



**stORM**  
RESOURCES

2010 YEAR-END REPORT



# President's Message

## 2010 FOURTH QUARTER AND YEAR-END HIGHLIGHTS

- Storm Resources Ltd. ("Storm" or the "Company") commenced operations on August 17, 2010 after certain assets were transferred to Storm as part of the Plan of Arrangement involving the sale of Storm Exploration Inc. to ARC Energy Trust. The assets transferred to Storm included approximately 117,200 net acres of undeveloped land and share ownership positions in Storm Gas Resource Corp., Bellamont Exploration Ltd., Bridge Energy ASA and Chinook Energy Inc.
- Storm's undeveloped land position grew to 144,000 net acres by the end of 2010 primarily as a result of acquiring an additional 17,100 net undeveloped acres at Umbach in North East British Columbia which are prospective in the Montney formation. Undeveloped land holdings at Umbach currently total 46,000 net acres which represents a sizeable increase from 31,200 net acres at the end of 2010.
- In 2010, Storm drilled five wells (1.8 net) with a 100% success rate including two horizontal wells (0.8 net) in the Muskwa/Otter Park formation of the Horn River Basin ("HRB") in North East British Columbia, two horizontal wells (0.4 net) in the Slave Point formation at Red Earth, Alberta, and one vertical delineation well (0.6 net) into the Montney formation at Umbach.
- At Umbach, the first horizontal well into the Montney formation (60% working interest) was completed with seven 100 ton fracture treatments and the final test rate of 4.6 Mmcf per day confirms the resource potential of the Montney in this area.
- In the Horn River Basin, the first horizontal well testing the Muskwa and Otter Park shales (40% working interest) was flow tested for 12 days with a final stabilized test rate of 8.1 Mmcf per day of gross raw gas (rate was restricted during the entire flow test period).
- Capital investment was \$13.4 million in the fourth quarter and totaled \$16.8 million for 2010 (August 17, 2010 to December 31, 2010) with the major expenditures being \$3.0 million for land acquisitions and \$13.7 million for drilling and completions.
- At December 31, 2010, proved reserves totaled 0.7 million Boe ("Mmboe") and proved plus probable reserves were 2.5 Mmboe. The all-in cost to add reserves was \$29.10 per Boe for proved reserves and \$15.07 per Boe for proved plus probable reserves (includes all capital expenditures, the change in future development costs, acquisitions, dispositions and revisions).
- As a result of fourth quarter activities, current production is approximately 100 Boe per day and production exiting the first quarter of 2011 is expected to be 500 to 700 Boe per day.
- At December 31, 2010, Storm's available cash, adjusted for accounts receivable and payable, was \$19.9 million. In addition, the value of Storm's investments in publicly listed companies totaled \$15.3 million (proceeds from the possible future sale of these securities may also be used to finance the company's capital programs).

## OPERATIONS REVIEW

### **Horn River Basin ("HRB"), North East British Columbia**

Storm's undeveloped land position in the HRB is prospective for Devonian shale gas in the Muskwa, Otter Park, and Evie/Klua formations and currently totals 109 gross sections at a 40% working interest (28,300 net acres), with Storm Gas Resource Corp. ("SGR") owning the remaining 60% working interest. Our land position combined with Storm's 22% equity ownership position in SGR, gives us 53% exposure to this unconventional shale gas play.

Storm's initial efforts in the HRB have been directed towards proving commerciality of the Muskwa and Otter Park shales within a central project area of 19 gross sections (7.6 net to Storm's working interest). Within this area, Storm and SGR have completed and tested two vertical wells in the Muskwa, Otter Park, and Evie/Klua shales and have

participated in recording 47 square miles of 3-D seismic. InSite Petroleum Consultants Ltd. estimates that gross Discovered Petroleum Initially in Place ("DPIIP")<sup>(1)</sup> in the Muskwa and Otter Park shales totals 1.8 to 2.05 Tcf within this area. The Evie/Klua shale interval was not included in estimated DPIIP because less information is available regarding the productivity of this shale in the area.

In October 2010, the first horizontal well was drilled in the central project area to a total depth of 4,300 metres with a 1,750 metre horizontal section in the Muskwa and Otter Park shales. It was completed in December 2010 with 12 fracture treatments each consisting of approximately 300 tonnes of sand and 2,900 cubic metres of water. Test rates and flowing pressures stabilized relatively quickly during the 12-day flow period with an average test rate of 9.1 Mmcf per day and a final test rate of 8.1 Mmcf per day (rate was restricted during the entire flow test). In determining sales gas volumes, raw gas volumes are reduced by approximately 12% as a result of CO<sub>2</sub> content and processing losses. Total cost to drill and complete the first horizontal well was approximately \$14.5 million. A second horizontal well (40% working interest) was drilled in December 2010 at a gross cost of approximately \$4.3 million with completion tentatively planned for later in 2011 depending on natural gas prices, production performance of the first horizontal well and potential reserve additions from additional undrilled horizontal locations that would be recognized with a successful completion. Based on Storm's experience to date, future horizontals are expected to be approximately \$4.0 to \$4.5 million to drill and \$8.0 to \$9.5 million to complete. The first horizontal well is expected to begin producing in early March and, at current natural gas prices, Storm expects that no royalties will be paid for the next one to two years due to qualification under British Columbia's Deep Royalty Credit Program.

Although a substantial resource exists on Storm's lands, exploitation is likely to be challenging given access constraints which result in a higher cost structure, operational complexities associated with pumping extremely large fracture treatments and the continued weakness in natural gas prices.

#### **Umbach, North East British Columbia**

At Umbach in North East British Columbia, Storm has 46,000 net undeveloped acres which are primarily prospective in the Montney formation (86 gross sections, 68 net sections). The first horizontal well (0.6 net) was drilled into the Montney formation in July 2010, tested 4.6 Mmcf per day after completion in September 2010 with seven 100 ton fracture treatments, and will begin producing in early March 2011. This horizontal offsets a vertical well which had a final stabilized test rate of 600 Mcf per day from the Montney formation after completion in 2009 with a 100 ton fracture treatment. In the fourth quarter of 2010, Storm also drilled and completed a vertical well (0.6 net) approximately 4 miles north of the first horizontal well with the final test rate stabilizing at 300 Mcf per day after a 100 ton fracture treatment.

In the first quarter of 2011, Storm also completed two vertical delineation wells (100% working interest) in the Montney formation to test productivity on a second prospect. The vertical wells were acquired as part of land acquisitions and were completed with 100 ton fracture treatments with final test rates on each well being approximately 150 Mcf per day. Although encouraging in that both verticals confirm the Montney to be productive over a large area, the low final test rates on both wells are indicative of reduced reservoir quality which may not be economically exploitable with multi-stage frac horizontals. Results from both verticals are being evaluated and will be used to identify lands with potential for improved reservoir quality which will be tested with vertical delineation wells later in 2011.

During 2011, Storm plans to drill four horizontal wells (2.4 net) and one to two vertical delineation wells (0.6 to 1.2 net). The cost per well to drill, complete and tie-in horizontals with 10 fracture treatments is forecast to be \$4.0 to \$4.5 million. Initially, infrastructure costs are not expected to be significant given that Storm can access existing facilities and pipelines which are connected to Spectra's McMahon Gas Plant.

Storm management estimates that DPIIP in the Montney formation ranges from 14 to 28 Bcf of raw gas per section which is based on log analysis from a limited number of vertical wells on Storm's lands plus core data from two vertical wells in the area. The specific parameters used in estimating DPIIP include net pay of 15 to 30 metres (using a 3% sandstone scale cut-off), average porosity of 7%, average gas saturation of 83% and reservoir pressure of 15,300 kPa. The natural gas produced from the Montney formation benefits from higher heat or Btu content per Mcf which is expected to result in the recovery of approximately 20 to 25 barrels per Mmcf of natural gas liquids at the McMahon Gas Plant.

(1) Discovered Petroleum Initially in Place ("DPIIP") - Is defined in the COGEH handbook as the quantity of hydrocarbons that are estimated to be in place within a known accumulation. Original Gas in Place ("OGIP") is a more commonly used industry term when referring to gas accumulations. DPIIP is divided into recoverable and unrecoverable portions, with the estimated future recoverable portion classified as reserves and contingent resources. There is no certainty that it will be economically viable or technically feasible to produce any portion of this DPIIP except for those portions identified as proved or probable reserves.

## **Red Earth, North West Alberta**

In the Red Earth area, Storm participated in two Slave Point horizontal wells (0.4 net) which were completed with 30 ton fracture treatments across 14 and 20 intervals. Cost to drill, complete and equip each horizontal averaged \$5.1 million (\$1.0 million net). Both horizontals commenced production in early February and production to date has averaged approximately 100 net barrels of oil per day. Netbacks are estimated to be approximately \$65.00 per barrel at current oil prices given that both horizontals benefit from a 5% royalty rate under Alberta's New Well Royalty Rate program.

## **INVESTMENTS**

Storm has share ownership positions in one private company and three publicly traded companies. These shareholdings were transferred to Storm under the Plan of Arrangement with ARC Energy Trust. The value of the share positions in the three public companies totaled \$15.3 million at the end of 2010 and these securities could possibly be sold in the future with the proceeds being used to finance the Company's capital programs.

### **Storm Gas Resource Corp. ("SGR")**

SGR is a private company formed in June 2007 to pursue unconventional gas opportunities in the HRB and elsewhere. Storm's share ownership position totals 2.5 million shares, representing 22% ownership of SGR. Currently, SGR's land position totals 76,500 acres with 56,600 acres in the HRB. Storm estimates that SGR's working capital available for investment was \$15.0 million at the end of 2010.

### **Chinook Energy Inc. ("Chinook")**

Storm holds 4.5 million shares of Chinook which is a TSX-listed oil and gas exploration and production company (symbol 'CKE') based in Calgary with operations focused in Tunisia and Western Canada.

### **Bridge Energy ASA ("Bridge")**

Storm holds 1.05 million common shares of Bridge (symbol 'Bridge' on the Oslo Stock Exchange), a Norwegian based exploration and production company with production of approximately 1,500 Boe per day, several development opportunities in the UK sector of the North Sea, and a number of exploratory leads in the Norwegian sector of the North Sea.

### **Bellamont Exploration Ltd. ("Bellamont")**

At December 31, 2010, Storm held 5.08 million shares of Bellamont, a TSX-V-listed oil and gas exploration and production company.

## **OUTLOOK**

Capital investment in 2011 is expected to total \$24.0 million with \$7.0 million allocated to land and asset acquisitions and \$17.0 million for drilling, completions, facilities and tie-ins. Approximately 50% of this amount will be spent in the first half of 2011. Ultimately, capital allocation and the size of the drilling program will depend on results, natural gas prices and the size of any asset or undeveloped land acquisitions. Additional information regarding Storm's guidance for 2011 is provided below:

- Drilling will include five gross wells (3.0 net) with four horizontals and one vertical all at Umbach.
- Exit production or production for the final quarter of 2011 is expected to be approximately 1,000 to 1,200 Boe per day (12% oil and NGLs).
- Operating costs for the year are forecast to be \$7.00 per Boe.
- Cash general and administrative costs for the year are expected to total \$2.8 million.
- The corporate royalty rate is expected to be approximately 8% which includes the effect of royalty incentive programs in Alberta and British Columbia.

The current cash balance, cash flow and the possible sale of our share positions in the three public companies listed on stock exchanges will be used to fund planned 2011 capital expenditures.

Production is currently approximately 100 Boe per day and first quarter production is expected to average 100 to 200 Boe per day.

Storm had significant capital resources at the end of 2010 with \$36 million in working capital and publicly listed securities which can be used to advance current projects and to fund potential new ventures or acquisitions. In the current natural gas price environment, our focus will be on delineating resource and/or adding reserves as this is expected to provide a greater return on capital invested than growing production and cash flow. Vertical wells will be used to delineate and validate productivity of the resource and a limited number of horizontal wells will be drilled to determine production profiles, potential reserves and development costs. Most of our activity in 2011 is expected to be at Umbach given the favorable economics of exploiting natural gas in the Montney formation with higher liquids recovery and lower drilling and completion costs. Reserve additions in the HRB in 2011 could still be significant as additional undrilled locations are likely to be recognized if production performance of the first horizontal meets expectations and if the second horizontal completion is successful. If first quarter drilling and completion results are supportive of doing so, capital investment and drilling activity may be expanded in the second half of 2011. Given the future growth potential offered by our existing asset base, we fully expect that the patience and support of Storm's shareholders will be rewarded.

Respectfully,



Brian Lavergne,  
President and Chief Executive Officer

March 3, 2011

**Boe Presentation** – For the purpose of calculating unit revenues and costs, natural gas is converted to a barrel of oil equivalent (“Boe”) using six thousand cubic feet (“Mcf”) of natural gas equal to one barrel of oil unless otherwise stated. Boe may be misleading, particularly if used in isolation. A Boe conversion ratio of six Mcf to one barrel (“Bbl”) is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. All Boe measurements and conversions in this report are derived by converting natural gas to oil in the ratio of six thousand cubic feet of gas to one barrel of oil. Mboe means 1,000 Boe.

**Forward-Looking Statements** – such statements made in this report are subject to the limitations set out in the Management's Discussion and Analysis for the period to December 31, 2010.

## Reserves at December 31, 2010

Storm's year-end reserve evaluation effective December 31, 2010 was prepared by InSite Petroleum Consultants Ltd. ("InSite") which was formerly Paddock Lindstrom & Associates Limited. InSite has evaluated all of Storm's crude oil, NGL and natural gas reserves. The InSite price forecast at December 31, 2010 was used to determine all estimates of future net revenue (also referred to as net present value or NPV). Storm's Reserves Committee, comprised of independent and appropriately qualified directors, has reviewed and approved the evaluation prepared by InSite and the report of the Reserves Committee has been accepted by the Company's Board of Directors.

### Summary

- Proved reserves totaled 738 Mboe and proved plus probable reserves totaled 2,512 Mboe.
- The proved finding and development cost as per NI 51-101 requirements was \$29.10 per Boe and the proved plus probable finding and development cost, as per NI 51-101 requirements, was \$15.07 per Boe. This includes the change in future development costs ("FDC") and excludes the effect of acquisitions, divestitures, and revisions.
- The all-in cost to add proved reserves was \$29.10 per Boe and for proved plus probable reserves was \$15.07 per Boe. The all-in calculation reflects the result of Storm's entire capital investment program as it takes into account the effect of acquisitions, dispositions, revisions, as well as the change in future development costs.
- The net present value of proved plus probable reserves, discounted at 10% before tax, amounted to \$14.2 million. The InSite published price forecast effective December 31, 2010 was used for the independent reserve evaluation.
- Future development costs ("FDC") were \$4.7 million on a proved basis and \$21.1 million on a proved plus probable basis.
- In the HRB, proved plus probable reserves were 1,578 Mboe with 9.1 Bcf gross recoverable raw gas (537 MBoe net sales) assigned to the first horizontal which had a final test rate of 8.1 Mmcf per day. Proved plus probable reserves were also assigned for the completion of the second horizontal shale well (0.4 net) that was drilled in December 2010 and to one undrilled horizontal shale well (0.4 net). Proved plus probable FDC was \$37.6 million gross (\$15.0 million net) which includes \$9.0 million (\$3.6 million net) being invested in the first quarter of 2011 for associated infrastructure. In general, undrilled horizontal development wells are recognized as part of proved plus probable reserves if there is sufficient horizontal plus vertical well control and if they are likely to be drilled within three years.
- InSite estimated DPIIP of 1.8 to 2.05 Tcf gross raw gas in the Muskwa and Otter Park shales (721 to 822 Bcf DPIIP net to Storm's working interest) in Storm's Central Project Area in the HRB which consisted of 19 gross sections (7.6 net). This is based on 96 metres of Muskwa and Otter Park shale thickness, average porosity of 3.5% to 4.5%, adsorbed gas content of 69 Scf per ton, reservoir pressure of 28,100 kPa and 75% gas saturation.
- At Umbach, proved plus probable reserves totaled 857 Mboe net sales which were assigned to three Montney horizontal wells (1.8 net) which included two undrilled locations. Each horizontal was assigned 2.9 Bcf of gross recoverable raw gas reserves (286 Mboe net sales). Proved plus probable FDC totaled \$8.9 million gross (\$5.4 million net) and is primarily associated with the undrilled horizontal locations. In general, undrilled horizontal development wells are recognized as part of proved plus probable reserves if there is sufficient horizontal plus vertical well control and if they are likely to be drilled within three years.
- At Red Earth, proved plus probable reserves totaling 77 Mbbls net were assigned to two Slave Point horizontal wells (average of 196 gross Mbbls of oil per horizontal).

## Future Development Costs

|                                 |                     |                 |
|---------------------------------|---------------------|-----------------|
| Proved                          |                     | \$ 4.7 million  |
| HRB                             | 0.4 net horizontals | \$ 4.5 million  |
| Umbach                          | 0.6 net horizontals | \$ 0.0 million  |
| Miscellaneous                   |                     | \$ 0.2 million  |
| <hr/>                           |                     |                 |
| Proved Plus Probable Additional |                     | \$ 21.1 million |
| HRB                             | 1.2 net horizontals | \$ 15.5 million |
| Umbach                          | 1.8 net horizontals | \$ 5.4 million  |
| Miscellaneous                   |                     | \$ 0.2 million  |
| <hr/>                           |                     |                 |
|                                 |                     |                 |
|                                 | 2011                | 2012            |
| Proved                          | \$ 3.7 million      | \$ 1.0 million  |
| Proved plus probable additional | \$ 13.4 million     | \$ 7.7 million  |

## Gross Company Interest Reserves as at December 31, 2010 (Before deduction of royalties payable, not including royalties receivable)

|                            | Light Crude Oil<br>(Mbbbls) | Sales Gas<br>(Mmcf) | NGL<br>(Mbbbls) | 6:1 Oil Equivalent<br>(Mboe) |
|----------------------------|-----------------------------|---------------------|-----------------|------------------------------|
| Proved producing           | -                           | -                   | -               | -                            |
| Proved non-producing       | 63.4                        | 3,889.5             | 26.2            | 737.9                        |
| Total proved developed     | 63.4                        | 3,889.5             | 26.2            | 737.9                        |
| Proved undeveloped         | -                           | -                   | -               | -                            |
| Total proved               | 63.4                        | 3,889.5             | 26.2            | 737.9                        |
| Probable additional        | 13.2                        | 10,172.9            | 65.7            | 1,774.3                      |
| Total proved plus probable | 76.6                        | 14,062.4            | 91.9            | 2,512.2                      |

## Gross Company Reserve Reconciliation for 2010 (Gross company interest reserves before deduction of royalties payable)

|                                     | 6:1 Oil Equivalent (Mboe) |          |                         |
|-------------------------------------|---------------------------|----------|-------------------------|
|                                     | Total<br>Proved           | Probable | Proved plus<br>Probable |
| Opening balance                     | -                         | -        | -                       |
| Acquisitions                        | -                         | -        | -                       |
| Discoveries                         | 675                       | 148      | 823                     |
| Extensions                          | 63                        | 1,626    | 1,689                   |
| Dispositions                        | -                         | -        | -                       |
| Technical revisions                 | -                         | -        | -                       |
| Production                          | -                         | -        | -                       |
| December 31, 2010 – closing balance | 738                       | 1,774    | 2,512                   |



## NI 51-101 Finding and Development Costs

|   |    |        |
|---|----|--------|
| Total Proved Finding and Development Cost                                   |    | 2010   |
| Capital expenditures excluding acquisitions and dispositions (000s)         | \$ | 16,800 |
| Future development capital (000s) <sup>(1)</sup>                            |    | 4,679  |
| Total capital including the net change in future capital (000s)             | \$ | 21,479 |
| Reserve additions excluding acquisitions, dispositions and revisions (Mboe) |    | 738    |
| Total proved finding and development costs (per Boe)                        | \$ | 29.10  |

(1) As there were no assigned reserves at commencement of operations on August 17, 2010, no change in previously allocated future development costs is applicable.

|   |    |        |
|---|----|--------|
| Total Proved Plus Probable Finding and Development Cost                     |    | 2010   |
| Capital expenditures excluding acquisitions and dispositions (000s)         | \$ | 16,800 |
| Future development capital (000s) <sup>(1)</sup>                            |    | 21,057 |
| Total capital including the net change in future capital (000s)             | \$ | 37,857 |
| Reserve additions excluding acquisitions, dispositions and revisions (Mboe) |    | 2,512  |
| Total proved plus probable finding and development costs (per Boe)          | \$ | 15.07  |

(1) As there were no assigned reserves at commencement of operations on August 17, 2010, no change in previously allocated future development costs is applicable.

## All-In Finding, Development and Acquisition Costs

|  |    |        |
|--|----|--------|
| Total Proved All-In Finding, Development and Acquisition Cost including FDC, Acquisitions, Dispositions, Revisions |    | 2010   |
| Capital expenditures including acquisitions and dispositions (000s)  | \$ | 16,800 |
| Future development capital (000s) <sup>(1)</sup>   |    | 4,679  |
| Total capital including the net change in future capital (000s)  | \$ | 21,479 |
| Reserve additions including acquisitions, dispositions and revisions (Mboe)  |    | 738    |
| All-in total proved finding and development costs (per Boe)  | \$ | 29.10  |

(1) As there were no assigned reserves at commencement of operations on August 17, 2010, no change in previously allocated future development costs is applicable.

|  |    |        |
|--|----|--------|
| Total Proved Plus Probable All-In Finding, Development and Acquisition Cost including FDC, Acquisitions, Dispositions, Revisions |    | 2010   |
| Capital expenditures including acquisitions and dispositions (000s)  | \$ | 16,800 |
| Future development capital (000s) <sup>(1)</sup>   |    | 21,057 |
| Total capital including the net change in future capital (000s)  | \$ | 37,857 |
| Reserve additions including acquisitions, dispositions and revisions (Mboe)  |    | 2,512  |
| All-In total proved plus probable finding and development costs (per Boe)  | \$ | 15.07  |

(1) As there were no assigned reserves at commencement of operations on August 17, 2010, no change in previously allocated future development costs is applicable.

### Net Present Value Summary (before tax) as at December 31, 2010

Benchmark oil and NGL prices used are adjusted for quality of oil or NGL produced and for transportation costs. The calculated NPVs include a deduction for estimated future well abandonment costs.

|                            | Undiscounted<br>(000s) | Discounted at<br>5%<br>(000s) | Discounted at<br>10%<br>(000s) | Discounted at<br>15%<br>(000s) | Discounted at<br>20%<br>(000s) |
|----------------------------|------------------------|-------------------------------|--------------------------------|--------------------------------|--------------------------------|
| Proved producing           | -                      | -                             | -                              | -                              | -                              |
| Proved non-producing       | \$ 13,329              | \$ 9,447                      | \$ 7,118                       | \$ 5,570                       | \$ 4,469                       |
| Total proved developed     | \$ 13,329              | \$ 9,447                      | \$ 7,118                       | \$ 5,570                       | \$ 4,469                       |
| Proved undeveloped         | -                      | -                             | -                              | -                              | -                              |
| Total proved               | \$ 13,329              | \$ 9,447                      | \$ 7,118                       | \$ 5,570                       | \$ 4,469                       |
| Probable additional        | \$ 26,534              | \$ 13,679                     | \$ 7,114                       | \$ 3,323                       | \$ 940                         |
| Total proved plus probable | \$ 39,863              | \$ 23,126                     | \$ 14,232                      | \$ 8,893                       | \$ 5,409                       |

### Net Present Value Summary (after tax) as at December 31, 2010

Benchmark oil and NGL prices used are adjusted for quality of oil or NGL produced and for transportation costs. The calculated NPVs each include a deduction for estimated future well abandonment costs.

|                            | Undiscounted<br>(000s) | Discounted at<br>5%<br>(000s) | Discounted at<br>10%<br>(000s) | Discounted at<br>15%<br>(000s) | Discounted at<br>20%<br>(000s) |
|----------------------------|------------------------|-------------------------------|--------------------------------|--------------------------------|--------------------------------|
| Proved producing           | -                      | -                             | -                              | -                              | -                              |
| Proved non-producing       | \$ 13,329              | \$ 9,447                      | \$ 7,118                       | \$ 5,570                       | \$ 4,469                       |
| Total proved developed     | \$ 13,329              | \$ 9,447                      | \$ 7,118                       | \$ 5,570                       | \$ 4,469                       |
| Proved undeveloped         | -                      | -                             | -                              | -                              | -                              |
| Total proved               | \$ 13,329              | \$ 9,447                      | \$ 7,118                       | \$ 5,570                       | \$ 4,469                       |
| Probable additional        | \$ 25,838              | \$ 13,472                     | \$ 7,047                       | \$ 3,300                       | \$ 932                         |
| Total proved plus probable | \$ 39,167              | \$ 22,919                     | \$ 14,165                      | \$ 8,870                       | \$ 5,401                       |

### InSite Petroleum Consultants Ltd. Escalating Price Forecast as at December 31, 2010

|      | WTI<br>Crude Oil<br>(US\$/Bbl) | Edmonton<br>Light Crude Oil<br>(Cdn\$/Bbl) | Henry Hub<br>Natural Gas<br>(US\$/Mmbtu) | AECO<br>Natural Gas<br>(Cdn\$/Mmbtu) | Propane<br>(Cdn\$/Bbl) | Butane<br>(Cdn\$/Bbl) |
|------|--------------------------------|--|--|--------------------------------------|------------------------|-----------------------|
| 2011 | 88.00                          | 87.30                                      | 4.50                                     | 4.14                                 | 52.38                  | 69.84                 |
| 2012 | 90.00                          | 90.28                                      | 5.20                                     | 4.71                                 | 54.17                  | 72.23                 |
| 2013 | 92.00                          | 93.83                                      | 5.75                                     | 5.29                                 | 56.30                  | 75.07                 |
| 2014 | 94.00                          | 95.88                                      | 6.25                                     | 5.76                                 | 57.53                  | 76.70                 |
| 2015 | 96.00                          | 97.92                                      | 6.75                                     | 6.27                                 | 58.75                  | 78.34                 |

# Management's Discussion and Analysis

## INTRODUCTION

Set out below is management's discussion and analysis ("MD&A") of financial and operating results for Storm Resources Ltd. ("Storm" or the "Company") for the period from inception, June 8, 2010 and for the three months to December 31, 2010. It should be read in conjunction with the audited financial statements for the period from June 8, 2010 to December 31, 2010 and other operating and financial information included in this report. In addition, readers are directed to the discussion below regarding Forward-Looking Statements, Boe Presentation and Non-GAAP Measurements.

The Company was incorporated on June 8, 2010 as 1541229 Alberta Ltd. with nominal share capital and was inactive until August 17, 2010 when the Company participated in a Plan of Arrangement (the "Arrangement") along with Storm Exploration Inc ("SEO"), ARC Energy Trust ("ARC") and ARC Resources Ltd. The Arrangement resulted in the sale of SEO to ARC and the spin out of the Company as a junior exploration and development company. As part of the series of transactions associated with the Arrangement, the Company issued shares in exchange for certain assets formerly owned by SEO as more fully described in Note 4 to the audited financial statements for the period ended December 31, 2010. On August 31, 2010 the Company began trading on the TSX Venture Exchange under the symbol "SRX". Although the Company's corporate existence began on June 8, 2010, operating activity only began upon completion of the Arrangement. Consequently the discussion of operations in this MD&A is for the fifteen week period from August 17, 2010 (the "Arrangement date") to December 31, 2010 and for the quarter ended December 31, 2010.

This management's discussion and analysis is dated March 3, 2011. Unless otherwise indicated all dollar amounts are in thousands.

## LIMITATIONS

**Basis of Presentation** – Financial data presented below have largely been derived from the Company's audited financial statements for the period from June 8, 2010 to December 31, 2010, prepared in accordance with International Financial Reporting Standards ("IFRS"). Accounting policies compliant with IFRS adopted by the Company are set out in Note 3 to the audited financial statements. The reporting and the measurement currency is the Canadian dollar. Unless otherwise indicated, tabular financial amounts, other than per share amounts, are in thousands.

The Company's use of IFRS in the audited financial statements for the period ended December 31, 2010 anticipates the mandatory adoption of IFRS in Canada, which is effective for reporting periods ending after December 31, 2010. The Company has received the necessary regulatory approvals for early adoption of IFRS.

**Forward-Looking Statements** – Certain information set forth in this document, including management's assessment of Storm's future plans and operations, contains forward-looking information (within the meaning of applicable Canadian securities legislation). Such statements or information are generally identifiable by words such as "anticipate", "believe", "intend", "plan", "expect", "estimate", "budget", "outlook", "forecast" or other similar words and include statements relating to or associated with individual wells, regions or projects. Without limitation, any statements regarding the following are forward-looking statements:

- future crude oil or natural gas prices;
- future production levels;
- future revenues or costs or revenues or costs per commodity unit;
- future capital expenditures and their allocation to specific exploration and development activities or periods;
- future drilling;
- future earnings;

- future asset acquisitions or dispositions;
- future sources of funding for capital program;
- future decommissioning costs;
- development plans;
- ultimate recoverability of reserves or resources;
- expected finding and development costs, operating costs and general and administrative costs;
- estimates on a per-share basis;
- dates or time periods by which certain geographical areas will be developed; and
- changes to any of the foregoing.

Statements relating to “reserves” or “resources” are forward-looking statements, as they involve the implied assessment, based on estimates and assumptions, that the reserves and resources described exist in the quantities predicted or estimated, and can be profitably produced in the future.

The forward-looking statements are subject to known and unknown risks and uncertainties and other factors which may cause actual results, levels of activity and achievements to differ materially from those expressed or implied by such statements. Such factors include the material risks described in this MD&A under “Critical Accounting Estimates” and the material assumptions described under the headings “Overview”; “Share-based Payments”; “Depreciation”; “Accretion”; “Investment Loss”; “Income Taxes”; “Comprehensive Income (Loss)”; “Financial Resources and Liquidity”; “Investments”; “Investment in Associate”; “Accounts Payable and Accrued Liabilities”; “Decommissioning Liability”; industry conditions, volatility of commodity prices, currency fluctuations, imprecision of reserve estimates, environmental risks, competition from other industry participants, the lack of availability of qualified personnel or management, stock market volatility and ability to access sufficient capital from internal and external sources. All of these caveats should be considered in the context of current economic conditions, in particular reduced prices for natural gas, the condition of financial institutions and markets as well as the stability of joint venture and other business partners, all of which are outside the control of the Company. Readers are advised that the assumptions used in the preparation of such information, although considered reasonable at the time of preparation, may prove to be imprecise and, as such, undue reliance should not be placed on forward-looking statements. Storm’s actual results, performance or achievement, could differ materially from those expressed in, or implied by, these forward-looking statements. Storm disclaims any intention or obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required under securities law. References to forward-looking information are also made in the year-end report this MD&A forms part of. The forward-looking statements contained therein are expressly qualified by this cautionary statement.

**Boe Presentation** – Natural gas is converted to a barrel of oil equivalent (“Boe”) using six thousand cubic feet (“Mcf”) of natural gas equal to one barrel of oil unless otherwise stated. Boe may be misleading, particularly if used in isolation. A Boe conversion ratio of six Mcf to one barrel (“Bbl”) is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. All Boe measurements and conversions in this report are derived by converting natural gas to oil in the ratio of six thousand cubic feet of gas to one barrel of oil.

**Non-GAAP Measurements** - Within management’s discussion and analysis, there may be references made to terms which are not recognized under GAAP. Specifically, “funds from operations”, “funds from operations per share” and netbacks do not have any standardized meaning as prescribed by GAAP and are regarded as non-GAAP measures. It is likely that these non-GAAP measurements may not be comparable to the calculation of similar amounts for other entities. In particular, funds from operations is not intended to represent, or be equivalent to, cash flow from operating activities calculated in accordance with GAAP which appears on the Company’s statement of cash flows. Funds from operations and similar non-GAAP terms are used to benchmark operations against prior periods and peer group companies.

## OPERATIONAL AND FINANCIAL RESULTS

### Overview

In the period to December 31, 2010, the Company drilled a total of five wells. Two horizontal wells at a working interest of 40% were drilled in the Horn River Basin in North East British Columbia; one well was completed and tested at 8 to 9 Mmcf per day (rate was restricted for the duration of the flow test) and the remaining well is awaiting completion. The Company's partner and operator of the wells is its 22% owned associate, Storm Gas Resource Corp. The Company expects to tie in and begin producing natural gas from the Muskwa and Otter Park formations from the first well in March 2011 and is planning to complete the second well later in 2011.

At Umbach in North East British Columbia the Company, as operator, drilled and completed a vertical delineation well and completed an operated horizontal well at a 60% working interest into the Montney formation. The horizontal well is expected to begin production of natural gas and natural gas liquids in March 2011. Drilling in the final quarter of 2010 represents the first stage in what is hoped to be a multi-year development program at each of the Horn River Basin and Umbach.

The Company also drilled two non-operated 20% working interest horizontal oil wells at Red Earth in North Central Alberta, with each well currently producing approximately 50 barrels of light sweet crude per day net to the Company's interest. Red Earth is not regarded as a core property to the Company; however, the Company will remain active in the area as long as there is a near term opportunity to access high netback revenue.

During the period to December 31, 2010, the Company was also an active participant at land sales in its core areas, as well as other activities necessary to advance knowledge of the areas and prepare for production.

During the period from the Arrangement date to December 31, 2010, the Company built out land, administrative, accounting and reporting systems and secured a listing on the TSX Venture Exchange. The administrative structures should now be in place to handle several years' expansion with only modest growth in overhead costs.

### Production and Revenue

During the period from June 8, 2010 to December 31, 2010, the Company had no production and no production revenue.

### General and Administrative Costs

|                           | Quarter Ended<br>December 31, 2010 | June 8 to<br>December 31, 2010 |
|---------------------------|------------------------------------|--------------------------------|
| Charge for period – gross | \$ 863                             | \$ 1,146                       |
| Overhead recoveries       | (65)                               | (81)                           |
| Charge for period net     | \$ 798                             | \$ 1,065                       |

Compensation costs were consistent for each of the two periods above, accounting for approximately 56% of the gross charge with office accommodation costs accounting for an additional 16% and public company costs accounting for 16%. Although Storm commenced operations August 17, 2010, the Company was incorporated June 8, 2010.

### Share-Based Payments

Share-based payments are non-cash charges which reflect the estimated value of stock options issued to Storm's directors, officers and employees. The value of the award is recognized as an expense over the period from the grant date to the date of vesting of the award. In August 2010, options in respect of approximately two million shares were issued with an exercise price of \$3.28. This issue, considerable in size, formed part of the initial compensation program put in place for directors, officers and staff for the newly established business. No additional options were issued in the quarter ended December 31, 2010.

### Depreciation

The charge for depreciation for the period relates to office equipment which is depreciated over its estimated useful life. No depletion or depreciation is provided in respect of intangible and tangible field assets as the Company has no production and no facilities in use.

## Accretion

Accretion represents the time value increase of the Company's decommissioning liability for the period.

## Interest Income

|                   | Quarter Ended<br>December 31, 2010 | June 8 to<br>December 31, 2010 |
|-------------------|------------------------------------|--------------------------------|
| Income for period | \$ 90                              | \$ 109                         |

Interest is received on cash on deposit with the Company's bankers, ATB Financial.

## Investment Loss

|                        | Quarter Ended<br>December 31, 2010 | June 8 to<br>December 31, 2010 |
|------------------------|------------------------------------|--------------------------------|
| Equity loss for period | \$ 89                              | \$ 114                         |

As described in Notes 3 and 7 to the audited financial statements for the period to December 31, 2010, the Company accounts for its 22% ownership position in an associated company, Storm Gas Resource Corp. ("SGR") using the equity method, where the Company's pro rata share of changes in SGR's equity is included in the determination of the Company's net loss for the period. The investment loss recorded represents Storm's share of changes in SGR's equity from the Arrangement date to December 31, 2010. Summarized financial information regarding SGR is provided in Note 7 to the Company's audited financial statements for the period ended December 31, 2010. SGR's principal business activity in 2010 was the development of a natural gas prospect in the Horn River Basin of North East British Columbia in a 60:40 joint venture with Storm. There was no production from this prospect.

## Income Taxes

Due to uncertainty of realization, no deferred income tax asset has been set up in respect of potential future income tax reductions resulting from the use of the taxable loss for the period.

## Other Comprehensive Income (Loss)

Comprehensive income (loss) comprises net loss for the period plus the unrealized gains and losses resulting from the mark-to-market valuation of certain assets and liabilities. For the period to December 31, 2010, Storm's comprehensive income included adjustments to reflect the period end mark-to-market valuation of listed securities as follows:

|                            | Holding               | Number of<br>Shares | Quarter Ended<br>December 31, 2010 | June 8 to<br>December 31, 2010 |
|----------------------------|-----------------------|---------------------|------------------------------------|--------------------------------|
| Bellamont Exploration Ltd. | Class A Common Shares | 5,080,645           | \$ 305                             | \$ 305                         |
| Bridge Energy ASA          | Common Shares         | 1,052,910           | 121                                | 590                            |
| Chinook Energy Inc.        | Common Shares         | 4,500,001           | (1,260)                            | (810)                          |
| Net loss for period        |                       |                     | \$ (834)                           | \$ 85                          |

## INVESTMENT AND FINANCING

### Financial Resources and Liquidity

The Company has cash on deposit derived from the following transactions:

|   | Transaction Date   | Amount    |
|---|--------------------|-----------|
| Received under Arrangement                                  | August 17, 2010    | \$ 9,370  |
| Proceeds of private placement                               | August 17, 2010    | 7,544     |
| Proceeds from exercise of warrants - net                    | September 22, 2010 | 21,432    |
| Total cash received   |                    | 38,346    |
| Net cash outlays from Arrangement date to December 31, 2010 |                    |           |
| Operating activities  |                    | (1,509)   |
| Investing activities  |                    | (6,113)   |
| Total   |                    | (7,622)   |
| Cash at end of period                                       |                    | \$ 30,724 |
| Accounts receivable   |                    | 780       |
| Accounts payable  |                    | (11,583)  |
| Net funds available for investment                          |                    | \$ 19,921 |

Cash has been placed on deposit with the Company's bankers, ATB Financial. Protection of principal is paramount; correspondingly the Company does not seek to maximize interest and other income from speculative investment of cash which may be surplus to immediate operating requirements. Monies on deposit with ATB Financial are guaranteed by the Government of Alberta, which has a triple A credit rating.

### Investments

The Company owns listed securities as set out below which are valued at the closing price on the relevant stock exchange at December 31, 2010. Proceeds from the possible future sale of these securities may be used to finance the Company's capital programs.

|                           | Holding               | Number of Shares | Exchange        | Closing Price December 31, 2010 | Value at December 31, 2010 |
|---------------------------|-----------------------|------------------|-----------------|---------------------------------|----------------------------|
| Bellmont Exploration Ltd. | Class A Common Shares | 5,080,645        | TSX-V           | \$ 0.59                         | \$ 2,998                   |
| Bridge Energy ASA         | Common Shares         | 1,052,910        | Oslo Børs Axess | \$ 2.56 <sup>(1)</sup>          | 2,696                      |
| Chinook Energy Inc.       | Common Shares         | 4,500,001        | TSX             | \$ 2.14                         | 9,630                      |
| Total                     |                       |                  |                 |                                 | \$ 15,324                  |

(1) Canadian dollar equivalent – share trading is in Norwegian Kroner.

### Capital Outlays

Additions to exploration and evaluation assets in 2010 were as follows:

|                                      | Quarter Ended December 31, 2010 | June 8 to December 31, 2010 |
|--------------------------------------|---------------------------------|-----------------------------|
| Land and lease                       | \$ 2,833                        | \$ 3,010                    |
| Seismic                              | 1,151                           | 1,151                       |
| Drilling                             | 6,617                           | 7,149                       |
| Completions                          | 3,931                           | 6,510                       |
| Facilities                           | 447                             | 513                         |
| Recompletions and workovers          | 394                             | 394                         |
| Dispositions                         | (2,000)                         | (2,000)                     |
| Administrative equipment             | -                               | 70                          |
| Total capital expenditures in period | 13,373                          | 16,797                      |

Major expenditures in 2010 included \$3.7 MM at Umbach to drill a vertical delineation gas well and complete a horizontal gas well (both at 60% working interest), \$8.0 MM in the Horn River Basin drilling two non-operated horizontal gas wells (40% working interest) and completing one of these wells, and \$1.8 MM at Red Earth drilling two non-operated horizontal oil wells.

### Investment in Associate

The Company owns 2,500,000 common shares of Storm Gas Resource Corp., representing a 22% interest. The Company accounts for its interest in SGR using the equity method. The carrying amount of the Company's interest in SGR at December 31, 2010 is \$5.55 per share, representing the transfer amount under the Arrangement, plus the Company's share of SGR's loss since the Arrangement date. This amount should not be regarded as representative of the value of Storm's investment in SGR. In addition to its investment in SGR, Storm has a direct 40% working interest in undeveloped lands jointly acquired with SGR in the Horn River Basin of North East British Columbia. This interest, together with Storm's investment in SGR, provides the Company with 53% exposure to the potential upside in the Horn River Basin lands. The Company also provides management services to SGR and the amount billed for such services totaled \$68,000 for the quarter ended December 31, 2010 and \$101,000 for the period from the Arrangement date to December 31, 2010.

### Accounts Payable and Accrued Liabilities

Accounts payable and accrued liabilities include operating, administrative and capital costs payable. Net payables in respect of cash calls issued to partners regarding capital projects and estimates of amounts owing but not yet invoiced to the Company have been included in accounts payable.

### Decommissioning Liability

The Company's decommissioning liability represents the present value of estimated future costs to be incurred to abandon and reclaim wells drilled on lands transferred to the Company under the Arrangement. Changes in amount of the liability between the Arrangement date and December 31, 2010 comprise the present value of additional liabilities accruing to the Company as a result of field activity during the period, plus the time related increase in the present value of the liability. The risk free discount rate used to establish the present value is 4%. Future costs to abandon and reclaim the Company's properties are based on an internal evaluation, supported by external data from industry sources.

### Shareholders' Equity

Details of share issuances from June 8, 2010 to December 31, 2010 are as follows:

|                    | Nature of Transaction            | Number of Shares | Price per Share | Gross Proceeds |
|--------------------|----------------------------------|------------------|-----------------|----------------|
| June 8, 2010       | Issued upon incorporation        | 1                | \$ 1.00         | \$ -           |
| August 17, 2010    | Issued to ARC Resources Ltd.     | 884,173          | \$ 3.28         | 2,900          |
| August 17, 2010    | Issued under the Arrangement     | 16,631,240       | \$ 3.28         | 54,700         |
| August 17, 2010    | Issued under private placement   | 2,300,000        | \$ 3.28         | 7,544          |
| September 22, 2010 | Issued upon exercise of warrants | 6,561,556        | \$ 3.28         | 21,522         |
| Total              |                                  | 26,376,970       |                 | \$ 86,666      |

## CONTRACTUAL OBLIGATIONS

In the course of its business, Storm enters into various contractual obligations, including the following:

- purchase of services;
- royalty agreements;
- operating agreements;
- processing agreements;
- right of way agreements; and
- lease obligations for accommodation, office equipment and automotive equipment.



All such contractual obligations reflect market conditions at the time of contract and do not involve related parties except that SGR subleases office space from the Company at the same rate as the Company's head lease. At present the Company has no obligations with a term longer than twelve months.

## QUARTERLY RESULTS

Summarized information for the two reporting quarters since inception are as follows:

|  | Quarter Ended<br>September 30, 2010 | Quarter ended<br>December 31, 2010 |
|--|-------------------------------------|------------------------------------|
| Funds applied to operations (\$000s)   | (248)                               | (708)                              |
| Per share  |                                     |                                    |
| - basic (\$)   | (0.03)                              | (0.03)                             |
| - diluted (\$)   | (0.03)                              | (0.03)                             |
| Net loss (\$000s)  | (406)                               | (1,087)                            |
| Per share  |                                     |                                    |
| - basic (\$)   | (0.05)                              | (0.04)                             |
| - diluted (\$)   | (0.05)                              | (0.04)                             |
| Other comprehensive income (loss) (\$000s)   | 919                                 | (834)                              |
| Capital expenditures (\$000s)  | 3,424                               | 13,373                             |
| Net funds available for investment and held-for-sale<br>investments – end of period (\$000s) | 50,563                              | 35,245                             |

## CRITICAL ACCOUNTING ESTIMATES

Financial amounts included in this Management's Discussion and Analysis and in the audited financial statements for the period ended December 31, 2010 are based on accounting policies, estimates and judgments which reflect information available to management at the time of preparation. Certain financial amounts are derived from a fully completed transaction cycle, or are validated by events subsequent to the end of the reporting date, or are based on established and effective measurement and control systems. However, other amounts, as described below, are based on estimations using information that involves a high degree of measurement uncertainty which could have a material effect on Storm's operating results and financial position.

### Acquisition of Net Assets

The carrying amount of net assets acquired by the Company under the Arrangement is based on management's estimate of the fair value of the net assets at the time of closing of the Arrangement. The fair value of certain assets can be established by reference to objective third party data, for example, cash and listed securities. However, the estimated fair value of other assets acquired under the Arrangement was based on management's judgment which, in part, included references to third party data. Management's estimate of fair value may differ from estimates of fair value determined by other parties and such differences could be material. There has been no revision subsequent to the Arrangement date to management's estimate of the fair values of the assets transferred under the Arrangement.

### Exploration and Evaluation Assets

At present the Company has no production and recovery of the Company's investment in oil and gas properties is dependent on the future identification, development and sale of hydrocarbons at a price sufficient to recover and provide an acceptable return on the Company's existing and future investment. The Company's properties are largely natural gas prone and recovery of the Company's investment and the establishment of operations providing an acceptable level of profit is dependent on pricing for natural gas increasing considerably from current levels. Continuing low natural gas prices will have an effect on the timing and nature of future capital programs which will have a material effect on future financial results.

### Decommissioning Liability

Storm records as a liability the estimated fair value of obligations associated with the decommissioning of field assets. Although the Company had no production in the period from the Arrangement date to December 31, 2010, a provision is required for certain standing wells, wells drilled in the period to December 31, 2010, as well as an interest in a currently unused pipeline. The carrying amount of exploration and evaluation assets is increased by an amount

equivalent to the liability. The decommissioning liability reflects estimated costs to complete the abandonment and reclamation of field assets as well as the estimated timing of the costs to be incurred in future periods. The liability is increased each reporting period to reflect the passage of time, with the accretion charged to earnings. The liability is also adjusted to reflect changes in the amount and timing of future retirement obligations and is reduced by the amount of any costs incurred in the period. The amount of future decommissioning costs and the charge for accretion are subject to uncertainty of estimation.

## **Income Taxes**

The measurement of Storm's tax pools, losses and deferred tax assets and liabilities requires interpretation of complex laws and regulations. All tax filings and compliance with tax regulations are subject to audit and reassessment, potentially several years after the initial filing. Accordingly, actual income tax assets or liabilities may differ significantly from the amounts initially estimated.

## **Share-Based Payments**

To determine the charge for share-based payments, the Company estimates the fair value of stock options at the time of issue using assumptions regarding the life of the option, dividend yields, interest rates and the volatility of the security under option. Although the assumptions used to value a specific option remain unchanged throughout the life of the option, assumptions may change with respect to subsequent option grants. In addition, the assumptions used may not properly represent the fair value of stock options at any time; as no alternative valuation model is applied, the difference between the Company's estimation of fair value and the actual value of the option is not measurable.

## **RISK ASSESSMENT**

There are a number of risks facing participants in the Canadian oil and gas industry. Some risks are common to all businesses while others are specific to the industry. The following reviews a number of the identifiable business risks faced by the Company. Business risks evolve constantly and additional risks emerge periodically. The risks below are those identified by management at the date of completion of this report, and may not describe all of the business risks faced by the Company.

### **Exploration**

Storm's exploration program requires sophisticated and scarce technical skills as well as capital and access to land and oilfield service equipment to generate and test exploration ideas. Further, the drilling of an exploratory prospect frequently does not result in the discovery of economical reserves. Storm endeavours to minimize finding risk by ensuring that:

- Where possible, prospects have multi-zone potential.
- Activity is focused in core regions where expertise and experience can be levered.
- Prospects are internally generated.
- Geophysical techniques such as seismic are utilized where appropriate and available.

### **Commodity Price Fluctuations**

When the Company identifies hydrocarbons of sufficient quantity and quality and successfully brings them on stream, it will face a pricing environment which is volatile and subject to a myriad of factors, largely out of the Company's control. Low prices, particularly for the Company's expected primary product, natural gas, will have a material effect on the Company's re-investment capacity, and hence ultimate growth potential and profitability. Low prices will also limit access to capital, both equity and debt. The Company may mitigate the risk of pricing volatility through the use of financial instruments, such as fixed priced sales, swaps and similar contracts. However, access to such price protection instruments may not be available in future periods, or available only at a cost considered to be uneconomic.

## **Adverse Well or Reservoir Performance**

Changes in productivity in wells and pools developed and brought on stream by the Company in future periods could result in termination or limitation of production, or acceleration of decline rates, resulting in reduced overall corporate volumes and revenues. In addition, new wells, particularly new wells in the Horn River Basin, the Company's primary investment focus, tend to produce at high initial rates followed by rapid declines until a flattening decline profile emerges. There is a risk that the sustainable decline profile which eventually emerges is sub-economic. In addition, the Horn River Basin is in the early stage of development and there is a risk that unforeseeable circumstances may emerge which will adversely affect reservoir performance. Also, at Umbach, a key area for future development activity, there is little public third party well information about the Montney formation which would assist future investment decisions.

## **Field Operations**

Storm's current and future exploration, development and production activities involve the use of heavy equipment and the handling of potentially volatile liquids and gases. Catastrophic events such as well blowouts, explosions and fires within pipeline, gathering, or facility infrastructure, as well as failure of mechanical equipment, could lead to releases of liquids or gases, spills, personal injuries and damage to the environment, as well as uncontrolled cost escalation. With support from suitably qualified external parties, the Company has developed and implemented policies and procedures to mitigate environmental, health and safety risks. These policies and procedures include the use of formal corporate policies, emergency response plans, and other policies and procedures reflecting best oil field practices. These policies and procedures are subject to periodic review. Storm also manages environmental and safety risks by maintaining its operations to a high standard and complying with all provincial and federal environmental and safety regulations.

The Company's areas of activity, particularly the Horn River Basin in North East British Columbia, are remote and climatically hostile. With any new area of activity for the oil and gas industry in Canada, access and production facilities require considerable additional investment to support expansion of production, which is not necessarily applicable to more mature producing areas. In addition, supervision and maintenance of production facilities is likely to be more expensive than in existing and more southerly producing areas.

Storm maintains industry-specific insurance policies, including, in future, business interruption on production facilities. Although the Company believes its current insurance coverage corresponds to industry standards, there is no guarantee that such coverage will be available in the future, and if it is, at a cost acceptable to the Company, or that existing coverage will necessarily extend to all circumstances or incidents resulting in loss.

## **Environmental**

The Company's operations are subject to extensive environmental regulation which are addressed through formal policies and procedures and application of best field practices. In addition, the Company's area of focus in the Horn River Basin in North East British Columbia, involves the exploitation of potentially several shale gas formations. Exploitation of shale gas is relatively new and involves horizontal drilling and fracturing applications specific to shale formations. Fracturing involves the use of large quantities of liquids and chemicals, whose use and subsequent disposal has resulted in the emergence of environmental concerns, primarily in more heavily populated areas elsewhere in North America. In addition, exploitation of shale gas in the Horn River Basin suggests that management of carbon dioxide volumes produced concurrently with natural gas may become an operational issue.

The evolution of environmental regulation, in particular as it relates to shale gas exploitation, cannot be predicted at this stage. Nevertheless it is reasonable to expect that management of environmental issues and related societal expectations will become an increasingly important part of the Company's business, with a corresponding effect on costs.

In addition to Company-specific environmental concerns, increasing public and political focus on climate change and its possible amelioration, may cause changes in demand for the Company's products and the introduction of regulations which may result in changes to the Company's operating practices as well as additional and unforeseeable costs. Changes in public policy over the next several years, and the effect on the Company, cannot be determined at this stage, but given that the Company is a producer of primary hydrocarbons it is likely that its business will be subject to increased regulation and potentially subject to additional taxes and costs.

## **Industry Capacity Constraints**

High levels of field activity can result in shortages of services, products, equipment, or manpower in many or all necessary components of the exploration and development cycle. Increased demand leads to higher land and service costs during peak activity periods. Activity in the Canadian oil and gas industry, particularly in the last two years, has been considerable and competition in the Company's most prospective areas continues to be intense, in spite of current depressed natural gas prices. Storm's competitors include companies with far greater resources, including access to capital and the ability to secure oilfield services at more favourable prices. Storm competes by maintaining a large inventory of self-generated exploration and development locations, by acting as operator where possible, and through facility access and ownership. Storm also seeks to mitigate such risks through careful management of key supplier relationships.

## **Capital Programs**

Capital expenditures are designed to accomplish two main objectives, being the generation of short and medium term cash flow from development activities, and expansion of future cash flow from the discovery of reserves through exploration. The Company focuses its activity in core areas, which allows it to leverage its experience and knowledge, and will act as operator wherever possible. The Company uses farmouts to minimize risk on plays it considers higher risk or where total capital invested exceeds an acceptable level. In addition, Storm may enter into hedging agreements in support of capital programs, particularly when cash flow for any period is anticipated to be lower than capital expenditures. Current capital programs are being financed from existing cash resources. Failure to develop producing wells and an acceptable level of cash flow will result in the exhaustion of available cash or near cash resources and will require the Company to seek additional capital which may not be available, or only available on terms dilutive to existing shareholders. In addition, although the Company at present has no bank debt, future credit availability from the Company's bankers will also be necessary to support capital programs and any changes to credit availability may have an effect on both the size of the Company's future capital program and the timing of expenditures.

## **Acquisitions**

The Company's objective of rapid and controlled growth is, in part, supported through carefully selected and managed acquisitions. Acquisitions have to be acceptably priced and production should provide acceptable netbacks, or provide identifiable opportunities to increase value. Under current natural gas prices, properties providing a reasonable netback are difficult to identify. An acquisition should also offer potential for near and medium term development and be in areas where the Company can readily add to the acquired land position. Processing and transportation infrastructure must also be in place, or within the Company's financial capacity to construct.

## **Reserve Estimates**

Estimates of economically recoverable oil and natural gas reserves and natural gas liquids, and related future net cash flows, are based upon a number of variable factors and assumptions. These include commodity prices, production, future development and operating costs and potential changes to the Company's operations arising from regulatory or fiscal changes. All of these estimates may vary from actual results, with the result that estimates of recoverable oil and natural gas reserves attributable to any property are subject to revision. In future the Company's actual production, revenues, taxes, development and operating expenditures associated with its reserves may vary from such estimates, and such variances may be material.

## **Production**

Production of oil and natural gas reserves at an acceptable level of profitability may not be possible during periods of low commodity prices. The Company will attempt to mitigate this risk by focusing on high netback opportunities and will act as operator where possible, thus allowing the Company to manage costs, timing, method and marketing of production. Production risk is also addressed by concentrating exploration efforts in regions where infrastructure is or will be Storm owned or readily accessible at an acceptable cost.

## **Financial and Liquidity Risks**

The Company faces a number of financial risks over which it has no control, such as commodity prices, exchange rates, interest rates, access to credit and capital markets, as well as changes to government regulations and tax and royalty policies. The Company uses the guidelines below to address financial exposure. Although these guidelines

result in conservative management of the Company's finances, they cannot eliminate the financial risks the Company faces.

- Internally available cash and marketable securities provide the initial source of funding on which the Company's capital expenditure program is based.
- Debt, if available, may be utilized to expand capital programs, including acquisitions, when it is deemed appropriate and where debt retirement can be controlled.
- Equity, including flow-through shares, if available on acceptable terms, may be raised to fund acquisitions and development expenditures.
- Farmouts of projects may be arranged if management considers that a project requires too much capital or where the project affects the Company's risk profile.
- Financial instruments may be used to manage commodity price volatility when the Company has capital programs, including acquisitions, whose cost exceeds near term projected cash flows.

### **Marketing Risks**

Markets for future production of oil and natural gas are outside the Company's capacity to control or influence and can be affected by events such as weather, climate change, regulation, regional, national and international supply and demand imbalances, geopolitical events, currency fluctuation, introduction of new, or termination of existing supply arrangements, as well as downtime due to facility maintenance or damage. The Company will attempt to mitigate these risks as follows:

- Natural gas properties are developed in areas where there is or will be suitable processing and pipeline infrastructure.
- The Company will delay tie in of new wells or shut in production if an acceptable netback cannot be realized.

### **Access to Debt and Equity**

The Company's cash and potential proceeds from the sale of listed securities are sufficient to fund its existing capital budget. Nevertheless, available cash is finite and investment must result in production being brought on stream, the generation of cash flow, and the identification of proven and probable reserves. The Company's current asset base cannot yet be used as security for bank financing, which for junior oil and gas companies like Storm, is conventionally a loan, renewable annually, which is based on anticipated future cash flows. Correspondingly, the emergence of profitable operations, from investment of existing cash and proceeds from the sale of listed securities, is essential if the Company is to receive bank financing to expand future operations. Proceeds from the sale of listed securities are dependent on a continuing liquid market for the shares of each company. It should also be recognized that the size of the Company's holdings in each entity may make the shareholdings difficult to sell within a reasonable time, or saleable only at a significant discount to quoted prices.

Concurrent with the completion of the Arrangement, the Company completed two equity placements. The first was a private placement of the maximum amount of 2.3 million shares to directors, officers and employees, with the second being the issue of 6.6 million shares upon the exercise of warrants issued to existing shareholders. The take up of the warrants was 99%. Both transactions were priced at \$3.28 per share and aggregate gross proceeds amounted to \$29 million. Although these share sales show considerable support for the Company in the equity markets, such support will only be sustainable if the Company can execute a successful investment program. Even if profitable operations do emerge, the Company will be exposed to changes in the equity markets, which could result in equity not being available, or only available under conditions which are dilutive to existing shareholders. The inability of the Company to develop profitable operations, with the consequent exclusion from debt and equity markets, will result in the Company curtailing or suspending operations.

### **Extraordinary Circumstances**

Storm's operations and its financial condition may be affected by uncontrollable and unpredictable circumstances such as weather patterns, changes in contractual, regulatory or fiscal terms, exclusion from third party pipelines or facilities, or actions by certain groups such as industry organizations, local communities, or militant groups.

## **INTERNATIONAL FINANCIAL REPORTING STANDARDS**

The Canadian Institute of Chartered Accountants, the primary source for accounting standards in Canada, proposes to implement International Financial Reporting Standards ("IFRS") as part of Canadian GAAP. Such standards have

been established cooperatively by many countries and have widespread application to financial reporting throughout the world. The effective date of introduction for IFRS in Canada is proposed for reporting periods beginning after December 31, 2010. Rather than apply existing Canadian GAAP to financial statements for the reporting periods ended September 30, 2010 and December 31, 2010, and then adopt IFRS for all subsequent reporting periods, the Company elected to adopt IFRS with immediate effect, as permitted under NI 51-107 and has applied for and received the necessary regulatory approvals for early adoption.

With respect to implementation of IFRS, the Company recruited appropriately qualified staff and identified external resources to assist in the process. Key elements of the implementation plan to IFRS included: staff education; choosing among policies permitted under IFRS; evaluating the effect of adoption on the Company's information technology and data systems and internal control over financial reporting and disclosure controls and procedures; alignment of internal and outsourced processes, applications and internal controls; external and internal communications; and liaison with peers, industry groups and professional advisors.

As discussed in Note 2, the Company elected to adopt IFRS at inception. The following table provides a brief summary of the primary financial statement line items affected by IFRS and the effect on Storm's financial statement presentation, measurement and disclosure:

| Financial Statement Category              | Change Under IFRS   | Effect on Financial Statements of Storm   |
|---|---|---|
| Exploration and evaluation ("E&E") assets | Under Canadian GAAP, E&E assets were accounted for using the full-cost rules and grouped with property and equipment. Exploration and evaluation expenditures are now segregated from development and producing assets until commercial production commences, at which time, the assets are tested for impairment and the recoverable amount transferred to property and equipment. | New line item on the Statement of Financial Position<br><br>More disclosure required in both <i>Accounting Policies</i> and <i>E&amp;E</i> notes to the financial statements  |
| Exploration and evaluation ("E&E") assets | E&E assets are only tested for impairment when indicators of impairment exist.<br><br>Under full-cost rules, E&E assets were excluded from the ceiling test calculation.  | If an indicator of impairment exists, assets in that area must be written down to their net recoverable amount and the difference charged as impairment expense on the statement of income.<br><br>More note disclosure required in the event of a write-down |
| Property and Equipment                    | Development and producing assets to be allocated into cash generating units ("CGUs") and depleted at the CGU level.   | Multiple depletion calculations will be required at each reporting period once production commences.  |
| Property and Equipment                    | Depletion can be calculated using either proven or proved plus probable reserves.   | Use of proved plus probable reserves in depletion calculation will likely reduce depletion expense.   |
| Property and Equipment                    | Gains and losses on dispositions, including farmouts, will be measured and recognized in the statement of income. There is no de minimis rule as previously existed under Canadian GAAP.  | Gains and losses on property sales may be a frequent income statement item, leading to a more erratic earnings profile.   |
| Property and Equipment                    | Impairment test will be calculated at the CGU level. Changes to the impairment calculation methodology are also required.   | Impairment tests will be more difficult to pass as less profitable areas can no longer be sheltered by more successful ones.  |
| Share-Based Payments                      | Stock options that vest in installments are valued separately.  | The graded vesting rules result in higher share-based payment expense in the earlier years of the amortization period.  |

## ADDITIONAL INFORMATION

Additional information relating to the Company can be viewed at [www.sedar.com](http://www.sedar.com) or on the Company's website at [www.stormresourcesltd.com](http://www.stormresourcesltd.com). Information can also be obtained by contacting the Company at Storm Resources Ltd., 800, 205 – 5<sup>th</sup> Avenue SW, Calgary, Alberta, T2P 2V7.

# Financials

## MANAGEMENT'S REPORT

To the Shareholders of Storm Resources Ltd.

The financial statements of Storm Resources Ltd. were prepared by management in accordance with International Financial Reporting Standards ("IFRS") as adopted by the Canadian Institute of Chartered Accountants ("CICA"). Management has used estimates and careful judgment, particularly in those circumstances where transactions affecting current periods are dependent on information not known for certain until a future period. The financial and operational information contained in this year-end report is consistent with that reported in the financial statements.

Management is responsible for the integrity of the financial and operational information contained in this report. The Company has designed and maintains internal controls to provide reasonable assurance that assets are properly safeguarded and that the financial records are well maintained and provide relevant, timely and reliable information to management. The financial statements have been prepared within reasonable limits of materiality and within the framework of the significant accounting policies summarized in the notes to the financial statements.

External auditors appointed by the shareholders have conducted an independent examination of the corporate and accounting records in order to express their opinion on the financial statements. The Audit Committee has met with the external auditors and management in order to determine if management has fulfilled its responsibilities in the preparation of the financial statements. The Board of Directors has approved the financial statements on the recommendation of the Audit Committee.



Donald McLean  
Chief Financial Officer



John Devlin  
Vice President, Finance

March 3, 2011

## INDEPENDENT AUDITORS' REPORT

To the Shareholders of Storm Resources Ltd.

We have audited the accompanying financial statements of Storm Resources Ltd., which comprise the statement of financial position as at December 31, 2010 and the statements of income and comprehensive income (loss), changes in equity, and statement of cash flows for the period June 8, 2010 to December 31, 2010, and the related notes including a summary of significant accounting policies.

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

In our opinion, the financial statements present fairly, in all material respects, the financial position of Storm Resources Ltd. as at December 31, 2010 and its financial performance and its cash flows for the period June 8, 2010 to December 31, 2010 in accordance with International Financial Reporting Standards.

*PricewaterhouseCoopers LLP*

Chartered Accountants  
Calgary, Alberta

March 3, 2011



## Statement of Financial Position

| (Canadian \$000s)                                | December 31, 2010 |
|--|-------------------|
| <b>ASSETS</b>                                    |                   |
| <b>Current</b>                                   |                   |
| Cash   | \$ 30,724         |
| Accounts receivable                              | 780               |
| Investments (Note 6)                             | 15,324            |
| Prepays and deposits                             | 672               |
|  | 47,500            |
| Investment in associate (Note 7)                 | 13,836            |
| Exploration and evaluation assets (Note 5)       | 36,937            |
|  | \$ 98,273         |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>      |                   |
| <b>Current</b>                                   |                   |
| Accounts payable and accrued liabilities         | \$ 11,583         |
|  | 11,583            |
| Decommissioning liability (Note 8)               | 1,121             |
|  | 12,704            |
| <b>Shareholders' equity</b>                      |                   |
| Share capital (Note 10)                          | 86,576            |
| Contributed surplus (Note 11)                    | 401               |
| Retained earnings (deficit)                      | (1,493)           |
| Accumulated other comprehensive income (deficit) | 85                |
|  | 85,569            |
|  | \$ 98,273         |

On behalf of the Board:



Director



Director

## Statement of Income and Comprehensive Income (Loss)

| (Canadian \$000s except per-share amounts)  | Inception, June 8, 2010<br>to December 31, 2010 |
|---|---|
| <b>Expenses</b>   |   |
| General and administrative  | 1,065   |
| Share-based payments  | 401   |
| Depreciation  | 7   |
| Accretion   | 15  |
|   | 1,488   |
| <b>Interest income</b>  | 109   |
| <b>Income (loss) before the following:</b>  | (1,379)   |
| Changes in equity of associate (Note 7)   | (114)   |
| <b>Net income (loss) for the period</b>   | (1,493)   |
| Other comprehensive income - unrealized gain (loss) on<br>investments available for sale (Note 6) | 85  |
| <b>Comprehensive income (loss) for the period</b>   | \$ (1,408)                                      |
| <br>  |   |
| <b>Net income (loss) per share (Note 12)</b>  |   |
| - basic   | \$ (0.09)                                       |
| - diluted   | \$ (0.09)                                       |

## Statement of Changes in Equity

| (Canadian \$000s)  | Inception, June 8, 2010<br>to December 31, 2010 |                        |                                   |   |                  |
|--|---|------------------------|-----------------------------------|---|------------------|
|  | Share<br>Capital                                | Contributed<br>Surplus | Retained<br>Earnings<br>(Deficit) | Accumulated<br>Other<br>Comprehensive<br>Income | Total<br>Equity  |
| Balance, beginning of period                               | \$ -  | \$ -                   | \$ -                              | \$ -  | \$ -             |
| Net loss for the period                                    | -   | -                      | (1,493)                           | -   | (1,493)          |
| Issue of common shares (Note 10)                           | 86,666  | -                      | -                                 | -   | 86,666           |
| Share issue costs (Note 10)                                | (90)  | -                      | -                                 | -   | (90)             |
| Share-based payments (Note 11)                             | -   | 401                    | -                                 | -   | 401              |
| Unrealized gain on investments available for sale (Note 6) | -   | -                      | -                                 | 85  | 85               |
| <b>Balance, end of period</b>                              | <b>\$ 86,576</b>                                | <b>\$ 401</b>          | <b>\$ (1,493)</b>                 | <b>\$ 85</b>                                    | <b>\$ 85,569</b> |

## Statement of Cash Flows

| (Canadian \$000s)  | Inception, June 8, 2010<br>to December 31, 2010 |
|--|---|
| <b>Operating activities</b>                                |   |
| Net income (loss) for the period                           | \$ (1,493)                                      |
| Non-cash items:  |   |
| Changes in equity of associate (Note 7)                    | 114   |
| Depreciation and accretion                                 | 22  |
| Share-based payments                                       | 401   |
| Funds from operations                                      | (956)   |
| Net change in non-cash working capital items (Note 16)     | (553)   |
|  | (1,509)   |
| <b>Financing activities</b>                                |   |
| Cash transferred under Plan of Arrangement (Notes 1 and 4) | 9,370   |
| Issue of common shares - net of expenses (Note 10)         | 28,976  |
|  | 38,346  |
| <b>Investing activities</b>                                |   |
| Additions to exploration and evaluation assets (Note 5)    | (16,797)  |
| Net change in non-cash working capital items (Note 16)     | 10,684  |
|  | (6,113)   |
| Change in cash during the period                           | 30,724  |
| Cash, beginning of period                                  | -   |
| Cash, end of period  | \$ 30,724                                       |

# Notes to the Financial Statements

From inception, June 8, 2010 to December 31, 2010

Tabular amounts in thousands of Canadian dollars, except per share amounts

## 1. REPORTING ENTITY

Storm Resources Ltd. (the "Company" or "Storm"), is an oil and gas exploration and development company incorporated in the province of Alberta, Canada on June 8, 2010 and is listed on the TSX Venture Exchange under the symbol "SRX". The Company operates in the provinces of Alberta and British Columbia and its head office is located at 800, 205 – 5th Avenue S.W., Calgary, Alberta T2P 2V7.

The Company became a reporting issuer subsequent to a plan of arrangement (the "Arrangement") involving ARC Energy Trust ("ARC"), ARC Resources Ltd., Storm Exploration Inc. ("SEO") and the Company. Under the Arrangement, which was completed on August 17, 2010, 884,173 common shares were issued to ARC and 16,631,241 common shares and 6,653,161 warrants to purchase common shares of the Company were issued to shareholders of SEO in exchange for undeveloped lands and facility interests in North East British Columbia and Alberta, various corporate investments and \$9.4 million in cash (see Note 4).

## 2. BASIS OF PRESENTATION

### *Statement of Compliance*

The financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") and Interpretations of the International Financial Reporting Interpretations Committee ("IFRIC") and adopted by the Canadian Institute of Chartered Accountants ("CICA"), including IAS 34 (Interim Financial Reporting). The Company received approval from the Canadian Securities Administrators under National Instrument 52-107, *Acceptable Accounting Principles, Auditing Standards and Reporting Currency* ("NI 52-107") to adopt IFRS as of June 8, 2010, the date of Storm's incorporation.

The financial statements were authorized for issue by the Board of Directors on March 3, 2011.

### *Basis of Measurement*

The Company's financial statements have been prepared on the historical cost basis, except for certain financial assets and financial liabilities, which are measured at fair value, as explained in Note 13.

### *Use of Estimates and Judgements*

The preparation of the financial statements in accordance with IFRS requires management to make judgements, estimates and assumptions that affect the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are continuously reviewed. Changes to accounting estimates are recognized in the period in which the estimates are revised.

Information about critical judgments in applying accounting policies that have the most significant effect on the amounts recognized in the financial statements is included in the following notes to the financial statements:

- Note 3 – Classification and valuation of exploration and evaluation assets
- Note 8 – Decommissioning liability
- Note 9 – Valuation and utilization of tax losses
- Note 11 – Measurement of share-based payments
- Note 13 – Valuation of financial instruments
- Note 14 – Capital management

### **3. SIGNIFICANT ACCOUNTING POLICIES**

#### **Jointly Controlled Assets and Operations**

Substantially all of the Company's exploration and production activities are conducted under joint operating agreements, whereby two or more parties jointly control the assets. These financial statements reflect only the Company's share of these jointly controlled assets and, once production commences, a proportionate share of the relevant revenue and related costs.

#### **Investment in Associate**

An associate is an entity over which the Company has significant influence, but not control, over financing and operations. The investment in an associated company was initially recognized at cost and subsequently accounted for using the equity method, with the Company's share of changes in equity of the investee company recognized in the statement of income.

The Company assesses at each reporting period whether there is any objective evidence that its interests in associates are impaired. If impaired, the carrying value of the Company's share of the underlying assets of associates is written down to its estimated recoverable amount and the amount of the write-down charged to the statement of income.

#### **Oil and Gas Exploration and Evaluation Expenditures**

Oil and gas exploration and evaluation ("E&E") expenditures are accounted for in accordance with IFRS 6, *Exploration for and Evaluation of Mineral Resources*, whereby costs associated with the exploration for and evaluation of oil and gas reserves are accumulated on an area-by-area basis and are capitalized as either tangible or intangible E&E assets when incurred. Future decommissioning costs relating to exploration and evaluation activities are also included. Costs incurred in advance of land acquisition are charged to the statement of income; however, all other costs, including directly attributable general and administrative costs, are added to E&E assets.

At each reporting date, E&E assets are reviewed for indicators of impairment and, if circumstances suggest that the carrying amount of a particular area exceeds its recoverable amount, the associated cost is written down to its estimated recoverable amount and the difference is accounted for as impairment expense on the statement of income. Once commercial production commences in a specific area, the associated E&E assets are tested for impairment and the estimated recoverable amount is transferred to property and equipment. If, at any time, it is determined that the Company has no future exploration plans and commercial production cannot be achieved in relation to an area, the associated costs are written down to the estimated recoverable amount or fully de-recognized and the amount of the write-down is expensed as impairment on the statement of income.

No depletion or depreciation is provided for exploration and evaluation assets.

#### **Property and Equipment**

Property and equipment, which includes oil and natural gas development and production assets, represents costs incurred in developing oil and natural gas reserves and maintaining or enhancing production from such reserves. Future decommissioning costs, related to producing assets, are also capitalized to property and equipment. Property and equipment is carried at cost, less accumulated depletion and depreciation and accumulated impairment losses. Gains and losses on disposal of property and equipment are determined as the difference between proceeds from disposal and the carrying amount of the asset sold and are recognized as other income or other expense in the statement of income. The Company had no property and equipment as at December 31, 2010.

#### *Depletion and Depreciation*

The net carrying value of the intangible oil and gas assets, categorized as property and equipment, is depleted using the unit-of-production method based on estimated proven and probable oil and natural gas reserves, taking into account the future development costs required to produce the reserves.

Proven and probable reserves are determined by independent engineers in accordance with Canadian National Instrument 51-101. Production and reserves of natural gas are converted to equivalent barrels of crude oil on the basis of six thousand cubic feet of gas to one barrel of oil. Changes in estimates used in prior periods, such as proved and probable reserves, that affect the unit-of-production calculations do not give rise to prior year adjustments and are dealt with on a prospective basis.

Processing facilities and well equipment will be depreciated on a straight-line basis over the estimated useful life of the facilities and equipment. Where facilities and equipment includes major components having different useful lives, they are depreciated separately.

Depreciation rates, useful lives and residual values are reviewed at each reporting date.

#### *Impairment*

The carrying amounts of property and equipment are reviewed at each reporting date to determine whether there is any indication of impairment. If such an indication exists, the estimated recoverable amount is calculated. For the purpose of impairment testing, property and equipment assets are grouped together into the smallest group of assets that generates cash inflows that are largely independent of the cash flows of other assets or group of assets (the "cash generating unit" or "CGU"). The recoverable amount of an asset or CGU is the greater of its value in use and its fair value less cost to sell. In assessing value in use, the estimated future cash flows are adjusted for the risks specific to the asset group and are discounted to their present value using a pre-tax discount rate that reflects current market assumptions regarding the time value of money. Fair value less costs to sell is the amount obtainable from the sale of an asset or CGU in an arm's length transaction between knowledgeable, willing parties, less the costs of disposal. An impairment loss is recognized in the statement of income if the carrying amount of an asset or CGU exceeds its estimated recoverable amount.

Impairment losses previously recognized are assessed at each reporting date for indications that the loss has decreased or no longer exists. An impairment loss is reversed to the extent that the asset's new carrying amount does not exceed the original carrying amount, net of related accumulated depletion and depreciation, if there has been an increase in the estimate of the recoverable amount.

#### **Decommissioning Liability**

Decommissioning liabilities are measured as the present value of management's best estimate of the expenditure required to settle the decommissioning liability at the reporting date using a risk-free discount rate. This estimate is recognized when a legal or constructive obligation arises and is capitalized as part of E&E assets or property and equipment. The amount capitalized to property and equipment is amortized on a unit-of-production basis as part of depreciation and depletion. Subsequent to the initial measurement, the obligation is adjusted at the end of each period to reflect the passage of time and changes in the estimated future costs underlying the obligation. The increase in the balance due to the passage of time is charged to accretion expense whereas increases or decreases due to changes in the estimated future costs are capitalized. Actual costs incurred upon settlement of the decommissioning obligations are charged against the liability or expensed if greater than the liability.

#### **Share-Based Payments**

The Company has issued options to acquire common shares to directors, officers and employees of the Company. These options are accounted for using the fair-value method which estimates the value of the options at the date of the grant using the Black-Scholes option pricing model. The fair value, of each tranche of options, thus established is recognized as compensation expense over the vesting period of the related tranche of options with an equivalent increase to contributed surplus. A forfeiture rate is estimated on the grant date and is subsequently adjusted to reflect the actual number of options that vest.

#### **Financial Instruments**

Financial assets and liabilities are recognized when the Company becomes a party to the contractual provisions of the instrument. Financial assets are derecognized when the rights to receive cash flows from the assets have expired, or when the Company has transferred substantially all risks and rewards of ownership.

Financial assets and liabilities are offset and the net amount reported in the statement of financial position when there is a legally enforceable right to offset the recognized amounts, and there is an intention to settle on a net basis, or realize the asset and settle the liability simultaneously.

#### *Cash and cash equivalents*

Cash and cash equivalents comprise cash on hand and other short-term highly liquid investments. Due to the short-term nature of cash and cash equivalents, its carrying value approximates fair value.

#### *Trade receivables, loans and other receivables*

Trade receivables, loans and other receivables, which are non-derivative financial assets that have fixed or determinable payment terms and are not quoted in an active market, are classified as loans and receivables. They are included in current assets, except for maturities greater than 12 months after the reporting date, which are classified as non-current assets. The Company's loans and receivables comprise accounts receivable in the statement of financial position.

Loans and receivables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest rate method, net of any impairment.

A provision for impairment of trade receivables is established when there is objective evidence that the Company will not be able to collect all amounts due according to the original terms of the receivables. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganization, and default or significant delinquency in payments are considered indicators that a trade receivable is impaired.

#### *Investments*

The Company's investments in publicly-listed companies are classified as available-for-sale investments. Available-for-sale financial investments are non-derivatives that are either designated in this category or not classified in any of the other categories.

Investments in publicly-listed companies are recognized initially at fair value and subsequently are fair valued using the closing price on the date of the financial statement. Gains or losses arising from changes in fair value are recognized in the statement of comprehensive income.

The investment in the associate is initially recognized at cost and subsequently accounted for using the equity method of accounting, with the Company's share of the investee's income or loss for the period recorded as investment income (loss) on the statement of income.

Available-for-sale investments are classified as current assets, unless the investment does not mature or management does not expect to dispose of the investments within twelve months. When an available-for-sale investment is sold or impaired, the accumulated gains or losses are transferred from accumulated other comprehensive income to the statement of income and included in other gains and losses.

#### *Accounts payable and accrued liabilities*

Accounts payable and accrued liabilities are obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers. Accounts payable are classified as current liabilities if payment is due within one year or less. Trade payables are measured at amortized cost using the effective interest method.

#### *Impairment of financial assets*

At each reporting date, the Company assesses whether there is objective evidence that a financial asset is impaired. If such evidence exists, the company recognizes an impairment loss, as follows:

- (i) Financial assets carried at amortized cost: The amount of any impairment is the difference between the amortized cost of the loan or receivable and the lesser amount of present value of the estimated future cash inflows, discounted using the original effective interest rate. The carrying amount of the asset is reduced and the amount of any loss is recognized in the statement of income.
- (ii) Available-for-sale financial assets: Any impairment loss is the difference between the original cost of the asset and the lesser amount of its fair value at the measurement date, less any impairment losses previously recognized in the statement of income.

#### **Borrowing Costs**

Borrowing costs attributable to the acquisition, construction or production of assets that require a considerable period of time to be ready for their intended use are added to the cost of those assets, until such time as the assets are substantially ready for their intended use. All other borrowing costs are recognized as interest expense in the statement of income in the period in which they are incurred.

## **Income Tax**

Income tax comprises current and deferred taxes. Income tax is recognized in the statement of income except to the extent that it relates to items recognized directly in other comprehensive income or elsewhere in shareholders' equity, in which case the related income tax expense or recovery is also recognized directly in other comprehensive income or elsewhere in shareholders' equity.

Current tax expense is the expected cash tax payable on the taxable income for the year, using tax rates enacted, or substantively enacted, at the end of the reporting period, and any adjustment to tax payable in respect of previous years.

In general, deferred tax expense and related liability is recognized in respect of temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred income tax is determined on a non-discounted basis using tax rates and laws that have been enacted or substantively enacted at the reporting date and are expected to continue to apply when the deferred tax asset or liability is settled. Deferred tax assets are recognized to the extent that it is probable that the assets can be recovered. Deferred income tax assets and liabilities are presented as non-current.

Tax on income in interim periods is accrued using the tax rate that would be applicable to expected total annual earnings.

## **Share Capital**

Proceeds from the issuance of common shares are classified as equity. Costs directly attributable to the issuance of shares are recognized as a deduction from equity.

## **Net Income (Loss) Per Share**

Net income (loss) per share is calculated by dividing the net income (loss) for the period attributable to equity owners by the weighted average number of common shares outstanding during the period.

Diluted net income (loss) per share is calculated by adjusting the weighted average number of common shares outstanding for dilutive instruments. The Company's potentially dilutive common shares comprise stock options granted to employees and directors. The number of shares included with respect to options is computed using the treasury stock method.

## **Changes in Accounting Policies**

International Financial Reporting Standard 9, Financial Instruments ("IFRS 9"), was issued in November 2009. It addresses classification and measurement of financial assets and replaces the multiple category and measurement models in IAS 39 (Financial Instruments - recognition and measurement) for debt instruments with a new mixed measurement model having only two categories: amortized cost and fair value. Under IFRS 9 such investments are either recognized at fair value through profit or loss or at fair value through other comprehensive income. Where such equity instruments are measured at fair value through other comprehensive income, dividends, to the extent not clearly representing a return of investment, are recognized in profit or loss; however, other gains and losses (including impairments) associated with such instruments remain in accumulated comprehensive income indefinitely. Requirements for financial liabilities were added in October 2010 and they largely carried forward existing requirements in IAS 39 except that fair value changes due to credit risk for liabilities designated at fair value through profit and loss would generally be recorded in other comprehensive income. This standard is required to be applied for accounting periods beginning on or after January 1, 2013, with earlier adoption permitted. The Company has not yet assessed the impact of the standard or determined whether it will adopt the standard early.

## **4. ACQUISITION OF ASSETS**

Under the Arrangement referred to in Note 1, the Company issued common shares to ARC and to the former shareholders of SEO in exchange for certain assets, being approximately 117,200 net acres of undeveloped land and facility interests in North East British Columbia and Alberta, as well as share ownership positions in Storm Gas Resource Corp. ("SGR"), Chinook Energy Inc. ("Chinook"), Bridge Energy Norge ASA ("Bridge") and Bellamont Exploration Ltd. ("Bellamont") and \$9.4 million in cash as follows:



|   |                  |
|---|------------------|
| Cash  | \$ 9,370         |
| Investment in SGR                                   | 13,950           |
| Investment in Chinook                               | 10,440           |
| Investment in Bridge                                | 2,106            |
| Investment in Bellamont                             | 2,693            |
| Exploration and evaluation assets                   | 19,041           |
| <b>Net assets acquired and share capital issued</b> | <b>\$ 57,600</b> |

The assets were transferred to the Company from SEO at the estimated fair values on the date of transfer as follows:

- Investment in SGR – private company, estimated fair value of SGR’s net assets
- Investment in Chinook – listed security, at market value
- Investment in Bridge - listed security, at market value
- Investment in Bellamont - listed security, at market value
- Exploration and evaluation assets – at estimated fair value

## 5. EXPLORATION AND EVALUATION ASSETS

|  | June 8 to December 31, 2010 |
|--|-----------------------------|
| Cost:                                  |                             |
| Balance, beginning of period           | \$ -                        |
| Acquisitions                           | 19,041                      |
| Additions                              | 17,903                      |
| Transfers to property and equipment    | -                           |
| <b>Cost, end of period</b>             | <b>\$ 36,944</b>            |
| Depreciation on furniture and fixtures | (7)                         |
| Impairment losses                      | -                           |
| <b>Carrying value, end of period</b>   | <b>\$ 36,937</b>            |

Acquisitions represents management’s estimate of the fair value of the exploration and evaluation assets transferred under the Arrangement with ARC. Additions include \$1.1 million in respect of the Company’s decommissioning provision on its existing wells.

## 6. INVESTMENTS

|                            | December 31, 2010 |
|----------------------------|-------------------|
| Bellamont Exploration Ltd. | \$ 2,998          |
| Bridge Energy ASA          | 2,696             |
| Chinook Energy Inc.        | 9,630             |
|                            | <b>\$ 15,324</b>  |

The investments in Bellamont, Bridge and Chinook shares are classified as available-for-sale financial instruments and are carried at fair value, determined with reference to the closing share prices on December 31, 2010. Holding gains for the period from August 17, 2010, the date of closing of the Arrangement, to December 31, 2010, in the amount of \$85,000 are recognized in other comprehensive income.

## 7. INVESTMENT IN ASSOCIATE

The Company’s 22% interest in SGR is accounted for using the equity method, and includes Storm’s pro-rata share of changes in SGR’s equity since August 17, 2010. The common shares of SGR are unlisted and the carrying amount of the Company’s investment does not represent a market valuation of the Company’s investment.

|   |                  |
|---|------------------|
| Fair value of the investment acquired under the Arrangement                     | \$ 13,950        |
| Storm’s share of SGR’s changes in equity for the period ended December 31, 2010 | (114)            |
| <b>Carrying value at December 31, 2010</b>                                      | <b>\$ 13,836</b> |

Summarized financial information as at and for the period ended December 31, 2010, is based on SGR's book values, is as follows:

|                   |                 |
|-------------------|-----------------|
| Total assets      | \$ 61.7 million |
| Total liabilities | \$ 10.0 million |
| Revenues          | \$ 0.2 million  |
| Net loss          | \$ 1.0 million  |

The Company also provides engineering and administrative services to SGR at a cost of \$101,000 for the period ended December 31, 2010. The Company and SGR are also 40:60 joint venture participants in certain undeveloped lands and as at December 31, 2010 the Company owed SGR \$633,000.

## 8. DECOMMISSIONING LIABILITY

The Company provides for the future cost of decommissioning oil and gas production facilities, including well sites and gathering systems. The total decommissioning obligation is estimated based on the Company's net ownership interest in wells and facilities, the estimated costs to abandon and reclaim the wells and facilities and the estimated timing of future costs. The total estimated undiscounted amount required to settle the Company's decommissioning obligation is approximately \$1.5 million, which will be paid over the next 18 years, with the majority of costs paid between 2012 and 2028. A risk-free discount rate of four percent was used to calculate the present value of the decommissioning obligation, amounting to \$1.1 million.

The following table provides a reconciliation of the carrying amount of the obligation associated with the decommissioning of oil and gas properties:

|                                | June 8 to December 31, 2010 |
|--------------------------------|-----------------------------|
| Balance, beginning of period   | \$ -                        |
| Liability recognized           | 1,106                       |
| Decommissioning costs incurred | -                           |
| Obligations disposed           | -                           |
| Accretion expense              | 15                          |
| Balance, end of period         | \$ 1,121                    |

## 9. DEFERRED INCOME TAXES

Deferred income tax assets and liabilities are based on the differences between the accounting amounts and the related tax bases of the Company's property and equipment, exploration and evaluation assets, decommissioning liability, share capital and unrealized fair market gains and losses on investments.

The Company has tax pools associated with exploration and evaluation assets of approximately \$32.9 million as well as a non-capital loss of approximately \$4.0 million. The tax loss expires in 2030. Deferred tax assets have not been recognized due to the uncertainty as to future realization.

The provision for deferred income taxes is different from the amount computed by applying the combined statutory Canadian federal and provincial tax rates to pre-tax income for the period.

The differences are as follows:

|  | June 8 to December 31, 2010 |
|--|-----------------------------|
| Statutory combined federal and provincial income tax rate                    | 28%                         |
| Expected income taxes  | \$ (418)                    |
| Add (deduct) the income tax effect of:                                       |                             |
| Share-based payments   | 112                         |
| Changes in equity of associate   | 32                          |
| Valuation allowance due to uncertainty of realization of loss carry forwards | 268                         |
| Other  | 6                           |
| Deferred income taxes  | \$ -                        |

## 10. SHAREHOLDERS' EQUITY

### Share Capital

#### Authorized

An unlimited number of voting common shares without nominal or par value

An unlimited number of first preferred shares without nominal or par value

Common shareholders are entitled to receive dividends if, as and when declared by the Board of Directors. In the event of liquidation, dissolution or winding up of the Company, common shareholders shall, subject to the priority of preferred shareholders, participate in any distribution in equal amounts per share.

#### Issued

|  | Number of Common Shares | Consideration |
|--|-------------------------|---------------|
| Balance as at June 8, 2010                             | -                       | \$ -          |
| Shares issued under plan of arrangement <sup>(1)</sup> | 17,515                  | 57,600        |
| Management private placement <sup>(2)</sup>            | 2,300                   | 7,544         |
| Exercise of warrants <sup>(3)</sup>                    | 6,562                   | 21,522        |
| Share issue costs                                      |                         | (90)          |
| Balance as at December 31, 2010                        | 26,377                  | \$ 86,576     |

(1) On August 17, 2010 the Company completed the Arrangement with ARC and SEO (Note 4) whereby the Company acquired from SEO undeveloped land, equipment, cash and corporate investments in exchange for 16,631,241 common shares of the Company which were transferred to the former shareholders of SEO. In addition, as per the terms of the Arrangement, 884,173 common shares were issued to ARC.

(2) Concurrent with the completion of the Arrangement, the Company completed a private placement of 2.3 million voting common shares, at a price of \$3.28 per share, with directors, officers and employees of the Company for total proceeds of \$7.5 million.

(3) As part of the Arrangement, the Company issued warrants to acquire common shares at a price of \$3.28 prior to September 21, 2010. A total of 6,562,000 warrants were exercised for total proceeds of \$21.5 million.

## 11. SHARE-BASED PAYMENTS

The Company has a stock option plan under which it may grant, at the Company's discretion, options to purchase common shares to directors, officers, employees and consultants. Options are granted at the market price of the shares on the date of grant, have a four-year term and vest in one-third tranches over three years. Under the stock option plan, a total of 2.6 million common shares have been reserved for issuance.

Details of the options outstanding at December 31, 2010 are as follows:

|   | Number of Options | Weighted Average Exercise Price |
|---|-------------------|---------------------------------|
| Outstanding at June 8, 2010             | -                 | \$ -                            |
| Granted during the period               | 1,974             | 3.28                            |
| Exercised during the period             | -                 | -                               |
| Expired during the period               | -                 | -                               |
| Forfeited during the period             | -                 | -                               |
| Outstanding at December 31, 2010        | 1,974             | \$ 3.28                         |
| Number exercisable at December 31, 2010 | -                 | \$ -                            |

| Range of Exercise Price | Number of<br>Options<br>Outstanding | Outstanding Options                              |  |
|-------------------------|-------------------------------------|--|--|
|                         |                                     | Weighted<br>Average<br>Remaining<br>Life (years) | Weighted<br>Average<br>Exercise<br>Price |
| \$0 to \$3.28           | 1,974                               | 3.6  | \$ 3.28                                  |

The fair value of employee stock options is measured using the Black Scholes option pricing model. Measurement inputs include the share price on measurement date, exercise price of the instrument, expected volatility (based on weighted average historical volatility adjusted for changes expected due to publicly available information), weighted average expected life of the instruments (based on historical experience and general option holder behavior), expected dividends, and the risk-free interest rate (based on government bonds).

The weighted average inputs used in the Black-Scholes pricing model to determine the fair value of the options at grant date of \$1.06 include the following:

|                         |      |
|-------------------------|------|
| Share price             | 3.28 |
| Exercise price          | 3.28 |
| Volatility              | 40%  |
| Forfeiture rate         | 10%  |
| Expected Option life    | 3.7  |
| Dividends               | -    |
| Risk-free interest rate | 1.9% |

The initial forfeiture rate was estimated to be 10%. This estimate will be adjusted to the actual forfeiture rate. Share-based payment expense of \$401,000 was charged to the statement of income during the period with an equivalent offset to contributed surplus.

## Contributed Surplus

|  | June 8 to December 31, 2010 |
|--|-----------------------------|
| Balance, beginning of period                     | \$ -                        |
| Share-based payments                             | 401                         |
| Transfer to share capital on exercise of options | -                           |
| Balance, end of period                           | \$ 401                      |

## 12. NET INCOME (LOSS) PER SHARE

Basic and diluted net income (loss) per share were calculated as follows:

|  | June 8 to December 31, 2010 |
|--|-----------------------------|
| Net loss for the period  | \$ 1,493                    |
| Weighted average number of common shares outstanding – basic:  |                             |
| Common shares outstanding at June 8, 2010                      | -                           |
| Stock options exercised  | -                           |
| Effect of shares issued  | 16,267                      |
| Weighted average number of common shares outstanding - basic   | 16,267                      |
| Effect of outstanding options                                  | 420                         |
| Weighted average number of common shares outstanding - diluted | 16,687                      |
| Net income (loss) per share                                    |                             |
| - basic  | \$ (0.09)                   |
| - diluted  | \$ (0.09)                   |

The average market value of the Company's shares for purposes of calculating the dilutive effect of share options was based on quoted market prices for the period that the options were outstanding.

### 13. FINANCIAL INSTRUMENTS

The following table sets out, for each class of financial asset and financial liability, the carrying amount and fair value as at December 31, 2010. The carrying value of cash and cash equivalents, accounts receivable and accounts payable and accrued liabilities included on the statement of financial position approximate their fair values due to the short-term nature of those instruments and are not included in the table below.

Storm classifies the fair value of these financial instruments according to the following hierarchy based on the amount of observable inputs used to value the instrument.

- Level 1 – Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions occur in sufficient frequency and volume to provide pricing information on an ongoing basis.
- Level 2 – Pricing inputs are other than quoted prices in active markets included in Level 1. Prices in Level 2 are either directly or indirectly observable as of the reporting date. Level 2 valuations are based on inputs, including quoted forward prices for commodities, time value and volatility factors, which can be substantially observed or corroborated in the marketplace.
- Level 3 – Valuations in this level are those with inputs for the asset or liability that are not based on observable market data.

|   |                    | December 31, 2010 |            |
|---|--------------------|-------------------|------------|
|   | Classification     | Carrying Amount   | Fair Value |
| Investments in publicly traded companies <sup>(i)</sup> | Available for sale | \$ 15,324         | \$ 15,324  |

- (i) The fair value of the Company's investments in Bellamont, Chinook and Bridge are determined with reference to published share prices and are therefore classified as Level 1 financial instruments.

Assessment of the significance of a particular input to the fair value measurement requires judgment and may affect the placement within the fair value hierarchy level.

#### Risk Management

The Company's activities expose it to a variety of financial risks that arise as a result of its exploration, development, production and financing activities such as:

- credit risk;
- market risk; and
- liquidity risk.

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.

#### Credit risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Company's receivables from joint venture partners. The maximum exposure to credit risk at period end is as follows:

|                           | Carrying Amount as at December 31, 2010 |           |
|---------------------------|---|-----------|
| Cash and cash equivalents |   | \$ 30,724 |
| Accounts receivable       |   | 780       |
|                           |   | \$ 31,504 |

#### *Cash and cash equivalents*

The Company limits its exposure to credit risk by only investing in liquid securities and only with counterparties that have an acceptable credit rating. Given these factors, management does not expect any counterparty to fail to meet its obligations.

### *Trade receivables*

In future periods a substantial portion of the Company's accounts receivable will be concentrated with a limited number of marketers of the Company's production and joint venture partners and will be subject to normal industry credit risk. The Company attempts to mitigate the risk from joint venture receivables by obtaining pre-approval and cash call deposits from its partners in advance of significant capital expenditures. The Company does not typically obtain collateral from joint venture partners.

The Company's accounts receivable are all current at December 31, 2010. No default on outstanding receivables is anticipated and, as such, no provision for doubtful accounts has been recorded.

### **Market risk**

Market risk is the risk that changes in market prices, such as commodity prices, the quoted price of listed securities, interest rates and foreign exchange rates, will affect the Company's income or the value of the financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimizing the return.

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

- commodity prices;
- prices of listed securities;
- interest rates;
- foreign exchange rates.

### *Commodity prices*

Commodity price risk is the risk that the fair value or future cash flows will fluctuate as a result of changes in commodity prices. Commodity prices for oil and natural gas are affected by many known and unknown factors such as demand and supply imbalances, the relationship between the Canadian and United States dollar as well as national and international economic and geopolitical events.

Although the Company currently does not have any production from its oil and gas properties, it is exposed to the risk of declining prices for anticipated future production resulting in a corresponding reduction in projected 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 production declines from existing properties.

Once production is established, the Company may choose to enter into contracts, including financial instruments, in order to reduce the fluctuation in production revenue by fixing prices of future deliveries of oil and natural gas and thus provide stability of future cash flow. The Company would not use these instruments for trading or speculative purposes.

### *Prices of listed securities*

The value of the investments held by the Company is affected by fluctuations in the price of these securities, which are listed on public stock exchanges. Reduced prices of these securities could result in lower levels of capital being available for future field activity.

### *Interest rates*

The Company does not currently have any debt and is not exposed to the risk of reduced cash flow from increasing interest rates.

### *Foreign exchange rates*

Prices for oil are determined in global markets and generally denominated in United States dollars. Natural gas prices are largely influenced by both US and Canadian supply and demand and by imports of liquefied natural gas. Changes in the Canadian dollar relative to the US dollar have no effect on the Company's results at this time.

## Liquidity risk

Liquidity difficulties would emerge if the Company was unable to establish a profitable production base and thus generate sufficient cash flow to cover both operating and capital requirements. This may be the consequence of insufficient cash flows resulting from low product prices, production interruptions, operating or capital cost increases, or unsuccessful investment programs.

Accounts payable and accrued liabilities, with a contractual maturity of less than one year, is the only financial liability outstanding and is more than offset by current assets at December 31, 2010.

## 14. CAPITAL MANAGEMENT

The Company's capital structure is comprised of shareholders' equity. The Company's objective when managing capital is to maintain financial flexibility to preserve its investment program until internally generated cash flow emerges. Capital management involves the preparation of an annual budget, which may only be implemented after approval by the Company's Board of Directors. As the Company's business evolves, the budget will be amended; however, any changes are again subject to approval by the Board of Directors. The Company is not currently exposed to any externally imposed capital restrictions.

At present the Company has no revenue from oil and natural gas operations. Cash and potential proceeds from sale of investments, will be invested in exploration and development operations with the intent of generating short and medium term cash flow, and thus financial sustainability. It may be that capital currently available to the Company is insufficient to generate positive cash flow, thus requiring additional capital which is likely to be available only on terms dilutive to existing shareholders, if available at all. However, the establishment of positive cash flow should enable the Company to access debt financing which will provide a source of investment capital additional to existing resources or future equity issues.

## 15. RELATED PARTY TRANSACTIONS

The remuneration of the key management personnel of the Company, which includes directors and officers, is set out below in aggregate:

|                                  | June 8 to December 31, 2010 |
|----------------------------------|-----------------------------|
| Salaries and short-term benefits | \$ 219                      |
| Share-based payments             | \$ 228                      |
|                                  | \$ 447                      |

## 16. SUPPLEMENTAL CASH FLOW INFORMATION

### Changes in non-cash working capital

|  | Period ended December 31, 2010 |
|--|--------------------------------|
| Accounts receivable                      | \$ (780)                       |
| Prepays and other                        | (672)                          |
| Accounts payable and accrued liabilities | 11,583                         |
| Change in non-cash working capital       | \$ 10,131                      |
| Relating to:                             |                                |
| Operating activities                     | \$ (553)                       |
| Financing activities                     | -                              |
| Investing activities                     | 10,684                         |
|  | \$ 10,131                      |

# Corporate Information

## Officers

Brian Lavergne  
President & CEO

Robert S. Tiberio  
Chief Operating Officer

Donald G. McLean  
Chief Financial Officer

Daniel J. Fitzgerald  
Vice President, Corporate Development

John Devlin  
Vice President, Finance

Mark G. Eade  
Corporate Secretary

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## Directors

Matthew J. Brister <sup>(1)(2)</sup>

John A. Brussa <sup>(3)</sup>

Mark A. Butler <sup>(3)</sup>

Stuart G. Clark <sup>(1)</sup>  
Chairman

Brian Lavergne  
CEO

Gregory G. Turnbull <sup>(3)</sup>

P. Grant Wierzba <sup>(2)</sup>

James K. Wilson <sup>(1)</sup>

*(1) Member, Audit Committee (2) Member, Reserves Committee (3) Member, Compensation, Governance and Nomination Committee*

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## Stock Exchange Listing

TSX Venture Exchange  
Trading Symbol "SRX"

## Solicitors

McCarthy Tétrault LLP  
Burnet Duckworth & Palmer LLP  
Calgary, Alberta

## Auditors

PricewaterhouseCoopers LLP  
Calgary, Alberta

## Registrar & Transfer Agent

Alliance Trust Company  
Calgary, Alberta

## Bankers

ATB Financial  
Calgary, Alberta

## Executive Offices

Suite 800, 205 – 5<sup>th</sup> Avenue S.W.  
Calgary, Alberta, T2P 2V7 Canada  
Tel: (403) 817-6145 Fax: (403) 817-6146  
[www.stormresourcesltd.com](http://www.stormresourcesltd.com)

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## Abbreviations

|        |   |         |   |
|--------|---|---------|---|
| 3-D    | Three-dimensional                       | Mcf/d   | Thousands of cubic feet per day               |
| API    | American Petroleum Institute            | Mmbbls  | Millions of barrels                           |
| Bbls   | Barrels of oil or natural gas liquids   | Mmbtu   | Millions of British Thermal Units             |
| Bbls/d | Barrels per day                         | Mmbtu/d | Millions of British Thermal Units per day     |
| Bcf    | Billions of cubic feet                  | Mmcf    | Millions of cubic feet                        |
| Bcfe   | Billions of cubic feet equivalent       | Mmcf/d  | Millions of cubic feet per day                |
| Boe    | Barrels of oil equivalent               | Mstb    | Thousand stock tank barrels                   |
| Boe/d  | Barrels of oil equivalent per day       | NAV     | Net Asset Value                               |
| Bopd   | Barrels of oil per day                  | NGL     | Natural gas liquids                           |
| Btu    | British thermal unit                    | NPV     | Net present value                             |
| Cdn\$  | Canadian dollar                         | OGIP    | Original Gas in Place                         |
| DPIIP  | Discovered Petroleum Initially in Place | OPEC    | Organization of Petroleum Exporting Countries |
| GJ     | Gigajoules                              | Scf/ton | Standard cubic foot per ton                   |
| GJ/d   | Gigajoules per day                      | STOOIP  | Stock Tank Original Oil in Place              |
| Mbbls  | Thousands of barrels                    | Tcf     | Trillions of cubic feet                       |
| Mboe   | Thousands of barrels of oil equivalent  | TSX     | Toronto Stock Exchange                        |
| Mcf    | Thousands of cubic feet                 | US\$    | United States dollar                          |
|        |   | WTI     | West Texas Intermediate                       |

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## Annual Meeting

**The Annual General Meeting of shareholders will be held at 3:30 p.m. on Thursday, May 19, 2011 in TELUS Room 109, Calgary TELUS Convention Centre, 136 Eighth Avenue S.E., Calgary, Alberta. All shareholders and invited guests are encouraged to attend.**



Storm Resources Ltd.

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