



PAN ORIENT ENERGY CORP.

**2009 CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2009 AND 2008**

MANAGEMENT'S REPORT TO THE SHAREHOLDERS

Management is responsible for the integrity and objectivity of the financial statements and the related management's discussion and analysis. The accompanying financial statements have been prepared by management in accordance with accounting principles generally accepted in Canada using estimates and careful judgment, particularly in those circumstances where transactions affecting a current period are dependent upon future events. The accompanying financial statements have been prepared using policies and procedures established by management and reflect fairly the Company's financial position, results of operations and changes in financial position, within reasonable limits of materiality and within the framework of the accounting policies outlined in the notes to the consolidated financial statements.

Management has established and maintains a system of internal controls which is designed to provide reasonable assurance that assets are safeguarded from loss or unauthorized use and the financial information is reliable and accurate.

The consolidated financial statements have been examined by external auditors. Their examination provides an independent view as to management's discharge of its responsibilities insofar as they relate to the fairness of reported operating results and financial condition of the Company.

The Audit Committee of the Board of Directors has reviewed the consolidated financial statements with management and the external auditors. The consolidated financial statements have been approved by the Board of Directors on the recommendation of the Audit Committee.

(*signed "Jeff Chisholm"*)
Jeff Chisholm
President & Chief Executive Officer

April 12, 2009

(*signed "William D. Ostlund"*)
William D. Ostlund
Vice President, Finance & Chief Financial Officer

April 12, 2009

AUDITORS' REPORT TO THE SHAREHOLDERS

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

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

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

(*signed "KPMG LLP"*)
Chartered Accountants
Calgary, Canada
April 12, 2009

**Pan Orient Energy Corp.
Consolidated Balance Sheets**

(\$000s)	December 31, 2009	December 31, 2008
Assets		
Current		
Cash and cash equivalents	44,760	98,925
Accounts receivable	13,104	13,161
	57,864	112,086
Deposits (note 5)	4,079	4,299
Petroleum and natural gas properties (note 6)	179,838	142,823
	241,781	259,208
Liabilities		
Current		
Accounts payable and accrued liabilities	14,287	14,739
Taxes payable (note 10)	14,918	55,260
	29,205	69,999
Future income tax (note 10)	34,812	22,698
Asset retirement obligation (note 7)	2,829	1,964
	66,846	94,661
Non-controlling interest	18,705	18,774
Shareholders' equity (note 8)		
Share capital	104,846	103,078
Contributed surplus	8,274	6,531
Accumulated other comprehensive income (loss)	(4,149)	4,037
Retained earnings	47,259	32,127
	43,110	36,164
	156,230	145,773
Commitments (note 13)		
	241,781	259,208

See accompanying notes to the consolidated financial statements.

Approved on behalf of the Board of Directors:

(signed "Michael Hibberd")
Director

(signed "Paul Wright")
Director

Pan Orient Energy Corp.
Consolidated Statements of Operations and Retained Earnings

(\$000s, except per share amounts)	Year Ended December 31	
	2009	2008
Revenue		
Petroleum revenue	98,236	147,554
Royalties	(6,843)	(10,336)
Interest	450	991
	91,843	138,209
Expenses		
Transportation	3,866	4,551
Operating	7,555	3,809
General and administrative	4,989	5,492
Depletion, depreciation and accretion	16,680	18,369
Stock-based compensation	1,769	575
Foreign exchange loss (gain) (note 9)	6,986	(6,824)
Foreign new venture expenditures (note 6)	62	731
	41,907	26,703
Income before taxes and non-controlling interest	49,936	111,506
Taxes (note 10)		
Special remuneratory benefit	6,751	35,489
Current income tax	15,423	30,109
Future income tax expense	12,686	14,383
	34,860	79,981
Income before non-controlling interest	15,076	31,525
Non-controlling interest	69	226
Net income	15,145	31,751
Retained earnings beginning of year	32,127	1,012
Repurchase of common shares (note 8)	(13)	(636)
Retained earnings end of year	47,259	32,127
Net income per share (note 8)		
Basic	0.33	0.70
Diluted	0.31	0.65

See accompanying notes to the consolidated financial statements.

Pan Orient Energy Corp.
Consolidated Statements of Comprehensive Income

(\$000s)	Year Ended	
	December 31	
	2009	2008
Net income	15,145	31,751
Foreign exchange gain (loss) on translation of self-sustaining operations	(3,540)	9,561
Foreign exchange gain realized	(4,646)	(3,802)
Comprehensive income	6,959	37,510

See accompanying notes to the consolidated financial statements.

Pan Orient Energy Corp.
Consolidated Statements of Cash Flows

(\$000s)	Year Ended December 31	
	2009	2008
Cash Provided By (Used in)		
Operating Activities		
Net income	15,145	31,751
Items not affecting cash		
Depletion, depreciation and accretion	16,680	18,369
Stock-based compensation	1,769	575
Future income tax expense	12,686	14,383
Unrealized foreign exchange (gain) loss (note 9)	10,636	(955)
Realized gain on Thailand investment transferred to investing activities (note 9)	(3,897)	-
Non-controlling interest	(69)	(226)
	52,950	63,897
Changes in non-cash working capital	(47,143)	53,337
	5,807	117,234
Investing Activities		
Petroleum and natural gas properties	(63,495)	(40,491)
Realized gain on Thailand investment (note 9)	3,897	-
Indonesia acquisition (note 4)	-	(15,157)
Deposits	220	(2,122)
Change in non-cash working capital	1,864	(1,163)
	(57,514)	(58,933)
Financing Activities		
Issue of common shares, net of issue costs	1,135	430
Repurchase of common shares	(24)	(1,092)
	1,111	(662)
Change in cash and cash equivalents	(50,596)	57,639
Effect of foreign exchange on cash balances	(3,569)	4,434
Cash and cash equivalents, beginning of year	98,925	36,852
Cash and cash equivalents, end of year	44,760	98,925
Taxes paid	57,732	19,436

See accompanying notes to the consolidated financial statements.

Pan Orient Energy Corp.
Notes to Consolidated Financial Statements

1) DESCRIPTION OF BUSINESS

Pan Orient Energy Corp. ("Pan Orient" or the "Company"), is an oil and natural gas company based in Calgary, Alberta, which holds properties onshore Thailand and Indonesia as well as interests in subsidiaries with properties in Northern Alberta. The Company pursues other oil and natural gas exploration acreage in Asia.

2) SIGNIFICANT ACCOUNTING POLICIES AND BASIS OF PRESENTATION

The consolidated financial statements for the years ended December 31, 2009 and 2008 are presented in accordance with Canadian Generally Accepted Accounting Principles ("GAAP") and are expressed in Canadian dollars. Tabular amounts, except as otherwise indicated, are presented in thousands of dollars.

(a) Principles of Consolidation

The consolidated financial statements include the accounts of Pan Orient and the accounts of its subsidiaries, all of which are wholly owned except for Andora Energy Corporation which is approximately 53.2% owned by Pan Orient. The consolidated financial statements include a non-controlling interest representing the 46.8% portion of assets and liabilities not owned by Pan Orient.

(b) Joint Venture Activities

The Company conducts substantially all its oil and gas exploration and production activities with others. These consolidated financial statements reflect the Company's proportionate interest in such activities.

(c) Cash and Cash Equivalents

Cash and cash equivalents consist of cash on deposit and short-term investments with an original maturity date of less than ninety days.

(d) Petroleum and Natural Gas Properties

The Company follows the full cost method of accounting for petroleum and natural gas properties and related expenses whereby all costs associated with the exploration for and development of oil and gas reserves are capitalized and accumulated in cost centres segregated by country. Such costs include royalty acquisition, land acquisition, geological and geophysical, costs of drilling both productive and non-productive wells and tangible equipment and administrative costs directly related to acquisition, exploration and development activities. Gains or losses are not recognized upon disposition of oil and natural gas properties unless crediting the proceeds against accumulated costs would result in a 20% or higher change in the depletion rate.

Costs associated with the investigating, bidding and acquiring petroleum properties are expensed prior to obtaining a petroleum lease or concession, with the exception of costs deferred on projects for which a bid is outstanding or for seismic and related costs in an area that the Company has existing plans to bid or negotiate a concession. The deferred costs are immediately expensed upon obtaining notice of an unsuccessful bid. Initial expenses and the write down of deferred costs are recorded as "Foreign New Venture Expenditures" in the consolidated statement of operations.

Depletion and Depreciation

The costs in cost centres from which there has been no commercial production are not subject to depletion until commercial production commences. Depletion is provided on costs accumulated using the unit-of production method based on an independent engineering estimate of the Company's share of proved reserves, before royalties. Included in the depletion base are estimated future costs to be incurred in developing proved reserves and, excluded are estimated salvage values and costs incurred acquiring and evaluating unproved properties.

Impairment

Petroleum and natural gas interests are evaluated quarterly to determine whether the costs capitalized are impaired. The costs are impaired if the carrying value of the assets exceeds the sum of the undiscounted cash flows expected from the production of proved reserves and the cost, less any impairment, of unproved properties. If the carrying value is assessed as impaired, an impairment loss is recognized to the extent that the carrying value of assets exceeds the sum of the discounted cash flows expected from the production of proved and probable reserves and the cost, less any

Pan Orient Energy Corp.
Notes to Consolidated Financial Statements

impairment, of unproved properties. The cash flows are estimated using expected future product prices and costs, discounted using a risk-free rate. Unproved properties are assessed for impairment on a regular basis and when circumstances arise that indicate an unproved property is impaired such as expiration of lease rights or prolonged negative exploration activities. Impairments of unproved properties are transferred to the related full cost pool.

(e) Asset Retirement Obligations

The Company recognizes the fair value of statutory, contractual or other legal obligations associated with the retirement of assets in the period the asset is incurred, when a reasonable estimate of the fair value can be determined. A corresponding increase to the carrying amount of the related asset is recorded. The liability is increased as accretion is recognized over time through charges to asset retirement accretion, which is included in depletion, depreciation and accretion expense. The costs capitalized to the related assets are amortized to earnings in a manner consistent with the depletion and depreciation of the underlying assets. Revisions to the estimated timing of cash flows or to the original estimated undiscounted costs could also result in an increase or decrease to the obligation. Actual costs incurred upon settlement of the retirement obligation are charged against the obligation to the extent of the liability recorded.

(f) Revenue Recognition

Revenue is recognized when title passes to the customer and when collection is reasonably assured.

(g) Stock-Based Compensation

The Company accounts for its stock-based compensation plans, as described in note 8, using the fair value method. Under this method, compensation costs attributable to stock options granted to officers, directors and employees is measured at fair value at the grant date and expensed over the vesting period with a corresponding increase to contributed surplus. Compensation costs attributable to stock options granted to consultants are re-valued each reporting period and expensed over the vesting period with a corresponding increase to contributed surplus. Consideration paid upon the exercise of stock options, together with corresponding amounts previously recognized in contributed surplus, is recorded as an increase to share capital. Previously recognized compensation cost for forfeited options is reversed in the period of forfeiture.

The Company has a share appreciation rights ("SARs") plan as described in note 8. Obligations for payments of cash under the SARs plan are accrued as compensation expense over the vesting period based on the positive difference, if any, between the exercise price and the closing price of Pan Orient common shares on the TSX Venture Exchange. The accrued compensation for a right that is forfeited or cancelled is adjusted by decreasing compensation cost in the period of forfeiture. As at December 31, 2009 there are no SARs issued under the plan.

(h) Income Taxes

The Company follows the asset and liability method of accounting for income taxes. Under this method, income tax liabilities and assets are recognized for the estimated tax consequences attributable to differences between the amounts reported in the financial statements and their respective tax bases, using enacted or substantively enacted tax rates respective to the periods that the temporary differences are expected to reverse. The effect of a change in income tax rates on future income tax liabilities and assets is recognized in income in the period that the change occurs. Tax assets are recognized if they are more likely than not to be realized.

(i) Per Share Amounts

Basic per share information is calculated on the basis of the weighted average number of common shares outstanding during the period. Diluted per share information is calculated using the treasury stock method which assumes that any proceeds received by the Company upon the exercise of in-the-money stock options, plus unamortized stock compensation costs, would be used to buy back common shares at the average market price for the period.

(j) Foreign Currency Translation

The Company's foreign operations are considered to be self sustaining and are translated to Canadian dollars using average exchange rates for the revenue and expenses. Assets and liabilities are translated at the year end exchange rate and gains and losses resulting from these translations are included in accumulated other comprehensive income. As the parent company realizes its investment, the proportionate amount of translation gains and losses in accumulated other comprehensive income is transferred to the statement of operations and included in the foreign exchange gain (loss).

Pan Orient Energy Corp.
Notes to Consolidated Financial Statements

Transactions denominated in foreign currencies are translated into their Canadian dollar equivalents at exchange rates prevailing at the transaction dates. Carrying values of monetary assets and liabilities reflect the exchange rates at the balance sheet date. Gains and losses on translation or settlement are included in net income.

(k) Use of Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, revenues and expenses, and disclosure of contingent assets and liabilities at the date of the consolidated financial statements. Actual results could differ from those estimates.

The amounts recorded for depletion and depreciation of petroleum and natural gas interests and for asset retirement obligations are based on estimates of petroleum and natural gas reserves and future costs. Proved and probable reserves also provide the basis for determining whether the carrying value of petroleum and natural gas interests is impaired. The determination of stock-based compensation involves estimates of the volatility of the Company's common shares for future rates and expected life. Income tax expense is calculated using tax rates based on the estimated timing of reversal of temporary differences between accounting and tax values of certain assets and liabilities and involves forecasting the amount of the future income tax asset that will be realized. By their nature, these estimates are subject to uncertainty and the impact on the financial statements of future periods could be material.

(l) Financial Instruments

All financial assets, liabilities and financial derivatives are initially recognized on the balance sheet at fair value and must be classified as one of the following five categories: held-for-trading; held-to-maturity instruments; loans and receivables; available-for-sale financial assets; or other financial liabilities. Loans and receivables, held-to-maturity instruments and other financial liabilities are subsequently measured at amortized cost. Held-for-trading financial assets are measured at fair value with changes in fair value recognized in earnings. Available-for-sale financial assets are measured at fair value with changes in fair value recognized in comprehensive income and reclassified to earnings when derecognized or impaired.

The Company has classified cash and cash equivalents as held-for-trading, accounts receivable and deposits as loans and receivables, and accounts payable and accrued liabilities as other liabilities.

3) RECENT ACCOUNTING PRONOUNCEMENTS

Business Combinations

In January 2009, the CICA issued section 1582, "Business Combinations," which will replace CICA section 1581 of the same name. Under this guidance, the purchase price used in a business combination is based on the fair value of shares exchanged at their market price at the date of the exchange. Currently the purchase price used is based on the market price of the shares for a reasonable period before and after the date the acquisition is agreed upon and announced. This new guidance requires all acquisition costs to be expensed, which currently are capitalized as part of the purchase price. Contingent consideration is to be recognized at fair value at the acquisition date and will be measured at fair value through earnings each period until settled. Currently only contingent consideration that is resolved and payable is included in the cost to acquire the business. In addition, negative goodwill (bargain purchase gain) is required to be recognized immediately in earnings, unlike the current requirement to first reduce certain non-current assets in the purchase price allocation with any excess being recognized as an extraordinary gain. Section 1582 is effective January 1, 2011 with prospective application and early adoption permitted.

Consolidated Financial Statements

In January 2009, the CICA issued section 1601, "Consolidated Financial Statements" which will replace CICA section 1600 of the same name. This guidance requires uniform accounting policies to be consistent throughout all consolidated entities and the difference between reporting dates of a parent and a subsidiary to be no longer than three months. These are not explicitly required under the current standards. Section 1601 is effective on January 1, 2011 with early adoption permitted. This standard is not anticipated to have a significant effect on the Company.

Pan Orient Energy Corp.
Notes to Consolidated Financial Statements

Non-controlling Interests

In January 2009 the CICA issued section 1602, "Non-controlling Interests" which will replace the associated portion of CICA section 1600, "Consolidated Financial Statements". Under the new standard non-controlling interest will be presented within equity and when there is a loss of control, a gain or loss is recognized on the sold and retained interests. Increases or decreases in a parent's ownership interest while retaining control is a capital transaction. Section 1602 is effective on January 1, 2011 with early adoption permitted.

All three standards are effective January 1, 2011 at which time the Company will have adopted IFRS. Early adoption is permitted; however, the early adoption of one of the three standards would require adoption of the other two standards. The Company is assessing if it will early adopt these standards in 2010.

4) ACQUISITION ACTIVITIES

Indonesia

During 2008 the Company acquired all of the issued and outstanding shares of three privately-held companies with interests in Indonesia. These entities hold a 90% operated working interest in the Batu Gajah Production Sharing Contract (PSC) located onshore south Sumatra, a 69% operated working interest in the Citarum PSC located onshore West Java and a 90% operated interest in a joint study located onshore Sumatra, which subsequently became the South CPP PSC. The allocation of the purchase price was as follows:

(\$000s)	
Consideration:	
Cash	14,741
Common shares	4,124
Transaction costs	1,115
	<u>19,980</u>
Allocated as follows:	
Petroleum and natural gas properties	20,180
Working capital, including cash of \$0.7 million	264
Asset retirement obligations	(464)
	<u>19,980</u>

The purchase was reported in the 2008 consolidated statement of cash flows as follows:

(\$000s)	
Cash consideration	14,741
Transaction costs paid in cash	1,115
Cash acquired	(699)
	<u>15,157</u>

5) DEPOSITS

The Company has cash deposits relating to: 1) guarantees to the Thailand and Indonesia governments for the Company's work commitments; and 2) customs importation permits in Thailand.

Pan Orient Energy Corp.
Notes to Consolidated Financial Statements

6) PETROLEUM AND NATURAL GAS PROPERTIES

As at December 31, 2009 (\$000s)	Cost	Accumulated Depreciation and Amortization	Net Book Value
Oil & Natural Gas			
Canada	56,624	-	56,624
Thailand	123,936	(39,429)	84,507
Indonesia	37,958	-	37,958
Office equipment	1,754	(1,005)	749
	220,272	(40,434)	179,838
As at December 31, 2008 (\$000s)			
Oil & Natural Gas			
Canada	55,075	-	55,075
Thailand	81,765	(23,303)	58,462
Indonesia	28,504	-	28,504
Office equipment	1,491	(709)	782
	166,835	(24,012)	142,823

General and administrative and stock-based compensation costs totaling \$2.8 million (2008 - \$0.5 million) that were directly related to exploration and development activities have been capitalized for the year ended December 31, 2009.

Costs associated with unproven properties of \$20.9 million (2008 - \$13.8 million) with respect to the Thai full cost pool have been excluded from the depletion calculation. The capitalized costs associated with Canada and Indonesia are not subject to depletion as production has not commenced.

Recoverability of the Canadian and Indonesian capitalized costs is dependent on successfully completing development of the properties. With respect to the Canadian properties, recoverability is also dependent on determining the technical feasibility of the project. Capitalized costs incurred to date do not necessarily represent present or future values.

The carrying value of the Company's unproved Canadian and Indonesian properties are expected to be recoverable and as such no writedown has been recorded.

During 2008 Andora settled a \$3.7 million account payable related to certain dissenting shareholders from a previous business acquisition. In lieu of a cash settlement Andora issued 2.2 million common shares which diluted Pan Orient's interest from 55.4% in 2007 to 53.2% in 2008. The transaction resulted in the following effects on the 2008 consolidated balance sheet: (i) a decrease in accounts payable of \$3.7 million, (ii) a decrease in petroleum and natural gas properties of \$3.6 million, (iii) a decrease in the future income tax liability of \$0.9 million, and (iv) an increase in non-controlling interest of \$1.0 million.

In 2009 the Company terminated its agreement to acquire an interest in the Tungkal PSC in Indonesia. As a result, costs of \$25,000 pertaining to the agreement were expensed and included in foreign new venture expenditures. In 2008 the Company was not successful in its bid for various oil and gas concessions in India. As a result, additional costs of \$37,000 in 2009 (2008 - \$0.7 million) pertaining to India were expensed and included in foreign new venture expenditures.

The Company performed a ceiling test calculation at December 31, 2009 to assess any impairment of petroleum and natural gas interests in Thailand. Based on the assumptions in the calculation there was no impairment at December 31, 2009.

Pan Orient Energy Corp.
Notes to Consolidated Financial Statements

The benchmark prices used in the ceiling test calculation were as follows:

Year	WTI Oil (\$US/bbl)	\$US/\$CAD Exchange Rate	WTI Oil (\$CAD/bbl)
2010:	71.43	0.95	75.19
2011:	74.65	0.95	78.58
2012:	78.04	0.95	82.15
2013:	81.52	0.95	85.81
2014:	85.09	0.95	89.57
2015:	88.76	0.95	93.43
Thereafter:	Escalated at 2% per annum	0.95	Escalated at 2% per annum

7) ASSET RETIREMENT OBLIGATIONS

(\$000s)	Year Ended December 31	
	2009	2008
Asset retirement obligations, beginning of year	1,964	84
Obligations acquired	-	464
Obligations incurred	607	616
Revisions to obligations	-	791
Accretion	258	9
Asset retirement obligations, end of year	2,829	1,964

Asset retirement obligations are based on the Company's net ownership of wells and facilities in Thailand, Indonesia and Canada, management's estimates of costs to abandon and reclaim those wells and facilities and the potential future timing of the cost to be incurred.

Total undiscounted cash flows, escalated at 2.0%, required to settle the Company's asset retirement obligations are estimated to be \$8.5 million (2008 - \$6.2 million). Payments to settle these obligations will occur over the operating lives of the underlying assets, estimated, for the majority of wells, to be between 2020 and 2025. Estimated costs have been discounted at Pan Orient's credit-adjusted, risk-free interest rate of 10%.

Pan Orient Energy Corp.
Notes to Consolidated Financial Statements

8) SHARE CAPITAL

a) Authorized

Unlimited Common Voting Shares
Unlimited Preferred Shares

b) Issued and Outstanding Class A Common Shares

Common Shares	Number of shares	Amount (000s)
Balance as at January 1, 2008	45,218,842	\$ 98,800
Indonesian acquisition ⁽ⁱ⁾	378,324	4,124
Exercise of stock options ^(v)	94,600	115
Underwriters compensation options exercised ⁽ⁱⁱⁱ⁾	78,000	433
Repurchase of shares ⁽ⁱⁱⁱ⁾	(201,400)	(455)
Transfer from contributed surplus on exercise of stock options	-	61
Balance as at December 31, 2008	45,568,366	103,078
Exercise of stock options ^(v)	750,000	1,135
Repurchase of shares ^(iv)	(5,000)	(11)
Transfer from contributed surplus on exercise of stock options	-	644
Balance as at December 31, 2009	46,313,366	\$ 104,846

- I. On June 18, 2008 the Company issued 378,324 shares to partially satisfy the purchase price of its Indonesian acquisition (see note 4).
- II. In connection with an offering completed in 2006, the Company issued 240,000 underwriters compensation options that were exercisable into common shares at \$4.04 per share at any time prior to April 28, 2008. During the year ended December 31, 2008, 78,000 underwriter's compensation options were exercised for common shares of the Company.
- III. A total of 201,400 common shares were acquired in 2008 at prices ranging from \$3.80 to \$8.00 per share. Shares purchased pursuant to the normal course issuer bid were cancelled and returned to treasury. As the consideration paid exceeded the stated value of the shares, the amount of excess totaling \$0.6 million was recorded as a reduction to retained earnings.
- IV. On September 28, 2009 Pan Orient announced that it acquired 5,000 of its common shares at a price of \$4.91 per share. These shares, purchased outside of the Company's expired normal course issuer bid, were cancelled and returned to treasury. As the consideration paid exceeded the stated value of the shares, the excess amount of \$13,000 was recorded as a reduction to retained earnings.
- V. Issued pursuant to stock option agreements with exercise prices between \$0.75 and \$3.90.

c) Options to Purchase Common Shares

	Number of options	Weighted average exercise price (\$)
Balance as at January 1, 2008	4,512,150	3.36
Granted	110,000	8.45
Exercised	(94,600)	1.22
Forfeited	(86,050)	2.88
Balance as at December 31, 2008	4,441,500	3.54
Granted	800,000	4.46
Exercised	(750,000)	1.51
Forfeited	(50,000)	11.75
Balance as at December 31, 2009	4,441,500	3.66

Pan Orient Energy Corp.
Notes to Consolidated Financial Statements

Options Outstanding December 31, 2009				Options Exercisable December 31, 2009		
Exercise Price (\$)	Number of Options	Weighted Average Exercise Price (\$)	Weighted Average Remaining Contractual Life (years)	Number of Options	Weighted Average Exercise Price (\$)	Weighted Average Remaining Contractual Life (years)
0.75 – 2.00	1,734,000	0.79	0.32	1,734,000	0.79	0.32
2.01 – 4.00	1,782,500	3.46	2.36	1,353,167	3.42	1.81
4.01 – 6.00	350,000	5.58	4.51	37,500	5.14	4.57
11.75	575,000	11.75	2.95	431,250	11.75	2.95
0.75 – 11.75	4,441,500	3.66	1.81	3,555,917	3.17	1.25

A total of 1,100,834 options were exercised subsequent to December 31, 2009. Of the options exercised, 767,334 had exercise prices ranging between \$0.75 and \$2.00 and 333,500 had exercise prices ranging between \$2.01 and \$4.00.

d) Stock-based Compensation

A Black-Scholes option pricing model is used to estimate the fair value of options on the date of the grant and revalue stock options granted to consultants on a quarterly basis. The fair value of the stock based compensation is amortized over the vesting period of the options, generally being two to three years.

Weighted average assumptions and resultant fair values for stock options granted or revalued during the years ended December 31, 2009 and 2008, including modified stock options, were as follows:

	Year Ended December 31	
	2009	2008
Risk free interest rate (%)	1.0	3.3
Expected lives (years)	5.0	3
Expected volatility (%)	83	75
Dividend per share (%)	-	-
Weighted average fair value (\$)	\$ 2.99	\$ 3.10

During the second quarter of 2009, the exercise price for 94,000 stock options previously granted to consultants and 70,000 stock options previously granted to employees (not officers or directors of the Company) was modified to \$3.41. The vesting, expiration and other terms remained unchanged. Of the 164,000 options, 70,000 originally had an exercise price of \$11.00 and 94,000 originally had an exercise price of \$11.75. The 90,000 consultant options are revalued each reporting period and the stock based compensation expense adjusted accordingly. The total incremental stock-based compensation expense related to the modification of the 70,000 stock options granted to employees, to be amortized over the remaining life of the options, is approximately \$38,000.

e) Andora Energy Corporation

i) Issued and Outstanding Class A Common Shares

As at December 31, 2009 and 2008 Andora had 57.6 million common shares issued and outstanding of which Pan Orient held 53.2%.

ii) Options to Purchase Common Shares of Andora

In 2008, 1,425,000 Andora stock options were granted, 862,500 of which vested upon grant, with the remainder vesting over 1.5 years. Each of these options has an exercise price of \$1.60 and an expiry of three years from the date of grant. Of the 5,175,000 options outstanding at the end of 2008, 3,750,000 expired unexercised in 2009 and 100,000 options were forfeited.

Pan Orient Energy Corp.
Notes to Consolidated Financial Statements

The following table provides Andora's stock options outstanding and exercisable at December 31, 2009:

Exercise Price (\$)	Options Outstanding December 31, 2009			Options Exercisable December 31, 2009		
	Number of Options	Weighted Average Exercise Price (\$)	Weighted Average Remaining Contractual Life (years)	Number of Options	Weighted Average Exercise Price (\$)	Weighted Average Remaining Contractual Life (years)
1.60	1,325,000	1.60	1.50	1,137,500	1.60	1.45

Weighted average assumptions and resultant fair values used in the Black Scholes calculations for Andora stock options granted or revalued during the years ended December 31, 2009 and 2008 were as follows:

	Year Ended December 31	
	2009	2008
Risk free interest rate (%)	1.68	3.10
Expected lives (years)	2	3
Expected volatility (%)	20	20
Dividend per share (%)	-	-
Weighted average fair value (\$)	\$ 0.20	\$ 0.29

f) Contributed Surplus

(\$000s)	Year Ended December 31	
	2009	2008
Balance, beginning of year	6,531	5,671
Pan Orient stock-based compensation expense	1,742	463
Pan Orient stock-based compensation capitalized	499	250
Andora stock-based compensation expense	27	112
Andora stock-based compensation capitalized	119	96
Transferred to share capital on exercise of options	(644)	(61)
Balance, end of year	8,274	6,531

Capitalized stock-based compensation relates to options granted to individuals engaged in exploration and development activities. The future income tax liability increased by \$0.2 million (2008 - \$0.1 million) as a result of capitalization of these costs.

g) Share Appreciation Rights Plan

During 2008 a share appreciation rights (SARs) plan was approved by the Board of Directors. Each right entitled the participant to receive cash from the Company of an amount equal to the positive difference, if any, between the exercise price and the closing price of Pan Orient common shares on the TSX Venture Exchange on the date of exercise.

At December 31, 2008 the Company had 55,000 share appreciation rights (SARs) outstanding with an exercise price of \$4.00 per SAR. During the first quarter of 2009, an additional 95,000 SARs were granted with an exercise price of \$4.00 per SAR. During the second quarter of 2009, all SARs were cancelled at no cost to the Company. No compensation expense has been recorded for the SARs in 2009.

Pan Orient Energy Corp.
Notes to Consolidated Financial Statements

h) Income per Share

The basic weighted average and diluted common shares outstanding were as follows:

	Year Ended December 31	
	2009	2008
Weighted average basic shares outstanding	46,007,897	45,495,486
Dilutive effect of stock options	2,116,856	3,431,674
Weighted average diluted	48,124,753	48,927,160

Options to purchase 925,000 common shares for the year ended December 31, 2009 (December 31, 2008 – 789,000) were not included in the computation of weighted average diluted common shares because they were anti-dilutive.

9) FOREIGN EXCHANGE

The Company's reporting currency is the Canadian dollar and its functional currencies are the Canadian dollar, the Thai baht and the US dollar. Each reporting period, the changes in the values of the baht and U.S. dollar relative to the Company's reporting currency must be recognized.

The Company's treasury function has been established with the goal of minimizing foreign currency exchange fluctuations to the extent possible. In addition to expatriating surplus funds from Thailand to Canada to hold in Canadian dollars, an integral part of this process is maintaining an appropriate cushion of baht in Thailand to satisfy payments in that currency as they come due, the most significant of which are the Company's SRB and taxes.

The Company's Thailand operations have a functional currency of Thai baht. Prior to April 1, 2009, the Company's net investment in the Thailand operations included intercompany loans that were denominated in baht, U.S. dollars and Canadian dollars and there was no planned or anticipated settlements of these loans contemplated. Accordingly, foreign currency translation gains and losses on these intercompany loans and the Company's investment in the shares of its Thailand subsidiaries were recognized in other comprehensive income. As a result, translation gains and losses on the Thailand operations were included in accumulated other comprehensive income (AOCI) on the balance sheet. Commencing April 1, 2009 the Company made a decision to repatriate funds from the Thailand operations through settlement of the intercompany loans and payment of dividends. Once this decision was reached, the intercompany loans were not considered as part of the Company's net investment in the Thailand operations. Therefore, effective April 1, 2009:

- translation gains and losses included in accumulated other comprehensive income on the investment in the Thailand operations that was planned to be repatriated was reclassified to net income as the investment was repatriated; and
- translation gains and losses on the permanent investment in the Thailand operations continue to be included in other comprehensive income.

Exchange gains or losses on assets and liabilities held in Canada are included in earnings and translation gains or losses from the Company's self-sustaining Indonesia entities are recorded in AOCI.

Pan Orient Energy Corp.
Notes to Consolidated Financial Statements

a) Foreign Exchange Gain (Loss)

The components of the Company's foreign exchange gain (loss) were as follows:

(\$000s)	Year Ended December 31	
	2009	2008
Realized		
Canada	(996)	2,067
Gain on Thailand investment	3,897	3,802
Gain transferred from Thailand OCI	749	-
Total realized	3,650	5,869
Unrealized	(10,636)	955
Total Foreign Exchange Gain (Loss)	(6,986)	6,824

With respect to realized amounts, the gains (losses) in Canada and the amounts transferred from Thailand AOCI are included in operating activities while the gain on the Thailand investment is reported as an investing activity.

b) Accumulated Other Comprehensive Income

Activity related to the AOCI balance for the years ended December 31, 2009 and 2008 was as follows:

(\$000s)	Year Ended December 31	
	2009	2008
Balance at beginning of year	4,037	(1,722)
Unrealized foreign currency translation (loss) gain	(3,540)	9,561
Gain on Thailand investment transferred to earnings	(3,897)	(3,802)
Gain transferred from Thailand OCI	(749)	-
Balance at end of year	(4,149)	4,037

Accumulated other comprehensive income at the following balance sheet dates was comprised of the following:

(\$000s)	As at	
	December 31, 2009	December 31, 2008
Foreign exchange (loss) gain related to Thailand	(2,633)	3,810
Foreign exchange (loss) gain related to Indonesia investment	(1,516)	227
Total Accumulated Other Comprehensive (Loss) Income	(4,149)	4,037

The amount included in AOCI for Thailand relates to translation gains and losses on the permanent portion of the investment and will continue to fluctuate based on the exchange rates between the Thai baht and Canadian dollar. The balance of the Indonesia AOCI will continue to fluctuate in future periods depending on the amount of capital invested in Indonesia and the exchange rates between the Canadian and U.S. dollar.

10) THAILAND SPECIAL REMUNERATORY BENEFIT TAX AND INCOME TAXES

The Company is required to pay both Special Remuneratory Benefit (SRB) and income tax in Thailand. Thai income tax is calculated at 50% of taxable income which is basically comprised of cash flow from operations before changes in working capital less capital expenditures and other permitted deductions.

SRB is calculated separately for each of the Company's four concessions and is not charged until all capital has been recovered. The sliding scale SRB rate ranges from 0 - 75% and is principally driven by production and pricing but is also subject to other adjustments such as changes in Thailand's consumer price index, wholesale price index and cumulative meters drilled on the concession. The calculated SRB tax rate is applied to petroleum profits as defined in Thai tax legislation which includes a deduction for capital spent.

The future income tax provision reflects an effective rate which differs from the expected statutory tax rate of a Canadian entity of 29.0% (2008 - 29.5%). Differences were accounted for as follows:

(\$000s)	Year Ended December 31	
	2009	2008
Income before income taxes and non-controlling interest	49,936	111,506
	29.0%	29.5%
Expected income taxes at the statutory rate	14,481	32,894
Increase (decrease) resulting from:		
Non-deductible stock-based compensation	513	170
Special remuneratory benefit tax	6,751	35,489
Income taxes in jurisdictions with different rates	10,885	11,457
Foreign exchange translation differences	2,729	-
Change in valuation allowance and other	(499)	(29)
Income taxes	34,860	79,981

The components of the net future income liability as at December 31 are as follows:

	2009	2008
Operating losses (expire up to 2029)	(4,078)	(4,744)
Petroleum and natural gas properties	33,906	23,969
Share issue costs	(519)	(1,161)
Valuation allowance	5,503	4,634
	34,812	22,698

A summary of tax payable for the years ended December 31, 2009 and 2008 are as follows:

(\$000s)	Year Ended December 31	
	2009	2008
Balance, beginning of year	55,260	4,645
SRB expense – current year	6,751	35,489
Income tax – current year	15,423	30,109
Prior period SRB paid	(36,048)	-
Prior period income tax paid	(21,684)	(19,436)
Foreign exchange	(4,784)	4,453
Balance, end of year	14,918	55,260

Pan Orient Energy Corp.
Notes to Consolidated Financial Statements

11) CAPITAL MANAGEMENT

The Company's capital consists of the following:

(\$000s)	Year Ended December 31	
	2009	2008
Working capital and deposits	32,738	46,386
Share Capital	104,846	103,078

Pan Orient's primary objective for managing its capital structure is to maintain financial capacity for the purpose of sustaining future development of its businesses and maintaining investor, creditor and market confidence.

The Company considers its capital structure to include shareholders' equity and working capital plus deposits. Management is continually monitoring changes in economic conditions and the risk characteristics of the underlying petroleum and natural gas industry. The Company currently has sufficient cash on hand to carry out its planned activities however, in the event that adjustments to the capital structure are necessary, the Company may consider issuing additional equity, raising debt or revising its capital investment programs.

Pan Orient's share capital is not subject to any external restrictions. The Company has not paid or declared any dividends since the date of incorporation, nor are any currently contemplated. There were no changes to the Company's approach to capital management during the year.

12) FINANCIAL INSTRUMENTS

Overview

The nature of Pan Orient's operations exposes the Company to credit risk, liquidity risk and market risk. Changes in commodity prices, foreign exchange rates and interest rates may have a material effect on cash flows, net income and comprehensive income.

This note provides information about the Company's exposure to each of the above risks as well as the Company's objectives, policies and processes for measuring and managing these risks.

Pan Orient's risk management policies are established to identify and analyze the risks faced by the Company, to set appropriate risk limits and to monitor market conditions and the Company's activities. The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management.

Credit Risk

Credit risk is the risk of financial loss to the Company if counterparties do not fulfill their contractual obligations. The most significant exposure to this risk is relative to the sale of oil production; all of the Company's production is sold to a refinery owned by the Thai National Oil Company. Pan Orient is paid for its production on a monthly basis, typically within a week of the end of the month. The Company has assessed the risk of non-collection from the Thai government as minimal.

Cash and cash equivalents consist of cash bank balances and short-term deposits maturing in less than 90 days. The Company's short-term investments are held with a chartered bank or the Thai government and are monitored to ensure a stable return. The Company's short-term investments currently consist of term deposits, bankers acceptances and government bonds and it is not the Company's policy to utilize complex, higher-risk investment vehicles.

The carrying amount of accounts receivable and cash and cash equivalents represents the maximum credit exposure. The Company did not write-off any receivables during the years ended December 31, 2009 or 2008.

As at December 31, 2009 there were no significant amounts past due or impaired.

Pan Orient Energy Corp.
Notes to Consolidated Financial Statements

Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet its work commitments and other financial obligations as they are due. Pan Orient's approach to managing liquidity is to ensure, to the extent possible, that it will have sufficient liquidity to meet its liabilities when due without incurring unacceptable losses or risking harm to the Company's reputation.

The Company's liquidity is dependent upon its operating cash flows. To forecast and monitor liquidity the Company prepares annual operating and capital expenditure budgets in each country which are monitored and updated as considered necessary. Expected future cash flow from the Thailand properties currently exceeds operating and future capital expenditures. Considering these circumstances and the cash balance at December 31, 2009 of \$44.8 million, the Company's liquidity risk is assessed as low.

The Company's only reported financial liabilities are accounts payable and accrued liabilities of \$14.3 million which will mature within one year. Taxes payable of \$14.9 million are not considered a financial instrument however, this amount is significant and Pan Orient is obligated to remit the reported amount by May 31, 2010.

The Company has work commitments in Thailand and Indonesia (see note 13) which are expected to be funded through cash balances and deposits currently held and expected future cash flow from Thailand properties.

Market Risk

Market risk is the risk that changes in foreign exchange rates, commodity prices and interest rates will affect the Company's cash flows, net income and comprehensive income. The objective of market risk management is to manage and control market risk exposures within acceptable limits, while maximizing returns.

Foreign Currency Exchange Rate Risk

Foreign currency exchange rate risk is the risk that future cash flows, net income and comprehensive income will fluctuate as a result of changes in foreign exchange rates. All of the Company's petroleum sales are denominated in Thai baht based on a \$USD oil price, and all operational and capital activities related to the Thailand properties are transacted in either Thai baht or the U.S. dollar. As well, the underlying market prices in Thailand for petroleum are impacted by changes in the exchange rate between the Thai baht and U.S. dollar.

The work commitments in Indonesia are expected to be carried out in U.S. dollars.

The Company's reporting currency is the Canadian dollar and its functional currencies are the Canadian dollar, the Thai baht and the U.S. dollar (USD). Changes in foreign exchange rates between the Canadian dollar and the U.S. dollar and Thai baht can affect net income and other comprehensive income as a portion of the Company's operations is considered a self-sustaining foreign operation. As at December 31 the following financial instruments were denominated in currencies other than the Canadian dollar:

(\$000s)	As at December 31, 2009		As at December 31, 2008	
	Thai baht (000s of Thai baht)	USD (\$000s)	Thai baht (000s of Thai baht)	USD (\$000s)
Cash and cash equivalents	796,260	2,759	2,239,756	7,675
Accounts receivable	323,721	780	305,993	1,753
Deposits	44,000	2,613	44,000	2,250
Accounts payable	(314,203)	(3,483)	(1,777,251)	(5,886)
Taxes payable	(460,704)	-	(1,570,818)	-
Net exposure in functional currency	389,074	2,669	(758,320)	5,792
Net exposure in Canadian dollars ⁽¹⁾ (\$000s)	12,340	2,808	(26,677)	7,082

(1) Translated at December 31, 2009 and 2008 exchange rates.

Pan Orient Energy Corp.
Notes to Consolidated Financial Statements

Based on financial instruments held at December 31, 2009 and 2008, fluctuations in the exchange rates as indicated below would have the following estimated effect on net income and other comprehensive income:

(\$000s)	As at December 31	
	2009	2008
Effect of 1% change in CAD\$ to USD exchange rate:		
Pre-tax net income	13	63
Other comprehensive income	17	8
Effect of 1% change in CAD\$ to baht exchange rate:		
Pre-tax net income	-	-
Other comprehensive income	130	269

The Company did not have any forward exchange contracts in place as at or during the year ended December 31, 2009 or 2008.

Commodity Price Risk

Commodity price risk is the risk that future cash flows will fluctuate as a result of changes in commodity prices, affecting results of operations and cash generated from operating activities. Such prices may also affect the value of exploration and development properties and level of spending for future activities. Prices received by the Company for its production are largely beyond Pan Orient's control as petroleum prices are impacted by world economic events that dictate the levels of supply and demand. All of Pan Orient's oil production is sold at spot rates exposing the Company to the risk of price movements.

The Company did not have any commodity price contracts in place as at or during the year ended December 31, 2009.

Interest Rate Risk

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. The Company is exposed to interest rate fluctuations on its cash and cash equivalents which bear a floating rate of interest.

The Company did not have any interest rate swaps or financial contracts in place as at or during the year ended December 31, 2009.

Fair Value of Financial Instruments

The Company's financial instruments as at December 31, 2009 included cash and cash equivalents, accounts receivable, deposits and accounts payable and accrued liabilities. The fair value of these financial instruments, except for the deposits, approximate their carrying amounts due to their short terms to maturity. The fair value of the deposits approximate their carrying value as they bear interest at market rates.

The Company will assess at each reporting period whether financial assets, other than those classified as held-for-trading, are impaired. Any impairment loss will be included in net income for the period.

Pan Orient Energy Corp.
Notes to Consolidated Financial Statements

13) COMMITMENTS

As at December 31, 2009 the Company's estimated outstanding capital commitments were as follows:

Country and Concession Name	Work Program Commitment	Obligation Period Ending	Estimated Net Financial Commitment	
			USD (\$000s)	CAD (\$000s) ⁽¹⁾
Thailand				
L 44/43	▪ study and training fund	July 2012	18	19
L33/43	▪ drill 2 exploration wells	July 2011	600	630
	▪ geological studies	July 2012	30	31
	▪ study and training fund	July 2012	18	19
L 53/48	▪ drill 4 exploration wells	January 2013	1,300	1,365
	▪ geological studies		80	84
	▪ study and training fund		47	49
Indonesia ⁽²⁾				
Citarum (3)	▪ 1,250 km 2D seismic	October 2010	17,679	18,562
	▪ drill 3 exploration wells			
Batu Gajah (3)	▪ 500 km 2D seismic	January 2011	26,573	27,902
	▪ 400 km 3D seismic			
	▪ drill 3 exploration wells			
South CPP (3)	▪ 500 km 2D seismic reprocessing	November 2011	4,982	5,231
	▪ drill one exploration wells			
Total			51,327	53,892

(1) Translated at December 31, 2009 exchange rate of US \$1 = CAD \$1.05.

(2) The Company owns a 90% working interest in the Batu Gajah production sharing contract (PSC) located onshore south Sumatra, a 69% operated working interest in the Citarum PSC located onshore west Java, and a 90% operated working interest in the South CPP PSC (formerly the Pamai Taluk joint study agreement) located onshore south central Sumatra. Amounts recorded in the financial statements and work commitments related to these PSCs include amounts paid by Pan Orient on behalf of a partner's carried interest (10% for Batu Gajah, 11% for Citarum and 10% for South CPP).

(3) "Work Program Commitment" is based on the original contract; however, the "Obligation Period Ending" has been extended subject to government approval.

Indonesia financial commitments as provided above represent the current exploration phase that the Company is conducting. If Pan Orient exercises its options to continue beyond the obligation periods noted, additional commitments will be determined on a year-by-year basis through submission of a work program and approval from the Government of Indonesia (GOI). The actual commitments are the work programs themselves as specified in the PSC agreement.

The obligation period shown for Citarum and Batu Gajah differs from the PSC agreement as commitments from previous years have been deferred and rolled forward. Every year the Company submits a work program for each PSC to the GOI and along with it, a request to roll forward any incomplete commitments from the previous year. Although this request is a departure from the original contract, it is considered standard practice in Indonesia. The above obligation periods for Citarum and Batu Gajah are consistent with this practice. In the past, such applications on behalf of Pan Orient have been approved by the GOI and management has no reason to believe that future requests will not be granted approval however there is no guarantee. Upon default of a commitment related to any of the first three years of a PSC the operator is required to relinquish 15% of the original PSC area, the actual acreage at the discretion of the operator. To date, Pan Orient has complied with all relinquishments as required. Depending on the stage of the PSC, failure to fulfill the required commitments may also result in penalty payment equal to the unspent commitments and/or forfeiture of the PSC.

The expenditures as provided in the table above represent the Company's estimated costs in completing the work program requirements. Actual expenditures required to carry out these commitments may be significantly different than the estimates.

The Company intends to fund commitments through existing cash surplus and expected cash flows from Thailand operations.

Pan Orient Energy Corp.
Notes to Consolidated Financial Statements

The Company is committed to future minimum payments for office space in Thailand, Indonesia and Canada. Payments required under these commitments for each of the next five years are as follows:

(\$000s)				
Year	Thailand	Indonesia	Canada	Total
2010	69	224	201	494
2011	69	117	202	388
2012	35	-	205	240
2013	-	-	171	171
2014	-	-	-	-
Total	173	341	779	1,293

14) SEGMENTED INFORMATION

The Company has properties in three countries, each of which is considered a separate operating segment. The three segments consist of: 1) partially developed conventional petroleum and natural gas properties in Thailand; 2) undeveloped petroleum and natural gas properties in Indonesia; and 3) an undeveloped heavy oil property in Canada. The following table provides information for each geographical segment as at and for the year ended December 31:

(\$000s)	Year Ended December 31	
	2009	2008
Petroleum revenue		
Thailand	98,236	147,554
Indonesia	-	-
Canada	-	-
Total	98,236	147,554
Interest revenue		
Thailand	407	506
Indonesia	-	-
Canada	43	485
Total	450	991
Current income tax expense ⁽¹⁾		
Thailand	22,174	65,598
Indonesia	-	-
Canada	-	-
Total	22,174	65,598
Depletion, depreciation and accretion		
Thailand	16,447	18,142
Indonesia	47	32
Canada	186	195
Total	16,680	18,369
Net income (loss) ⁽²⁾		
Thailand	14,544	33,062
Indonesia	(632)	(490)
Canada	1,233	(821)
Total	15,145	31,751

Pan Orient Energy Corp.
Notes to Consolidated Financial Statements

(\$000s)	Year Ended December 31	
	2009	2008
Capital expenditures ⁽³⁾		
Thailand	51,996	31,319
Indonesia	10,582	7,345
Canada	917	1,827
Total	63,495	40,491
Total assets		
Thailand	119,155	147,388
Indonesia	43,559	36,967
Canada	79,067	74,853
Total	241,781	259,208

(1) Includes SRB and income tax.

(2) The net income for Canada is a result of the general and administrative expenses, stock based compensation expense, depreciation, and foreign new venture expenses being more than offset by realized foreign exchange gains and a future income tax recovery of \$1.5 million relating to Andora.

(3) Does not include acquisition activities.



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