looking information including expectations of future production, components of cash flow and earnings, expected future events and/or financial results that are forward-looking in nature and subject to substantial risks and uncertainties. The reader is cautioned that assumptions used in the preparation of such information may prove to be incorrect. The Company cautions the readers that actual performance will be affected by a number of factors, many of which may respond to changes in economic and political circumstances throughout the world. Events or circumstances may cause actual results to differ materially from those predicted, a result of numerous known and unknown risks, uncertainties, and other factors, many of which are beyond the control of the Company. These risks include, but are not limited to, the risks associated with the oil and gas industry, and changes to commodity prices and interest and foreign exchange rates.

Industry related risks could include, but are not limited to, operational risks in exploration, development and production, delays or changes in plans, risks associated with the uncertainty of reserve estimates, health and safety risks and the uncertainty of estimates and projections of production, costs and expenses. These external factors beyond the Company's control may affect the marketability of oil and natural gas produced, industry conditions including changes in laws and regulations, changes in income tax regulations, increased competition, fluctuations in commodity prices, interest rates, and variations in the Canadian/United States dollar exchange rate. The reader is cautioned not to place undue reliance on this forward-looking information.

Painted Pony's production and exploration activities are concentrated in the Western Canadian Sedimentary Basin, where activity is highly competitive and includes a variety of different sized companies ranging from smaller junior producers to the much larger integrated petroleum companies. Painted Pony is subject to the various types of business risks and uncertainties including:

- *Finding and developing oil and natural gas reserves at economic costs;*
- *Production of oil and natural gas in commercial quantities; and*
- *Marketability of oil and natural gas produced.*

In order to reduce exploration risk, the Company strives to employ highly qualified and motivated professional employees with a demonstrated ability to generate quality proprietary geological and geophysical prospects. To help maximize drilling success, Painted Pony combines exploration in areas that afford multi-zone prospect potential, targeting a range of low to moderate risk prospects with some exposure to select high-risk plays with high-reward opportunities. Painted Pony also explores in areas where the Company's officers and employees have significant drilling experience.

The Company mitigates its risk related to producing hydrocarbons through the utilization of the most appropriate technology and information systems. In addition, Painted Pony seeks operational control of its projects, where feasible. Oil and gas exploration and production can involve environmental risks such as pollution of the environment and destruction of natural habitat, as well as safety risks such as personal injury.

Management's Discussion and Analysis

In order to mitigate such risks, Painted Pony conducts its operations at high standards and follows safety procedures intended to reduce the potential for personal injury to employees, contractors and the public at large. The Company maintains current insurance coverage for general and comprehensive liability as well as limited pollution liability. The amount and terms of this insurance are reviewed on an ongoing basis and adjusted as necessary to reflect changing corporate requirements, as well as industry standards and government regulations. Painted Pony may periodically use financial or physical delivery hedges to reduce its exposure against the potential adverse impact of commodity price volatility, as governed by formal policies approved by senior management, subject to controls established by the Board of Directors.

**This section contains forward-looking information. Please refer to "Forward-looking Information" and "Business Risks, Uncertainties and Forward-looking Information" for a discussion of the risks and uncertainties related to such information.*

LEGAL, ENVIRONMENTAL, REMEDIATION AND OTHER CONTINGENT MATTERS

The Company reviews legal, environmental, remediation and other contingent matters to both determine whether a loss is probable based on judgment and interpretation of laws and regulations, and determine that the loss can reasonably be estimated. When the loss is determined, it is charged to earnings. The Company's management monitors known and potential contingent matters and make appropriate provisions by charges to earnings when warranted by circumstances.

ADDITIONAL INFORMATION

Additional information regarding the Company and its business and operations is available on the Company's profile at www.sedar.com. Copies of the information can also be obtained by contacting the Company at Painted Pony Petroleum Ltd., 300, 602 - 12 Avenue SW., Calgary, Alberta T2R 1J3 (Phone 403 475-0440), by email at info@paintedpony.ca or on the Company's website at www.paintedpony.ca.

SELECTED CONSOLIDATED QUARTERLY INFORMATION

The following table sets forth selected consolidated financial information of the Company for the most recently completed quarters ending at the fourth quarter of 2009.

Quarter ended *(unaudited)* *($000s, except volumes and per share)*	**Mar 31, 2009**	**June 30, 2009**	**Sept 30, 2009**	**Dec 31, 2009**
Gross revenues [1]	4,560	4,889	7,834	11,612
Funds flow from operations	1,890	1,826	4,513	6,981
Basic, per share	0.05	0.06	0.12	0.17
Diluted, per share	0.05	0.06	0.12	0.16
Cash flow from operating activities	1,499	531	4,273	6,157
Net earnings (loss)	(1,598)	(1,965)	(2,046)	1,953
Basic and diluted, per share	(0.05)	(0.06)	(0.05)	0.05
Capital expenditures, net	7,306	4,633	12,141	16,483
Capital acquisitions, net	-	-	13,587	1
Total assets	92,605	108,308	112,861	164,907
Long-term liabilities *(ARO)* [2]	1,844	1,931	2,278	2,439
Average daily sales volumes *(boe per day)*	1,225	1,313	1,655	2,006

(1) Petroleum and natural gas sales, before royalties and transportation, excluding interest and other income.
(2) Asset retirement obligations.

Management's Discussion and Analysis

Quarter ended *(unaudited)* *($000s, except volumes and per share)*	**Mar 31, 2008**	**June 30, 2008**	**Sept 30, 2008**	**Dec 31, 2008**
Gross revenues[1]	1,355	6,436	7,189	5,656
Funds flow from operations	1,074	3,947	4,846	2,892
Basic, per share	0.06	0.15	0.16	0.08
Diluted, per share	0.06	0.14	0.16	0.08
Cash flow from operating activities	1,315	2,949	5,756	3,579
Net earnings	3,346	1,526	328	254
Basic and diluted, per share	0.19	0.06	0.01	0.01
Capital expenditures, net	8,894	10,659	15,790	12,245
Capital acquisitions, net	19,416	1,605	56	14
Total assets	58,660	96,362	100,934	97,194
Long-term liabilities *(ARO)*[2]	1,656	1,834	1,996	1,766
Average daily sales volumes *(boe per day)*	148	789	925	1,173

(1) Petroleum and natural gas sales, before royalties and transportation, excluding interest and other income.
(2) Asset retirement obligations.

SELECTED CONSOLIDATED ANNUAL INFORMATION

The following table sets forth selected consolidated annual financial information of the Company for the most recently completed periods ending at December 31, 2009.

Period ended *($000s, except volumes and per share)*	**2009**	**2008**	**2007**
Gross revenues[1]	**28,895**	20,635	783
Funds flow from operations	**15,210**	12,758	603
Basic and diluted, per share	**0.44**	0.38	0.07
Cash flow from operating activities	**12,460**	13,599	167
Net earnings (loss)	**(3,656)**	5,453	157
Basic and diluted, per share	**(0.10)**	0.16	0.02
Capital expenditures, net	**40,563**	47,589	6,058
Capital acquisitions, net	**13,588**	21,091	-
Total assets	**164,907**	97,194	26,194
Long-term liabilities *(ARO)*[2]	**2,439**	1,766	92
Average daily sales volumes *(boe per day)*	**1,552**	761	25

(1) Petroleum and natural gas sales, before royalties and transportation, excluding interest and other income.
(2) Asset retirement obligations.

Management's Discussion and Analysis

Significant factors and trends that have affected the Company's results during the above quarterly and annual periods are as follows:

a) Gross revenues are impacted by both volatile commodity pricing and production volumes, which have steadily increased over the quarters and years from drilling and acquisition activities. The Company's successful capital program has generated incremental production volumes, partially offset by normal production declines. The sales prices realized by the Company have generally approximated the Edmonton par light oil prices and AECO daily spot gas prices throughout the above periods. The reference price fluctuations reflect changes in supply and demand by commodity, both internationally and domestically.

b) Funds flow from operations have both increased and decreased over time, reflecting primarily the impact of fluctuating commodity prices on a growing production base. Per production unit operating and transportation cost variations track seasonal weather-related issues combined with fixed commitments. Throughout 2009, commodity prices have been substantially weaker than during 2008, reducing funds flow from operations. Royalty changes vary due to commodity prices, production levels and provincial royalty holiday incentive programs.

c) Cash flow from operating activities has increased or decreased in concert with funds flow from operations and is further impacted by the timing of related accounts payable and receivable settlements.

d) The net losses in the first three quarters of 2009 and for the year ended December 31, 2009 have been significantly impacted by the non-cash charges from stock-based compensation. As the Company's share trading price increased, the related stock-based compensation charge for options granted also increased, as the trading price as at the date of grant directly impacts the calculation. In the third quarter of 2009, the Company recorded a $1.1 million of non-cash stock-based compensation expense for share options surrendered for cancellation. Throughout 2008, net earnings reflect relatively strong commodity prices, lower option grant prices and, in the first quarter of 2008, recording of a $4.4 million future income tax reduction, primarily from the income tax effects of recognizing an offsetting, previously recorded liability and for flow-through shares issued.

e) Net capital expenditures fluctuations have reflected both available capital resources and intentional capital spending restraint during weaker economic periods.

f) Net capital acquisitions occurred in the first quarter of 2008 and the third quarter of 2009 when strategic opportunities were identified and completed.

g) Total assets and long-term liabilities (asset retirement obligations) have generally increased quarter over quarter and year over year since 2007 reflecting the execution of the Company's capital program, somewhat offset by depletion.

Management's Responsibility for Consolidated Financial Statements

The management of Painted Pony Petroleum Ltd. (the "Company") is responsible for the preparation and integrity of the accompanying consolidated financial statements and all other information contained in this report. The consolidated financial statements have been prepared in accordance with generally accepted accounting principles ("GAAP") in Canada and include amounts that are based on management's informed judgments and estimates where necessary.

The Company has established internal accounting control systems which are designed to provide reasonable assurance regarding the reliability of the Company's financial reporting and the preparation of the consolidated financial statements together with the other financial information for external purposes in accordance with Canadian GAAP.

The Board of Directors, through its Audit Committee, monitors management's financial and accounting policies and practices and the preparation of these consolidated financial statements. The Audit Committee meets periodically with the external auditors and management to review the work of each and the propriety of the discharge of their responsibilities.

The Audit Committee reviews the consolidated financial statements of the Company with management and the external auditors prior to submission to the Board of Directors for final approval. The Board of Directors also reviews the consolidated financial statements before they are finalized. The external auditors have full and free access to the Audit Committee to discuss auditing and financial reporting matters. The Audit Committee reviews the independence of the external auditors and pre-approves audit and permitted non-audit services and fees. The Shareholders have appointed KPMG LLP as the external auditors of the Company, and in that capacity, they have audited the consolidated financial statements for the years ended December 31, 2009 and 2008.

Patrick R. Ward
President and CEO

Joan E. Dunne
Vice President, Finance and CFO

March 24, 2010

Auditors' Report to the Shareholders

We have audited the consolidated balance sheets of Painted Pony Petroleum Ltd. as at December 31, 2009 and 2008 and the consolidated statements of operations, comprehensive income (loss) and retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2009 and 2008 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP

Chartered Accountants

Calgary, Canada
March 24, 2010

Consolidated Balance Sheets

($000s)

As at December 31,	2009	2008
ASSETS		
Current assets		
Cash and cash equivalents	$ 46,575	$ 19,793
Accounts receivable	5,198	5,822
Prepaid expenses and deposits	324	365
	52,097	25,980
Long-term assets		
Property and equipment *(notes 4 & 5)*	109,725	70,266
Future income tax *(note 12)*	3,085	948
	$ 164,907	$ 97,194
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable and accrued liabilities	$ 11,418	$ 14,145
Long-term liabilities		
Asset retirement obligations *(note 7)*	2,439	1,766
	13,857	15,911
Shareholders' equity		
Capital stock *(note 8)*	139,739	70,644
Contributed surplus *(note 9)*	10,360	6,032
Retained earnings	951	4,607
	151,050	81,283
	$ 164,907	$ 97,194

Basis of presentation *(note 2)*
Subsequent event *(note 8c)*
Commitments *(note 14)*

See accompanying notes to the consolidated financial statements.

Approved on behalf of the Board:

Arthur J. G. Madden
Director

Patrick R. Ward
Director

Consolidated Statements of Operations, Comprehensive Income (Loss) and Retained Earnings

($000s, except per share amounts)

Years ended December 31,	2009	2008
Revenue		
Petroleum and natural gas	**$ 28,895**	$ 20,635
Royalties	**(3,441)**	(3,298)
Interest	**72**	834
Other	**62**	369
	25,588	18,540
Expenses		
Operating	**4,939**	2,530
Transportation	**3,015**	1,873
General and administrative	**2,042**	1,047
Capital and other taxes	**382**	332
Stock-based compensation *(note 8)*	**3,540**	4,517
Depletion, depreciation and accretion	**16,709**	8,265
	30,627	18,564
Loss before income taxes	**(5,039)**	(24)
Future income tax reduction *(note 12)*	**1,383**	5,477
Net income (loss) and comprehensive income (loss) for the year	**(3,656)**	5,453
Retained earnings (deficit), beginning of year	**4,607**	(846)
Retained earnings, end of year	**$ 951**	$ 4,607
Net income (loss) per share *(note 10)*		
Basic and diluted	**$ (0.10)**	$ 0.16

See accompanying notes to the consolidated financial statements.

Consolidated Statements of Cash Flows

($000s)

Years ended December 31,	2009	2008
Cash provided by (used in)		
Operating activities		
Net income (loss) for the year	**$ (3,656)**	$ 5,453
Items not affecting cash:		
Stock-based compensation	**3,540**	4,517
Depletion, depreciation and accretion	**16,709**	8,265
Future income tax reduction	**(1,383)**	(5,477)
Asset retirement expenditures	**(50)**	(131)
Change in non-cash working capital *(note 11)*	**(2,700)**	972
	12,460	13,599
Financing activities		
Issuance of share capital	**71,920**	38,399
Share issuance costs	**(4,086)**	(2,504)
Change in non-cash working capital *(note 11)*	**(41)**	105
	67,793	36,000
Investing activities		
Expenditures on property and equipment additions	**(40,563)**	(47,589)
Property and equipment acquisitions *(note 4)*	**(13,588)**	(5,350)
Change in non-cash working capital *(note 11)*	**680**	5,783
	(53,471)	(47,156)
Change in cash and cash equivalents	**26,782**	2,443
Cash and cash equivalents, beginning of year	**19,793**	17,350
Cash and cash equivalents, end of year	**$ 46,575**	$ 19,793
Cash and cash equivalents is comprised of:		
Balances with banks	**$ 46,575**	$ 793
Short term deposits	**-**	19,000
	$ 46,575	$ 19,793

See accompanying notes to the consolidated financial statements.

Notes to Consolidated Financial Statements

Years ended December 31, 2009 and 2008

1. NATURE OF OPERATIONS

Painted Pony Petroleum Ltd.'s (the "Company") principal business activity is the exploration, development and production of petroleum and natural gas resources in western Canada.

2. BASIS OF PRESENTATION

The consolidated financial statements of the Company have been prepared by management in accordance with Canadian generally accepted accounting principles ("GAAP"). These consolidated financial statements include the accounts of Painted Pony Petroleum Ltd. and its wholly-owned subsidiaries, Painted Pony Petroleum Corp. and Painted Rock Resources Ltd. All intercompany transactions have been eliminated.

Effective March 20, 2007, the Company's debt and equity holders approved a financial reorganization, as part of an overall restructuring of the Company. The Company's assets and liabilities have been adjusted to reflect the values established during the financial reorganization. The contributed surplus and the original share capital were reclassified to deficit in the amount of $15.7 million.

3. SIGNIFICANT ACCOUNTING POLICIES

Use of Estimates

The preparation of consolidated financial statements in accordance with Canadian generally accepted accounting principles 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 balance sheet date and the reported amounts of revenue and expenses during the period. The consolidated financial statements have, in management's opinion, been properly prepared using careful judgment with reasonable limits of materiality and within the framework of the significant accounting policies summarized below. Actual results could differ from those estimates.

Property and Equipment

(i) Capitalized Costs

The Company follows the Canadian full cost method of accounting for its petroleum and natural gas operations. Under this method, all costs related to the exploration, development and production of petroleum and natural gas reserves are capitalized in a single Canadian cost centre. Costs include lease acquisition costs, geological and geophysical expenses, costs of drilling both productive and non-productive wells, production equipment costs, asset retirement costs, general and administrative costs, and stock-based compensation directly related to exploration and development activities. Proceeds from the sale of properties are applied against capitalized costs, without any gain or loss being realized, unless such sale would alter the rate of depletion by more than 20%. Office equipment and furniture and fixtures are recorded at cost.

(ii) Depletion and Depreciation

Petroleum and natural gas properties, including estimated costs of future development of proved undeveloped reserves are depleted and amortized using the unit-of-production method based on estimated gross proved petroleum and natural gas reserves as determined by independent engineers. For depletion and amortization purposes, relative volumes of petroleum and natural gas production and reserves are converted at the energy equivalent conversion rate of six thousand cubic feet of natural gas to one barrel of crude oil.

Costs of unproved properties and seismic costs on undeveloped land are initially excluded from petroleum and natural gas properties for the purpose of calculating depletion. When proved reserves are assigned, or the property or seismic is considered to be impaired, the costs of the property or seismic or the amount of the impairment is added to costs subject to depletion.

Furniture, fixtures, and office equipment are depreciated over their estimated useful life at a declining-balance rate of 20%.

Notes to Consolidated Financial Statements

Years ended December 31, 2009 and 2008

(iii) Ceiling Test

In applying the full cost method, the Company calculates a ceiling test whereby the carrying amount of property and equipment is compared to the sum of the undiscounted cash flows expected to result from the future production of proved reserves and the cost less impairment of unproved properties. Cash flows are based on third party quoted forward prices, adjusted for transportation and quality differentials. Should the ceiling test result in an excess of carrying amount, the Company would then measure the amount of impairment by comparing the carrying amounts of property and equipment to an amount equal to the estimated net present value of future cash flows from proved plus probable reserves and the cost less impairment of unproved properties. The Company's risk-free interest rate is used to arrive at the net present value of the future cash flows. Any excess carrying amount would be recorded as a permanent impairment.

Asset Retirement Obligations

The Company recognizes the fair value of an Asset Retirement Obligation in the period in which it is incurred when a reasonable estimate of the fair value can be made. The fair value is determined through a review of engineering studies, industry guidelines and management's estimate on a site-by-site basis. The fair value of the estimated Asset Retirement Obligations is recorded as a liability, with a corresponding increase in the carrying amount of the related asset. The capitalized amount is depleted on the unit-of-production method based on gross proved reserves. The liability amount is increased each reporting period to reflect the passage of time with the corresponding amount charged to earnings as accretion expense. Actual costs incurred upon the settlement of the asset retirement obligation are charged against the asset retirement obligations to the extent of the liability recorded.

Joint Operations

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

Income Taxes

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

Flow-Through Shares

Periodically, the Company may finance a portion of its exploration and development activities through the issuance of flow-through shares. Under the terms of the flow-through share issues, the tax attributes of the related expenditures are renounced to subscribers. Share capital is reduced and the future tax liability is increased by the tax effected amount of the renounced tax deductions at the time of renouncement, which is when the related documentation is filed with the appropriate governmental agency and there is reasonable certainty that the expenditures will be incurred.

Stock-Based Compensation

The Company accounts for stock option agreements using the fair value method. Under this method, the fair value of the stock options, measured at the grant date, is charged to operations over the vesting period, with a corresponding increase in contributed surplus. Upon exercise of the stock options, consideration paid by the option holder, together with the amount recognized in contributed surplus, is credited to share capital. The Company does not incorporate a forfeiture rate for stock options that will not vest, but rather accounts for actual forfeitures as they occur.

Notes to Consolidated Financial Statements

Years ended December 31, 2009 and 2008

Revenue Recognition

Revenue from the sale of crude oil, natural gas and natural gas liquids are recognized based on volumes delivered at contractual delivery points and rates. The costs associated with the delivery, including operating, transportation and production-based royalty expenses are recognized in the same period in which the related revenue is earned and recorded.

Per Share Amounts

Basic earnings or loss per share is computed by dividing net income or loss by the weighted average number of Class A and Class B shares outstanding during the period. In addition, Class B shares are converted into Class A shares at $10 divided by the greater of $1.00 and the Current Market Price, defined as the weighted average trading price per share of the Class A shares for the last 30 consecutive trading days as of the balance sheet date. The treasury stock method is used to calculate diluted per share amounts, whereby proceeds from the exercise of in-the-money stock options and the unrecognized future stock-based compensation expense is assumed to be used to purchase Class A shares of the Company at the weighted-average market price during the period.

Cash and Cash Equivalents

The Company considers all highly liquid investments with a maturity of three months or less at the time of purchase to be cash equivalents. These cash equivalents primarily consist of funds on deposit under various terms.

Measurement Uncertainty

The amounts recorded for depletion and depreciation of petroleum and natural gas properties and the ceiling test calculation are based on estimates of gross proved reserves (as determined by independent engineers) production rates, commodity prices, future costs and other relevant assumptions. The value of the asset retirement obligations was based on the Company's net ownership interests in all wells and facilities, and depends on estimates of current market interest rates, inflation rates, future restoration and reclamation expenditures, and timeliness. By their nature, these estimates are subject to measurement uncertainty and the effects on the consolidated financial statements of changes in such estimates in future years could be significant.

The calculation of future income tax is based on assumptions, which are subject to uncertainty as to timing as well as the tax rates at which temporary differences are expected to reverse.

The Black-Scholes option valuation model was developed for use in estimating the fair value of options, which were fully tradable with no vesting restrictions. This option valuation model requires the input of assumptions including the expected stock price volatility.

Accounting Changes

Accounting changes are applied retrospectively unless otherwise permitted or where impracticable to determine. As well, voluntary changes in accounting policy are made only when required by a primary source of GAAP or the change results in more relevant and reliable information.

Comprehensive Income

Comprehensive income includes unrealized gains and losses, such as changes in currency translation adjustments relating to self-sustaining foreign operations, unrealized gains or losses on available-for-sale investments and the effective portion of gains or losses on derivatives designated as cash flow hedges. For the periods presented, comprehensive income (loss) is the same as net income (loss).

Notes to Consolidated Financial Statements

Years ended December 31, 2009 and 2008

Financial Instruments

All financial instruments are classified into one of the following five categories: held-for-trading (cash and cash equivalents), held-to-maturity (none), loans and receivables (accounts receivable), available-for-sale financial assets (none), and other financial liabilities (accounts payable and accrued liabilities). Initial and subsequent measurement and recognition of changes in the value of financial instruments depends on their initial classification.

- *Held-to-maturity investments, loans and receivables, and other financial liabilities are initially measured at fair value and subsequently measured at amortized cost. Amortization of premiums or discounts and losses due to impairment are included in current period net income.*
- *Available-for-sale financial assets are measured at fair value. Revaluation gains and losses are included in other comprehensive income until the asset is removed from the balance sheet.*
- *Held for trading financial instruments are measured at fair value. All gains and losses are included in the net income in the period in which they arise.*
- *All derivative financial instruments are classified as held-for-trading financial instruments and are measured at fair value, even when they are part of a hedging relationship. All gains and losses are included in net income in the period which they arise.*

Changes in Accounting Policies

a) Goodwill and intangible assets

On January 1, 2009, the Company adopted the new accounting standard, Section 3064, “Goodwill and Intangible Assets”. This section provides guidance on the recognition, measurement, presentation and disclosure for goodwill and intangible assets, other than the initial recognition of goodwill or intangible assets acquired in a business combination. Retroactive application to prior-period financial statements was required. There was no impact of this new standard on the Company's financial statements.

b) Business combinations

In January 2009, the CICA Accounting Standards Board (AcSB) issued Section 1582, Business Combinations. Section 1582 replaces Section 1581, Business Combinations and harmonizes the Canadian standards with International Financial Reporting Standards (IFRS). Section 1582 establishes principles and requirements of the acquisition method for business combinations and related disclosures. This section is effective January 1, 2011, and applies prospectively to business combinations for which the acquisition date is on or after the first reporting period of the Corporation beginning on or after January 1, 2011. Early adoption is permitted. The Corporation expects to adopt Section 1582 effective January 1, 2011.

c) Consolidated statements and non-controlling interests

In January 2009, the AcSB issued Section 1601, Consolidated Financial Statements and Section 1602, Non-controlling Interests, which together replace Section 1600, Consolidated Financial Statements and harmonizes the Canadian standards with IFRS. Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 provides guidance on accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. These sections are effective on or after the beginning of the first reporting period beginning on or after January 1, 2011. Early adoption is permitted. The Corporation expects to adopt Section 1601 and Section 1602 effective January 1, 2011. Adoption of these sections is not expected to impact the Corporation's results of operations or financial position.

Notes to Consolidated Financial Statements

Years ended December 31, 2009 and 2008

d) Financial instruments

In May 2009, the CICA amended Section 3862, Financial Instruments - Disclosures, to improve disclosure requirements about fair value measurement for financial instruments and liquidity risk disclosures. These amendments require a three-level hierarchy that reflects the significance of the inputs used in making the fair value measurements. Fair values of assets and liabilities included in Level 1 are determined by reference to quoted prices in active markets for identical assets and liabilities. Assets and liabilities in Level 2 include valuations using inputs other than quoted prices for which all significant outputs are observable, either directly or indirectly. Level 3 valuations are based on inputs that are unobservable and significant to the overall fair value measurement. The amendments to Section 3862 apply for annual financial statements relating to fiscal years ending after September 30, 2009.

4. PROPERTY ACQUISITIONS

a) During the third quarter of 2009, the Company completed four separate acquisitions of certain crude oil properties (the "Q3 2009 Assets"). The acquisitions were accounted for at an estimated total cash cost of $13.6 million, including transaction costs and adjustments.

The following table summarizes the fair value of the Q3 2009 Assets acquired at the dates of acquisition.

Consideration:		*($000s)*
Cash	$	13,523
Transaction costs		65
Total consideration	$	13,588
Allocated to:		
Property and equipment	$	13,794
Asset retirement obligations		(206)
	$	13,588

b) On March 31, 2008, the Company completed the acquisition of certain natural gas properties in British Columbia (the "March 31, 2008 Assets"). The acquisition was accounted for at $3.83 per share for the 4,110,000 Class A shares of the Company issued and $5.4 million of cash and transaction costs, for a total purchase price of $21.2 million.

The following table summarizes the fair value of the March 31, 2008 Assets acquired at the date of acquisition.

Consideration:		*($000s)*
Issue of 4,110,000 Class A shares	$	15,741
Cash		5,268
Transaction costs		152
Total consideration	$	21,161
Allocated to:		
Property and equipment	$	22,725
Asset retirement obligations		(1,564)
	$	21,161

Notes to Consolidated Financial Statements

Years ended December 31, 2009 and 2008

5. PROPERTY AND EQUIPMENT

December 31, 2009 *($000s)*	Cost	Accumulated depletion and depreciation	Net book value
Petroleum properties, including exploration and development thereon	**$ 134,592**	**$ 25,065**	**$ 109,527**
Other	**272**	**74**	**198**
	$ 134,864	**$ 25,139**	**$ 109,725**

December 31, 2008 *($000s)*	Cost	Accumulated depletion and depreciation	Net book value
Petroleum properties, including exploration and development thereon	$ 78,645	$ 8,559	$ 70,086
Other	216	36	180
	$ 78,861	$ 8,595	$ 70,266

The Company has included $27.6 million (2008: $12.9 million) for future development costs and excluded $16.4 million (2008: $11.6 million) for undeveloped land and $0.8 million (2008: $nil) for seismic costs from the depletion calculation and the ceiling test. The Company has recognized a total of $0.2 million of British Columbia infrastructure royalty credits as a reduction of property and equipment during 2009.

For the years ended December 31, 2009 and 2008, the Company capitalized general and administrative expenses and stock-based compensation as follows:

($000s)

Years ended December 31,	2009	2008
General and administrative	**$ 954**	$ 626
Stock-based compensation	**938**	1,593
Total	**$ 1,892**	$ 2,219

Notes to Consolidated Financial Statements

Years ended December 31, 2009 and 2008

The Company performed a ceiling test calculation at December 31, 2009 and determined there was no impairment of its petroleum properties. The future prices used in the ceiling test calculation are as follows:

	Light oil (C$/bbl)	Gas (C$/mcf)	Pentanes Plus (C$/bbl)	NGL's (C$/bbl)	Exchange rate (US$/CAN$)
2010	83.90	5.02	80.14	50.88	0.92
2011	89.60	5.89	85.82	54.61	0.92
2012	92.23	6.11	88.13	56.26	0.92
2013	95.82	6.89	91.48	58.56	0.92
2014	97.76	7.66	93.26	59.80	0.92
2015	99.75	7.85	95.15	61.07	0.92
2016	101.77	8.05	97.02	62.32	0.92
2017	103.83	8.26	99.04	63.64	0.92
2018	105.94	8.45	101.20	65.02	0.92
2019	108.09	8.68	103.42	66.44	0.92
2020	110.29	8.87	105.63	67.88	0.92
2021	112.51	9.03	107.90	69.33	0.92
2022	114.79	9.25	110.21	70.81	0.92
2023	117.10	9.48	112.64	72.30	0.92
2024	119.45	9.63	114.79	73.74	0.92
2025	121.85	9.86	116.85	75.22	0.92
2026	124.29	9.99	118.94	76.74	0.92
2027	126.78	10.21	120.78	78.02	0.92
2028	129.32	10.27	122.45	78.96	0.92
2029	131.91	10.63	124.85	80.44	0.92
Thereafter	+ 2%/yr	+ 2%/yr	+ 2%/yr	+ 2%/yr	0.92

6. BANK DEBT

At December 31, 2009 and 2008, the Company had no bank debt. The Company has available a $33 million demand revolving credit facility and a $7 million demand non-revolving acquisition/development facility with a Canadian chartered bank. Security is provided by a first fixed and floating charge demand debenture of $100 million. Painted Pony has provided a negative pledge and undertaking to provide fixed charges over major petroleum and natural gas reserves in certain circumstances. Interest for the demand revolving credit facility is payable at a floating rate determined as the lender's prime rate plus between 0.25% and 2.5%, depending on the Company's debt to cash flow ratio, as defined by the lender. Interest on the non-revolving facility is payable at the lender's prime rate plus between 0.75% and 3.0%, depending on the Company's debt to cash flow ratio, as defined by the lender. A standby fee is charged on 0.25% to 0.50% of the undrawn portion of the credit facilities, depending on the Company's debt to cash flow ratio, as defined by the lender. The facilities are subject to a review on or before March 31, 2010.

7. ASSET RETIREMENT OBLIGATIONS

The total future asset retirement obligations were estimated by management based on the Company's net ownership in wells and facilities, estimated costs to reclaim and abandon the wells and facilities, and the estimated timing of the costs to be incurred in future periods. The Company has estimated the total undiscounted asset retirement obligations to be $8.5 million as at December 31, 2009 (2008: $6.2 million). These payments are expected to be made over the next 28 years, with the majority estimated to be spent between 2026 and 2028. The Company used a credit-adjusted risk-free rate of 8% and an inflation rate of 2% to calculate the present value of the asset retirement obligations.

Notes to Consolidated Financial Statements

Years ended December 31, 2009 and 2008

The following table reconciles the Company's asset retirement obligations:

($000s)

Years ended December 31,	2009	2008
Obligations, beginning of year	**$ 1,766**	$ 92
Liabilities incurred	**352**	362
Revisions	**-**	(234)
Abandonments	**(50)**	(131)
Liabilities acquired on property acquisitions *(note 4)*	**206**	1,564
Accretion expense	**165**	113
Obligations, end of year	**$ 2,439**	$ 1,766

8. CAPITAL STOCK

a) Authorized

Unlimited Class A shares
Unlimited Class B shares
Unlimited Preferred shares, none outstanding as at December 31, 2009 and 2008

The Class A Shares and the Class B Shares are voting on the basis of one vote per share. There are no fixed dividends payable on either the Class A Shares or the Class B Shares. In the event of the liquidation or dissolution of the Company, the Class B Shares will be converted at the conversion rate (further discussed under "Class B Shares") into Class A Shares and the Class A Shares are entitled to receive, on a pro rata basis, all assets of the Company as are distributable to the holders of shares.

The Class B Shares will be convertible, at the option of the Company, at any time after June 30, 2010 and on or before June 30, 2012 into Class A Shares. The number of Class A Shares obtained upon conversion of each Class B Share will be equal to $10.00 divided by the greater of $1.00 and the Current Trading Price (as defined see note 10) of the Class A Shares.

If the conversion has not occurred by the close of business on June 30, 2012, the Class B Shares become convertible, at the option of the shareholder, into Class A Shares on the same basis. Any Class B Shares outstanding at the close of business on August 1, 2012 shall be automatically converted into Class A Shares on the same basis.

Notes to Consolidated Financial Statements

Years ended December 31, 2009 and 2008

b) Issued and Outstanding

	Class A shares		Class B shares	
	Number of shares	Amount *($000s)*	Number of shares	Amount *($000s)*
Balance, December 31, 2007	15,282,700	$ 11,948	1,173,600	$ 10,762
Shares issued for property acquisition *(note 4)*	4,110,000	15,741	-	-
Private placement	8,800,000	38,280	-	-
Options exercised	30,000	119	-	-
Transfer from contributed surplus on exercise of options	-	78	-	-
Share issuance costs	-	(2,504)	-	-
Income tax effect of flow-through share renouncement, allocated	-	(378)	-	(3,402)
Balance, December 31, 2008	28,222,700	$ 63,284	1,173,600	$ 7,360
Issuance of shares	15,800,000	71,694	-	-
Options exercised	59,000	226	-	-
Transfer from contributed surplus on exercise of options	-	150	-	-
Share issuance costs	-	(4,086)	-	-
Tax effect of share issuance costs	-	1,111	-	-
Balance, December 31, 2009	44,081,700	$ 132,379	1,173,600	$ 7,360

On November 17, 2009, the Company completed a financing of 8,800,000 Class A Shares at a price of $5.88 per share on a bought deal basis for total gross proceeds of $51,744,000. Share issue costs were $2.8 million.

On June 30, 2009, the Company completed a financing of 7,000,000 Class A Shares at a price of $2.85 per share on a bought deal basis for total gross proceeds of $19,950,000. Share issue costs were $1.3 million.

On March 31, 2008, the Company issued 4,110,000 Class A shares at a deemed price of $4.33 per share as partial consideration for an acquisition of producing properties and undeveloped land located in NE British Columbia. Transaction costs were $0.2 million.

On April 30, 2008, the Company completed a private placement of 8,800,000 Class A Shares at a price of $4.35 per share on a bought deal private placement basis for total gross proceeds of $38,280,000. Share issue costs were $2.4 million.

On July 17, 2008, Painted Pony removed Common Voting and Common Non-Voting shares from its share structure through filing amended Articles of Incorporation.

c) Stock Option Plan

The Company has a Stock Option Plan (the "Plan") pursuant to which options to purchase Class A Shares may be granted by the Board of Directors to directors, officers, employees of, and consultants to the Company. The Plan has reserved for issuance a number of Class A shares equal to 10% of the aggregate number of Class A Shares and Class B Shares issued and outstanding from time to time.

As at December 31, 2009, 2,755,000 options (2008: 2,840,000) are issued and outstanding, at an average exercise price of $3.53 per option and with a weighted-average life of 3.9 years. A total of 1,388,000 of the options granted are vested and the remainder vest in equal tranches on the first and second anniversaries of the date of grant. The options expire five years from the date of grant.

Notes to Consolidated Financial Statements

Years ended December 31, 2009 and 2008

The following tables summarize information regarding stock options for the years ended December 31, 2009 and 2008:

	Weighted average exercise price	Number
Balance, December 31, 2007	-	-
Granted	$ 5.02	2,870,000
Exercised	3.97	(30,000)
Balance, December 31, 2008	$ 5.03	2,840,000
Granted	3.25	1,422,000
Exercised	3.84	(59,000)
Forfeited and cancelled	6.17	(1,448,000)
Balance, December 31, 2009	$ 3.53	2,755,000

Stock Options, December 31, 2009

Number of options outstanding	Exercise price	Weighted average remaining life *(yrs)*	Exercisable options	Exercise price
1,267,000	$ 3.97	3.1	873,000	$ 3.97
75,000	$ 1.40	3.9	50,000	$ 1.40
804,500	$ 2.85	4.6	268,167	$ 2.85
469,500	$ 3.15	4.6	150,500	$ 3.15
139,000	$ 5.88	4.9	46,333	$ 5.88
2,755,000	$ 3.53	3.9	1,388,000	$ 3.64

Subsequent to December 31, 2009, the Company issued 689,000 options to purchase Class A shares at a price of $5.88 per share. One third of the options vested immediately, and the remainder vest one third, one year after date of grant and one third, two years after date of grant. The options expire five years from grant date.

d) Stock-Based Compensation

The Company accounts for its stock options granted to employees, consultants, officers, and directors using the fair value method. In accordance with the Company's incentive stock plan, these options have an exercise price equal to the fair value of the security at the date of grant. The fair value of each option granted is estimated on the date of grant using the Black-Scholes option-pricing model. The following assumptions have been used:

Years ended December 31,	2009	2008
Fair value per option *(weighted average)*	**$ 2.12**	$ 3.17
Risk free rate *(%)*	**1.98**	3.13
Expected life *(years)*	**5**	5
Expected volatility *(%)*	**80**	80
Expected dividends	**-**	-

Notes to Consolidated Financial Statements

Years ended December 31, 2009 and 2008

9. CONTRIBUTED SURPLUS

($000s)		
Balance, December 31, 2007	$	-
Stock-based compensation *(note 8(d))*		6,110
Transfer to share capital on exercise of options		(78)
Balance, December 31, 2008	$	6,032
Stock-based compensation *(note 8(d))*		4,478
Transfer to share capital on exercise of options		(150)
Balance, December 31, 2009	$	10,360

For the year ended December 31, 2009, the Company recorded $4.5 million (2008: $6.1 million) of compensation cost related to stock options issued during the period. During the year ended December 31, 2009, $0.9 million (2008: $1.6 million) was capitalized to petroleum properties and $3.5 million (2008: $4.5 million) was expensed.

10. PER SHARE AMOUNTS

The weighted average number of Class A and Class B shares outstanding during the years ended December 31, 2009 and 2008 was as follows:

Years ended December 31,	2009	2008
Weighted average shares		
Class A - basic	**32,867,535**	24,313,807
Class A - diluted	**32,867,535**	24,411,066
Class B - basic	**1,173,600**	1,173,600
Class B - deemed conversion to Class A	**2,017,045**	9,187,412
Class A & B - basic	**34,884,580**	33,501,219
Class A & B - diluted	**34,884,580**	33,598,478

During the year ended December 31, 2009, 2,755,000 (2008: 1,553,000) options were excluded in the weighted-average diluted share calculation of Class A shares. Class B shares are converted into Class A shares at $10 divided by the greater of $1.00 and the Current Trading Price, defined as being the weighted-average trading price per share of Class A shares for the last 30 consecutive trading days.

11. CHANGES IN NON-CASH WORKING CAPITAL

($000s)

Years ended December 31,		2009		2008
Accounts receivable	**$**	**624**	$	(2,747)
Prepaid expenses and deposits		**41**		(299)
Accounts payable and accrued liabilities		**(2,726)**		9,906
	$	**(2,061)**	$	6,860

The change in non-cash working capital has been allocated to the following activities:

($000s)

Years ended December 31,		2009		2008
Operating	**$**	**(2,700)**	$	972
Financing		**(41)**		105
Investing		**680**		5,783
	$	**(2,061)**	$	6,860

Notes to Consolidated Financial Statements

Years ended December 31, 2009 and 2008

12. INCOME TAX

The provision for income tax differs from that which would be obtained from applying the combined Canadian federal and provincial income tax rate to the loss before income taxes. The difference results from the following:

($000s)

Years ended December 31,	2009	2008
Loss before income taxes	$ (5,039)	$ (24)
Combined corporate tax rate	29.89%	31.61%
Computed "expected" income tax reduction	(1,506)	(8)
Non-deductible expenses	9	9
Stock-based compensation	1,058	1,428
Change in valuation allowance	(1,178)	(6,775)
Change in tax rates	210	(131)
Other	24	-
Income tax reduction	$ (1,383)	$ (5,477)

The components of the Company's future income tax assets/(liability) are as follows:

($000s)

As at December 31,	2009	2008
Non-capital losses	$ -	$ 1,176
Property and equipment	967	(410)
Share issue costs	1,489	888
Asset retirement obligations	629	472
	3,085	2,126
Less: valuation allowance	-	(1,178)
	$ 3,085	$ 948

13. RELATED PARTY TRANSACTIONS

The Company utilizes the services of a law firm in which the Corporate Secretary is a Partner. During the year ended December 31, 2009, the Company incurred $264,000 (2008: $151,000) on services obtained from the firm. As at December 31, 2009, the Company owes this related party $2,347.

All related party transactions are in the normal course of business and have been valued at the agreed to terms and exchange values, being the consideration established and agreed to by the parties and on normal commercial terms.

14. COMMITMENTS

a) At December 31, 2009, the Company is committed to the physical delivery of five mmcf per day of natural gas production. The estimated remaining cost of the commitment is $562,000 for the year 2010.

Notes to Consolidated Financial Statements

Years ended December 31, 2009 and 2008

b) At December 31, 2009, the Company is further committed to a minimum toll for transportation of oil through a major carrier system beginning in 2010 and ending in 2014 as follows:

		Amount ($000s)
2010	$	684
2011		616
2012		466
2013		301
2014		219
Total	$	2,286

c) At December 31, 2009, the Company was committed to future payments for office space rental and a proportionate share of operating costs through 2013 as follows:

		Amount ($000s)
2010	$	360
2011		360
2012		360
2013		180
Total	$	1,260

15. CAPITAL DISCLOSURES

At December 31, 2009, the Company considers its capital structure to include shareholders' equity, working capital, and available credit facilities. The Company will adjust its capital structure to manage any projected deficiencies of working capital through the issuance of shares, the use of available credit facilities, and/or adjusting its capital spending. The Company monitors its capital spending program based on the current and projected ratios of net debt to funds flow from operations, being cash flow from operating activities adjusted for changes in non-cash working capital and asset retirement expenditures.

The Company's objectives in managing its capital structure are to:

a) Create and maintain flexibility to enable the Company to continue to meet its financial obligations; and
b) Finance its growth either through internally generated projects, joint interest relationships or asset/corporate acquisitions.

The Company monitors its capital structure using primarily the non-GAAP financial measure of net debt to annualized funds flow from operations ratio. The Company's objective is to maintain a net debt to funds flow from operations ratio of 1:1 or less. To facilitate the management of this ratio, the Company prepares an annual budget, which is updated as required throughout the year for any significant acquisition, a change in economic circumstances outside the control of the Company, and success or failure of capital deployed. Each of the annual budgets and periodic updates are approved by the Board of Directors. As at December 31, 2009, the Company had no debt and had positive working capital of $40.7 million as detailed below:

($000s)		As at December 31, 2009
Current assets	$	52,097
Current liabilities		(11,418)
Net working capital	$	40,679

The Company is required to maintain a minimum working capital ratio of 1:1 to remain in compliance with its credit facility. For purposes of this calculation, working capital ratio is defined as the ratio of current assets plus any undrawn availability under the revolving credit facility to current liabilities less any amount drawn under the credit facilities. At December 31, 2009, the Company had a working capital ratio of 7:1, which is greater than the minimum ratio required.

There have been no changes to the way the Company manages capital during the year.

Notes to Consolidated Financial Statements

Years ended December 31, 2009 and 2008

16. FINANCIAL INSTRUMENTS

Management has primary responsibility for monitoring and managing financial instrument risks under direction from the Board of Directors which has overall responsibility for establishing the Company's risk management framework. For example, when extending credit to purchasers of the Company's products, the Board has delegated responsibility for credit assessment to management, but receives frequent financial and operating reports.

The Company's financial instruments recognized on the balance sheet at December 31, 2009 and 2008 consist of cash and cash equivalents, accounts receivable and accounts payable and accrued liabilities. All of the Company's assets and liabilities are valued as Level 1 assets and liabilities. The fair value of these financial instruments approximates their carrying amounts, based on the short term nature of these instruments.

a) Credit risk: A substantial portion of the Company's accounts receivable are concentrated with a limited number of purchasers of commodities and joint interest partners in the oil and gas industry and are subject to normal industry credit risk. Management considers these concentrations of credit risk to be minimal, as the commodity purchasers are major industry participants, and receivables from partners are protected by effective industry standard legal remedies. Receivables related to the sale of the Company's production are normally collected on the 25th day of the month following delivery.

Accounts receivable was comprised of the following:

($000s)

As at December 31,	2009	2008
Sales revenue	**$ 4,756**	$ 1,909
Joint interest	**391**	3,660
Accrued and other	**51**	253
Total accounts receivable	**$ 5,198**	$ 5,822

The carrying amounts of cash, cash equivalents, and accounts receivable represent the Company's maximum credit exposure. The Company has not experienced any credit loss in the collection of its accounts receivable. The Company has no allowance for doubtful accounts as at December 31, 2009. As at December 31, 2009 the Company estimates its trade accounts receivable to be aged as follows:

Aging *($000s)*	
Not past due (less than 30 days)	$ 4,964
Past due 31-60 days	169
Past due 61-90 days	46
Past due more than 90 days	19
Total	$ 5,198

b) Market risk: Market risks are as follows and are largely outside of the control of the Company:

Commodity Prices

The Company is constantly exposed to the risk of volatility of prices for its products, with a corresponding impact on cash flow. Reduced cash flow may result in lower levels of capital being available for field activity, thus compromising the Company's capacity to grow production while at the same time replacing continuous declines from existing properties. In certain circumstances, usually when debt levels are forecast to increase due to capital expenditures exceeding cash flow, or where the Company has financed, in whole or in part, an acquisition using bank debt, the Company may enter into oil and natural gas risk management contracts in order to provide stability to future cash flow. These contracts reduce the fluctuation in production revenue by fixing prices of future deliveries of oil and natural gas. At December 31, 2009, the Company had no fixed price contracts or financial instruments associated with future production.

Notes to Consolidated Financial Statements

Years ended December 31, 2009 and 2008

Interest Rates

Interest on the Company's revolving bank facility varies, and is most commonly based on the lender's prime rate. The Company is thus exposed to increased borrowing costs during periods of increasing interest rates, with a corresponding reduction in both cash flows and project economics. The Company had no bank debt at December 31, 2009 and has had no interest rate swaps or similar contracts. The Company invests available cash in short-term term deposits or interest bearing accounts from which interest income will vary with changes in prime rates.

For the year ended December 31, 2009, if interest rates had been 0.5% lower than the 2009 weighted-average rate of 0.63%, with all other variables held constant, after tax net earnings for the period would have been $57,000 lower due to lower interest income. An equal and opposite impact would have occurred to net earnings had interest rates been 0.5% higher.

Foreign Exchange

Although the Company's product revenues are denominated in Canadian dollars, the underlying market prices are affected by the exchange rate between the Canadian and the United States dollar. As at December 31, 2009, the Company had no contracts in place to manage foreign exchange risk.

Liquidity Risk

Liquidity difficulties would emerge if the Company was unable to meet its financial obligations as they fell due within normal credit terms. This may be the consequence of diminished cash flows resulting from lower product prices, production interruptions, or unexpected operating or capital cost increases. Liquidity difficulties could also occur if the Company's bankers were unable to continue to provide credit at a level and on terms compatible with the Company's capital requirements. Generally the Company will, over a reasonable period of time, limit its capital programs to funds flow from operations, available cash, and available credit. In addition, the Company endeavours to maintain its debt at a level to ensure financial flexibility to deal with unforeseen or rapidly changing circumstances.

Corporate Information

BOARD OF DIRECTORS

Ronald R. Talbot, Chairman
President
557146 Alberta Inc.
Calgary, Alberta

Glenn R. Carley
Executive Chairman & Director
Galleon Energy Inc.
Calgary, Alberta

Kevin D. Angus
President
KD Angus & Associates Ltd.
Calgary, Alberta

Allan K. Ashton
President
Ashton Petroleum Consultants
Priddis, Alberta

Arthur J. G. Madden
Chief Financial Officer
Crown Point Ventures Ltd.
Calgary, Alberta

Patrick R. Ward
President & Chief Executive Officer
Painted Pony Petroleum Ltd.
Calgary, Alberta

OFFICERS

Patrick R. Ward
President & Chief Executive Officer

Joan E. Dunne
Vice President, Finance &
Chief Financial Officer

James H. French
Vice President, Engineering

Bruce M. Mezei
Vice President, Exploration South

James S. Thomson
Vice President, Land

Donald J. Slater
Vice President, Exploration North

Michael E. Belenkie
Vice President,
Corporate Development

Mary Kay Axford
Controller

Douglas T. McCartney
Partner, Burstall Winger LLP
Corporate Secretary

EXCHANGE LISTING

TSX Venture Exchange
Trading symbols:
Class A Shares: PPY.A
Class B Shares: PPY.B

LEGAL COUNSEL

Burstall Winger LLP

AUDITORS

KPMG LLP

BANKERS

National Bank of Canada

EVALUATION ENGINEERS

Sproule Associates Limited

REGISTRAR AND TRANSFER AGENT

Olympia Trust Company
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Designed by Sandy Seifert

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