



**2009 MANAGEMENT'S DISCUSSION AND ANALYSIS**

## MANAGEMENT'S DISCUSSION AND ANALYSIS

The following Management's Discussion and Analysis ("MD&A") as provided by the management of Midnight should be read in conjunction with the audited Consolidated Financial Statements and accompanying notes for the years ended December 31, 2009 and 2008. Additional information relating to Midnight, including a detailed reserve analysis, will be included in our Annual Information Form, which may be found on SEDAR at [www.sedar.com](http://www.sedar.com).

**Basis of Presentation** – The financial data presented below has been prepared in accordance with Canadian Generally Accepted Accounting Principles ("GAAP"). The reporting and the measurement currency is the Canadian dollar. For the purpose of calculating unit costs, natural gas is converted to a barrel equivalent ("boe") using six thousand cubic feet of natural gas equal to one barrel of oil unless otherwise stated. The following MD&A compares the results of the year ended December 31, 2009 ("2009") to the year ended December 31, 2008 ("2008") and the results of the three months ended December 31, 2009 ("Q4 2009") to the three months ended December 31, 2008 ("Q4 2008") and the results of the three months ended September 30, 2009 ("Q3 2009").

**Non-GAAP Measurements** - Within the Management's Discussion and Analysis references are made to terms commonly used in the oil and gas industry. Funds from operations, funds from operations per share and netbacks are not defined by GAAP in Canada and are referred to as non-GAAP measures. Funds from operations per share is calculated based on the weighted average number of common shares outstanding consistent with the calculation of net income per share. Netbacks equal total revenue less royalties and operating and transportation expenses calculated on a per boe basis. Management utilizes these measures to analyze operating performance and leverage. Funds from operations is not intended to represent operating profit for the period nor should it be viewed as an alternative to operating profit, net income, cash flow from operations or other measures of financial performance calculated in accordance with Canadian GAAP. Funds from operations is commonly referred to as cash flow by research analysts and is used to value and compare oil and gas companies and is frequently included in published research when providing investment recommendations. Total boes are calculated by multiplying the daily production by the number of days in the period.

The following table reconciles cash flow from operations to funds from operations which is used in the MD&A:

(\$000's)	Q4 2009	Q4 2008	Q3 2009	2009	2008
Cash flow from operations	<b>2,897</b>	7,563	2,603	<b>8,968</b>	26,853
Abandonment expenditures	-	484	-	<b>103</b>	554
Changes in non-cash working capital	<b>(566)</b>	(3,365)	(1,022)	<b>(1,343)</b>	(881)
Funds from operations	<b>2,331</b>	4,682	1,581	<b>7,728</b>	26,526

**Forward Looking Statements** - Certain statements contained within the Management's Discussion and Analysis, and in certain documents incorporated by reference into this document, constitute forward looking statements. These statements relate to future events or our future performance. All statements other than statements of historical fact may be forward looking statements. Forward looking statements are often, but not always, identified by the use of words such as "seek", "anticipate", "budget", "plan", "continue", "estimate", "expect", "forecast", "may", "will", "project", "predict", "potential", "targeting", "intend", "could", "might", "should", "believe" and similar expressions. These statements involve known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in such forward looking statements.

In particular, this MD&A contains the following forward looking statements pertaining to, without limitation, the following: Midnight's future production volumes and the timing of when additional production volumes will come on stream; Midnight's realized price of commodities in relation to reference prices; the Company's future commodity mix; future commodity prices; the Company's expectations regarding future royalty rates and the realization of royalty incentives; Midnight's expectation of future operating costs on a per unit basis; the relationship of Midnight's interest expense and the Bank of Canada interest rates; future general and administrative expenses; future development and exploration activities and the timing thereof; the future tax liability of the Company; the expected decrease in the rate of depletion, depreciation and accretion; the estimated future contractual obligations of the Company; the future liquidity and financial capacity of the Company; and, Midnight's ability to fund its working capital and forecasted capital expenditures. In addition, statements relating to "reserves" or "resources" are deemed to be forward looking statements, as they involve the implied assessment, based on certain estimates and assumptions, that the resources and reserves described can be profitably produced in the future.

With respect to the forward looking statements contained in the MD&A, Midnight has made assumptions regarding: future commodity prices; the impact of royalty regimes and certain royalty incentives; the timing and the amount of capital

expenditures; production of new and existing wells and the timing of new wells coming on-stream; future proved finding and development costs; future operating expenses including processing and gathering fees; the performance characteristics of oil and natural gas properties; the size of oil and natural gas reserves; the ability to raise capital and to continually add to reserves through exploration and development; the continued availability of capital, undeveloped land and skilled personnel; the ability to obtain equipment in a timely manner to carry out exploration and development activities; the ability to obtain financing on acceptable terms; the ability to add production and reserves through exploration and development activities; and, the continuation of the current tax and regulation.

We believe the expectations reflected in those forward looking statements are reasonable but no assurance can be given that these expectations will prove to be correct and such forward looking statements included in, or incorporated by reference into, this MD&A should not be unduly relied upon. These statements speak only as of the date of this MD&A or as of the date specified in the documents incorporated by reference into this Management's Discussion and Analysis, as the case may be. The actual results could differ materially from those anticipated in these forward looking statements as a result of the risk factors set forth below and elsewhere in this Management's Discussion and Analysis: which include volatility in market prices for oil and natural gas; counterparty credit risk; access to capital; changes or fluctuations in production levels; liabilities inherent in oil and natural gas operations; uncertainties associated with estimating oil and natural gas reserves; competition for, among other things, capital, acquisitions of reserves, undeveloped lands and skilled personnel; stock market volatility and market valuation of Midnight's stock; geological, technical, drilling and processing problems; limitations on insurance; changes in environmental or legislation applicable to our operations, and our ability to comply with current and future environmental and other laws; changes in income tax laws or changes in tax laws and incentive programs relating to the oil and gas industry, and the other factors discussed under "Risk Factors" in the following annual MD&A. Readers are cautioned that the foregoing lists of factors are not exhaustive. The forward looking statements contained in this MD&A and the documents incorporated by reference herein are expressly qualified by this cautionary statement. The forward looking statements contained in this document speak only as of the date of this document and Midnight does not assume any obligation to publicly update or revise them to reflect new events or circumstances, except as may be required pursuant to applicable securities laws. This Management's Discussion and Analysis is dated as of March 11, 2010.

## Selected Annual & Quarterly Information

Set out below is selected annual information for Midnight for the last three years:

<b>Financial</b> (000's, except for per share amounts)	<b>2009</b>	<b>2008</b>	<b>2007</b>
Petroleum and natural gas sales	\$ 23,173	\$ 49,577	\$ 43,153
Cash flow from operations	8,968	26,853	21,413
Funds from operations	7,728	26,526	21,374
Per share			
– Basic	0.13	0.56	0.45
– Diluted	0.13	0.56	0.45
Net income (loss)	\$ (10,836)	\$ 4,589	\$ (1,219)
Per share			
– Basic	(0.18)	0.10	(0.03)
– Diluted	(0.18)	0.10	(0.03)
Petroleum and natural gas additions	\$ 37,500	\$ 36,167	\$ 27,330
Property disposition	-	(30,371)	-
Long-term debt	8,907	18,844	28,934
Net debt	12,667	8,730	28,374
Total assets	165,250	177,056	164,681
Shares outstanding			
Basic	75,335	46,175	47,595
Diluted	78,294	50,318	52,600
<b>Operations</b>			
Average daily production			
Natural gas (mcf/d)	6,966	5,651	6,050
Oil & NGLs (bbls/d)	649	892	1,090
Combined (boe/d)	1,810	1,834	2,098
Netback (\$/boe)	\$ 17.60	\$ 45.69	\$ 34.48

Set out below is selected information by quarter for Midnight for the last eight quarters:

Financial (000's, except for per share amounts)	2009				2008			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Petroleum and natural gas sales	\$ 6,148	\$ 5,506	\$ 6,371	\$ 5,148	\$ 7,828	\$ 14,930	\$ 15,576	\$ 11,243
Cash flow from operations	2,897	2,603	97	3,371	7,563	7,031	3,802	8,457
Funds from operations	2,331	1,581	2,054	1,762	4,682	7,923	8,684	5,237
Per share – Basic	0.03	0.03	0.04	0.04	0.10	0.17	0.18	0.11
– Diluted	0.03	0.03	0.04	0.04	0.10	0.17	0.18	0.11
Net income (loss)	\$ (2,071)	\$ (3,190)	\$ (3,668)	\$ (1,907)	\$ 760	\$ 1,647	\$ 2,174	\$ 8
Per share – Basic	(0.03)	(0.06)	(0.06)	(0.04)	0.02	0.03	0.05	0.00
– Diluted	(0.03)	(0.06)	(0.06)	(0.04)	0.02	0.03	0.05	0.00
Petroleum and natural gas additions	\$ 5,091	\$ 4,043	\$ 4,081	\$ 24,285	\$ 13,423	\$ 6,417	\$ 4,695	\$ 11,632
Property disposition	-	-	-	-	(30,371)	-	-	-
Net debt	12,667	9,907	23,944	30,804	8,730	29,536	31,042	34,996
Total assets	165,250	166,386	169,471	183,219	177,056	172,180	172,905	169,706
Shares outstanding								
Basic	75,335	75,335	57,885	46,175	46,175	47,423	47,423	47,423
Diluted	78,294	80,664	62,053	50,353	50,318	53,591	53,543	52,430
<b>Operations</b>								
Average daily production								
Natural gas (mcf/d)	6,904	7,064	9,004	4,867	5,465	6,097	5,799	5,239
Oil & NGLs (bbls/d)	565	635	688	708	803	941	942	883
Combined (boe/d)	1,715	1,812	2,189	1,519	1,714	1,957	1,908	1,756
Operating netback (\$/boe)	\$ 21.24	\$ 15.90	\$ 16.34	\$ 17.29	\$ 28.96	\$ 54.12	\$ 57.66	\$ 39.67

Midnight is a junior oil and gas company with a portfolio of light oil and sweet natural gas opportunities. Midnight's properties are primarily focused within two core areas in Alberta: (i) the Deep Basin in the Peace River Arch where the Company has its multi-year natural gas resource play and, (ii) in Red Earth where the Company has its light oil production and development opportunities. In Q4 2007, the Company announced its strategy to increase its exposure to sweet natural gas prospects in the Deep Basin. During the first half of 2008, the Company farmed-in on opportunities to acquire land which led to the most active drilling program in the Company's history during the winter of 2008/2009. This capital program was funded through the West Central property disposition, Elmworth farm-out, Bilbo and Chinook Ridge participation agreements, and funds from operations. During 2009, the Company also entered into a farm-in agreement in the West Wapiti area that continued to expand its Deep Basin prospect inventory. Combined with the earlier activities, these programs have also been funded with two equity financings – one that closed on April 9, 2009 and the other that closed on September 30, 2009, which raised aggregate net proceeds of \$25.5 million.

The Company's net income and funds from operations have fluctuated with the changes in commodity prices and production levels. Growth in petroleum and natural gas sales and funds from operations are derived from the combination of increased oil and natural gas production and increased commodity prices. Comparatively lower commodity prices in the current period have had a negative impact on the Company's funds from operations and net income. In Q4 2008, Midnight disposed of its low working interest non-core West Central assets to help fund the exploration and development of its multi-zone Deep Basin tight gas resource play in the Peace River Arch area of Alberta. The Company increased production in Q2 2009 by 44%, after delaying the start up of the new wells until the beginning of Q2 2009 to take advantage of the lower royalty rates effective April 1, 2009. In response to the continued low natural gas prices, the Company continued to limit investment and restrict and defer production additions during Q3 2009. Further production additions and optimization were minimized in Q4 2009 with activity picking up late in the quarter. Natural production declines from bringing on flush production in Q2 2009 resulted in lower production volumes in the following two quarters.

In Q2 2009, Midnight experienced its lowest commodity price in the last eight quarters with combined revenue averaging \$31.99/boe. This contrasts to Q2 2008 where commodity prices peaked when the Company realized a combined revenue price of \$89.71/boe for the quarter. Natural gas prices were weak in Q3 2009 when the Company had its lowest realized gas price since its inception of \$2.85/mcf. Gas prices increased in Q4 2009 and the Company realized \$4.20/mcf on its gas sales. Oil prices on the other hand showed strength in the last half of 2009 and the Company realized a price of \$68.62/boe in Q3 2009 and \$74.12/boe in Q4 2009 which is the highest realized oil price since Q3 of 2008. Midnight has successfully reduced its transportation and operating costs from \$14.78/boe in Q1 2008 to \$10.53/boe in Q4 2009 with YTD 2009 averaging \$9.79/boe versus YTD 2008 of \$12.10/boe.

Commodity prices over the last two years were extremely volatile. The Company's oil price received peaked in July 2008 at \$136.27/bbl and subsequently plummeted to its lowest price of \$41.10/bbl in January 2009; the monthly gas price received also peaked in July 2008 at \$10.91/mcf in July 2008 and also plummeted to its lowest realized price of \$2.75/mcf in September 2009. The financial crisis that started in the U.S., created a global economic recession that caused a reduction in the demand for energy resulting in a reduction in commodity prices which is a key element to our business. Reduced commodity prices reduced available cash flow for re-investment and development and increased uncertainty in various aspects of our business. Although field activity in the Western Canadian Sedimentary Basin has seen some of its lowest levels in years, Midnight has been busy in terms of capital deployment. The Company focused its activities on its Deep Basin resource plays and has built a solid foundation to support the future growth of the Company.

## **Production**

Production for 2009 averaged 1,810 boe/d consisting of 6,966 mcf/d of natural gas and 649 boe/d of oil and natural gas liquids ("NGLs"). Production in 2008 averaged 1,834 boe/d, which included approximately 460 boe/d of production from our West Central assets which were disposed of in Q4 2008. Removing the impact of this asset sale, production increased 32% year over year as new production additions from our Deep Basin drilling program were put on stream, primarily in Q2 of 2009. Oil production decreased 29% year over year as there was no new development on our light oil property in Red Earth during the year. In response to low natural gas prices, Midnight restricted both capital spending and operating cost investments and also delayed certain field operations that would increase existing production to avoid selling gas at low prices.

Q4 2009 production was 1,715 boe/d which was the same as the corresponding period in 2008 where production averaged 1,714 boe/d. Production declined 5% from Q3 2009 as only one new low working interest well was brought on stream during the quarter. Gas production remained stable from Q3 2009 as the Company added some additional compression in the Deep Basin and brought one additional gas well on stream. Oil production in the quarter declined 15% with production declines in one of the Company's highest producing oil wells. Midnight's production mix has changed since 2008, with natural gas now contributing 67% of total production versus 53% in 2008.

As previously announced, following our winter program and the associated production additions, the Company did not anticipate any further production additions until late Q4 2009 and forecasted Q4 2009 average production to decline from Q3 2009. As outlined, the previously forecasted exit rate of over 2,500 boe/d will be deferred into the first quarter of 2010. We are maintaining this outlook on production and anticipate the average production for Q1 to be 1,800 boe/d to 1,900 boe/d depending on the ultimate timing of our tie-in work.

The following table outlines our production volumes for the periods indicated below:

<b>Production</b>	<b>Q4 2009</b>	Q4 2008	Q3 2009	<b>2009</b>	2008
Natural Gas (mcf/d)	<b>6,904</b>	5,465	7,064	<b>6,966</b>	5,651
Oil (bbls/d)	<b>457</b>	683	537	<b>534</b>	754
NGLs (bbls/d)	<b>108</b>	120	98	<b>115</b>	138
<b>Total (boe/d)</b>	<b>1,715</b>	1,714	1,812	<b>1,810</b>	1,834

## Commodity Pricing

Canadian natural gas prices are influenced by the overall North American supply and demand balance including imports of liquefied natural gas, actual and forecast weather and seasonal changes, Canadian and U.S. storage levels and transportation capacity. Canada produces more natural gas than it consumes and exports to the U.S. a large portion of its production. As a result, the U.S. domestic market dynamics significantly affect Canadian natural gas prices. A combination of the global economic crisis that reduced U.S. domestic demand and recent technological advancements in drilling and completion techniques applied to large scale tight gas and shale gas developments in numerous areas in the U.S. has significantly increased U.S. domestic supply offsetting the lower activity level and has negatively impacted North American natural gas prices. The natural gas price continued to move downward through the first three quarters of 2009 as storage levels continued to rise. Storage levels were drawn down in December when colder than normal weather brought the storage levels in line with the 5 year average.

Midnight markets substantially all of its gas in Alberta with a mix of daily and monthly pricing and therefore has a high correlation to a blend of Alberta spot prices and Monthly Index Prices. Midnight's realized natural gas price was \$3.79/mcf for 2009 and \$4.20/mcf for Q4 2009 compared to the Alberta daily index price of \$3.85 /mcf and \$4.50/mcf, respectively. During Q4 2009, our gas sold at a discount to the index price as we sold a portion of the gas at the monthly index in an increasing price environment which yielded a lower price. Overall for 2009 the gas price has tracked to the index.

World oil prices have been volatile and dynamic over the past number of years with the trend expected to continue. Near term and long term oil prices are determined by daily free trading of the commodity on various world wide commodity exchanges and are influenced by actual and forecast global economic activity that affects global supply and demand. In 2009, the crude oil prices increased throughout the year from approximately \$40 US at the beginning of the year to \$78 US by the end of the year, as supply declined faster than demand. The principal trading exchange that affects Midnight's oil price is the U.S. benchmark West Texas Intermediate at Cushing, Oklahoma ("WTI") price. Midnight's realized oil price has a high correlation to the Edmonton Par benchmark price which generally has a high correlation to WTI adjusted by the Canadian to U.S. dollar exchange rate as well as transportation costs and quality adjustments. Midnight's oil is high quality light, sweet crude that has tracked appropriately to the Edmonton par benchmark. Midnight's realized oil price was \$62.68/bbl for 2009 and \$74.12/bbl for Q4 2009 compared to the Edmonton benchmark prices of \$66.30/bbl for 2009 and \$76.73/bbl for Q4 2009.

Prices for Natural Gas Liquids ("NGLs") have their own market dynamic. NGLs include condensate, pentane, butane, propane and ethane. While prices for condensate and pentane have a relatively strong correlation to oil prices, prices for butane, propane and ethane trade at varying discounts due to the local market conditions of supply and demand. The change in product mix of liquids can cause significant variations in the realized liquids price. Midnight's liquid price has decreased from 2008 with the overall decline in the commodity prices as well as an increased percentage of the Company's liquids coming from ethane whose price tracks more closely to natural gas.

Midnight did not buy or sell any commodity or currency hedges during 2009 or 2008 and did not have any outstanding hedges at December 31, 2009.

Midnight's realized prices for commodities has tracked with the appropriate benchmark prices and are expected to continue with this correlation in 2010. The following table outlines benchmark prices compared to Midnight's realized prices:

<b>Prices and Marketing</b>	<b>Q4 2009</b>	Q4 2008	Q3 2009	<b>2009</b>	2008
<b>Benchmark Prices</b>					
Alberta spot (\$/mcf)	\$ 4.50	\$ 6.62	\$ 2.83	\$ 3.85	\$ 8.06
WTI oil (\$US/bbl)	78.91	59.06	68.14	62.59	99.92
Cdn/US average exchange rate	0.947	0.828	0.912	0.881	0.943
Edmonton Par (\$/bbl)	\$ 76.73	\$ 63.62	\$ 71.71	\$ 66.30	\$ 102.66
<b>Midnight's Realized Prices</b>					
Natural gas (\$/mcf)	\$ 4.20	\$ 6.96	\$ 2.85	\$ 3.79	\$ 8.53
Oil (\$/bbl)	74.12	61.63	68.62	62.68	102.49
NGLs (\$/bbl)	27.52	40.95	29.02	28.06	65.87
Combined oil & NGLs (\$/bbl)	65.19	58.54	62.52	56.57	96.81
Total (\$/boe)	\$ 38.96	\$ 49.65	\$ 33.02	\$ 35.09	\$ 73.87

### Petroleum and Natural Gas Sales

Petroleum and natural gas sales totalled \$23.2 million for 2009 compared to \$49.6 million in 2008 due to substantially lower commodity prices in 2009 as production was only 1% lower in the current year. The negative price component variance for 2009 versus 2008 was \$25.6 million whereas the production variance was \$0.8 million. Midnight's realized oil and liquids price declined 57% and the gas price declined 56% from 2008. Q4 2009 sales of \$6.1 million increased 12% from Q3 2009 and were 21% lower than Q4 2008.

The following table outlines our production sales for the periods indicated below:

<b>Petroleum and Natural Gas Sales (000's)</b>	<b>Q4 2009</b>	Q4 2008	Q3 2009	<b>2009</b>	2008
Natural Gas	\$ 2,667	\$ 3,497	\$ 1,851	\$ 9,646	\$ 17,637
Oil	3,113	3,873	3,392	12,218	28,275
NGLs	274	452	261	1,173	3,332
Royalty income	94	6	2	136	333
Total	\$ 6,148	\$ 7,828	\$ 5,506	\$ 23,173	\$ 49,577

### Royalties

Royalty payments are made by producers of oil and gas to the owners of the mineral rights on our leases that include provincial governments (Crown) and freehold landowners as well as to other third parties by way of contractual overriding royalties.

In January 2009, the new royalty framework ("NRF") was implemented by the Alberta government. The NRF calculates royalty rates based on an individual well's production, depth and the commodity reference price. Royalties under the NRF are based on individual well's production and on the Crown reference price. The sliding scale royalty calculation is based on a broader range of commodity prices where the price component of royalties increases up to maximum prices of approximately \$120/bbl for oil and \$16/gj for natural gas. The minimum Crown rate under the NRF is 5% and the maximum royalty rate is 50%. Subsequent to the initial legislation, the Alberta Government announced additional programs that may reduce royalties payable or provide drilling incentives in the form of royalty reductions for capital expenditures on qualifying wells. Midnight has and will continue to benefit from these programs including the natural gas deep drilling program, the new well royalty reduction for wells coming on production after April 1, 2009 and the drilling incentives for new wells. For new wells spud on or after April 1, 2009 and rig released before April 1, 2011, the Company may receive a royalty credit of \$200/metre drilled. Midnight's average well depth in the Deep Basin is approximately 3,500 metres which would earn \$700,000 in royalty credits. These credits can be used to shelter up to 50% of Midnight's Alberta Crown royalty payments and will be accounted for as a reduction to capital expenditures as incurred. A new well incentive program was also announced for new wells which come on production between April 1, 2009 and March 31, 2011. This program caps a

well's royalty at 5% for the first 12 months of production or for the first 50,000 bbls or 500 mmcf produced, whichever comes first. To obtain maximum benefit under this latter program, Midnight delayed bringing on new Q1 2009 production from a number of wells from its winter drilling program until April 1, 2009. Some new wells in Midnight's Deep Basin program are subject to gross overriding royalties to third parties which will increase the overall rate on these wells above 5%.

Midnight's 2009 royalties were 22.0% of revenue compared to 21.8% of revenue in 2008. Midnight's gas royalty rate averaged 11.3% for the year due to low commodity prices and the Company was able to utilize the Alberta Government's incentives which capped royalties at 5% for the new wells. Oil royalties averaged 30.2% of revenues in 2009 compared to 24.7% of revenues in 2008. Oil royalties dominate Midnight's royalty percentage as they made up 73% of royalties in 2009 while only accounting for 30% of the production. Oil royalties increased with the implementation of the NRF. The Company's oil royalty rate is heavily dependent on the Crown par price. NGL royalties averaged 25.6% of revenue for 2009 compared to 28.1% in 2008. NGL royalties only made up 6% of the Company's royalties for 2009 and are expected to be a small portion of total royalties in 2010.

Q4 2009 royalties were 18.4% of revenue compared to 24.3% in Q3 2009 and 19.4% in Q4 2008. The royalty rate declined 3.2% in Q4 2009 from Q3 2009 due to reduced oil production. Natural gas royalties remained low in Q4 2009 as adjustments to the NRF and capital cost allowance were taken into consideration.

The Company expects natural gas royalties to remain low in 2010 as production added after March 31, 2009 is subject to the new well royalty credit and most of the Company's planned drilling qualifies for the Natural Gas Deep Drilling Credits. Oil royalties are expected to be in the 30% range for 2010 based on an expected realized price of \$75.00/bbl in 2010.

The estimated royalty rates are based on many assumptions. The actual royalty rates may differ significantly as the rates will vary based on commodity prices, production profiles of new and existing wells, and the depth of new wells drilled along with the application of incentives received.

The following tables outline our royalties by type and by commodity:

<b>Royalties by Type</b> (000's)	<b>Q4 2009</b>	Q4 2008	Q3 2009	<b>2009</b>	2008
Crown	\$ 960	\$ 1,150	\$ 1,198	\$ 4,418	\$ 9,467
Gross overriding and other	174	365	142	669	1,327
<b>Total</b>	<b>\$ 1,134</b>	<b>\$ 1,515</b>	<b>\$ 1,340</b>	<b>\$ 5,087</b>	<b>\$ 10,794</b>
\$/boe	\$ 7.19	\$ 9.61	\$ 8.03	\$ 7.70	\$ 16.08
% of revenue	18.4	19.4	24.3	22.0	21.8

<b>Royalties by Commodity</b>	<b>Q4 2009</b>	Q4 2008	Q3 2009	<b>2009</b>	2008
<b>Natural Gas</b>					
000's	\$ 64	\$ 583	\$ 105	\$ 1,093	\$ 2,881
% of revenue	2.4	16.7	5.7	11.3	16.3
<b>Oil</b>					
000's	\$ 1,001	\$ 798	\$ 1,202	\$ 3,694	\$ 6,977
% of revenue	32.2	20.6	35.4	30.2	24.7
<b>NGLs</b>					
000's	\$ 69	\$ 134	\$ 33	\$ 300	\$ 936
% of revenue	25.2	29.6	12.6	25.6	28.1

## Operating and Transportation Expenses

Operating and transportation expenses totaled \$6.5 million for 2009 which is down 20% from the 2008 total of \$8.1 million. Midnight has targeted operating expense reductions over the last two years and has reduced operating expenses from \$12.91/boe in 2007 to \$9.79/boe in 2009 representing a 24% decrease on a per boe basis. In addition to the Company's focused effort on cost reduction, three additional factors have contributed to the lower costs including: the Company's new

gas production has generally been put on stream with lower operating costs; transportation costs have been reduced due to the construction of water handling facilities at Red Earth; and, the sale of our higher operating cost properties in West Central.

Q4 2009 operating costs of \$10.53/boe were less than the comparative period costs in Q4 2008 of \$11.08/boe due to the factors discussed above. Q4 2009 operating costs increased over Q3 2009 as the Company incurred additional repairs and maintenance costs primarily at Red Earth for mechanical repairs and regular workover activities.

The following table details the Company's operating and transportation expenses:

<b>Operating and Transportation Expenses</b> (000's)	<b>Q4 2009</b>	Q4 2008	Q3 2009	<b>2009</b>	2008
Operating	\$ 1,631	\$ 1,683	\$ 1,472	\$ 6,286	\$ 7,654
Transportation	31	64	43	179	465
<b>Total</b>	<b>\$ 1,662</b>	<b>\$ 1,747</b>	<b>\$ 1,515</b>	<b>\$ 6,465</b>	<b>\$ 8,119</b>
Operating (\$/boe)	\$ 10.33	\$ 10.67	\$ 8.83	\$ 9.52	\$ 11.41
Transportation (\$/boe)	0.20	0.41	0.26	0.27	0.69
<b>Total (\$/boe)</b>	<b>\$ 10.53</b>	<b>\$ 11.08</b>	<b>\$ 9.09</b>	<b>\$ 9.79</b>	<b>\$ 12.10</b>

### Interest Expense

Interest expense totalled \$509,000 in 2009 on average bank debt of approximately \$8.5 million for an effective interest rate of 6.0%. This compares to total interest expense of \$1,372,000 on average bank debt of \$28.7 million in 2008 for an effective interest rate of 4.9%. Midnight's total interest expense includes its bank refinancing charges as well as other interest not directly related to its bank debt and when these amounts are excluded, its effective interest rate was 4.6% for the 2009 year. Despite record low interest rates, Canadian banks in general have increased their stamp fees or "spreads" which has partially reduced the benefit of the lower rates. In addition, Midnight's stamp fees are based on a pricing grid which is dependent on its debt to cash flow ratio which has increased as lower commodity prices have reduced cash flows. Midnight reduced its net debt in Q4 2008 from the disposition of its West Central assets where ultimate proceeds of \$31.5 million were received. The Company also raised gross proceeds of \$27.3 million on two equity offerings that closed on April 9, 2009 and September 30, 2009, respectively. The long-term debt was redrawn to fund our 2009 exploration program of \$37.5 million.

Q4 2009 interest expense totalled \$0.1 million compared to \$0.3 million for the same period in 2008 as Midnight's average bank debt for the period was \$9.4 million compared to \$24.8 million in 2008.

Midnight's credit facility bears interest at the bank's prime rate plus a stamping fee or at Bankers' Acceptance rates plus a stamping fee based on the Company's debt to cash flow ratio as defined in the credit facility. Over the last year, Midnight's stamp fees have increased with each review of the credit facility due to pressure on the commercial banks resulting from the global credit crisis. Credit renewal fees have also increased and have been recorded as part of interest expense. Record low prime rates have reduced the impact of the increased fees but should prime rates increase, Midnight's effective interest rate will be higher than in past quarters.

<b>Interest Expenses</b> (000's)	<b>Q4 2009</b>	Q4 2008	Q3 2009	<b>2009</b>	2008
Interest	\$ 132	\$ 257	\$ 173	\$ 509	\$ 1,372
<b>Total (\$/boe)</b>	<b>\$ 0.84</b>	<b>\$ 1.63</b>	<b>\$ 1.04</b>	<b>\$ 0.77</b>	<b>\$ 2.05</b>

### General and Administration Expenses

Direct general and administration ("G&A") expenses totalled \$7.0 million for 2009 compared to \$7.6 million in 2008 representing a 7% decrease, while cash G&A charges decreased to \$3.4 million in 2009 from \$4.3 million in 2008 for a 20% decrease. Direct costs decreased as the Company did not pay out bonuses and utilized fewer external services in 2009.

Cash G&A costs further decreased from 2008 as the Company had increased operating recoveries from its operated drilling program. Q4 2009 cash G&A was consistent with Q3 2009 cash G&A and decreased 12% from Q4 2008 cash G&A with lower direct charges and slightly higher operating recoveries.

The largest portion of Midnight's cash G&A is comprised of salaries and benefits and, as such, Midnight's cash G&A will depend on the staffing levels in 2010 along with any changes to salaries and bonuses. The 2010 cash G&A is budgeted to remain consistent with 2009. The per boe cost will be significantly affected by future production volumes.

Non-cash expenses related to stock-based compensation expense totalled \$0.6 million in 2009 which was consistent with the 2008 expense of \$0.6 million. Midnight estimates the fair value of stock options when they are granted using the Black-Scholes pricing model and expenses the options over the vesting period of the options and capitalizes amounts associated with employees' salaries that are capitalized. Since Midnight's inception, the Company has expensed \$4.2 million of stock based compensation with \$1.8 million of this being capitalized. No options have been exercised since inception. Our stock option plan is the only long term incentive program used to attract and retain our personnel. To make the plan effective and to align the program with the employees and shareholders, a three year life of options was deemed appropriate. During the fourth quarter of 2009, all options were standardized to a three year life resulting in 2,640,000 options expiring. As most of these options were already vested, the impact to stock-based compensation expense was \$0.1 million. During 2009, 1,528,500 options were granted at an average exercise price of \$0.97/option. These options were granted with a three year life and one third vests every nine months. Midnight's unamortized portion of stock based compensation expense is \$0.6 million at December 31, 2009. Midnight had 2,958,500 options outstanding with a weighted average exercise price of \$1.19/option at December 31, 2009 of which 1,060,667 were exercisable with a weighted average exercise price of \$1.44/option.

The components of general and administration expense are as follows:

<b>General and Administration Expenses</b> (000's)	<b>Q4 2009</b>	Q4 2008	Q3 2009	<b>2009</b>	2008
Direct G&A	\$ 1,759	\$ 1,815	\$ 1,672	\$ 7,031	\$ 7,599
Overhead recoveries	(272)	(237)	(164)	(1,185)	(609)
Capitalized G&A	(598)	(566)	(611)	(2,423)	(2,697)
<b>Cash G&amp;A</b>	<b>\$ 889</b>	\$ 1,012	\$ 897	<b>\$ 3,423</b>	\$ 4,293
Stock-based compensation	219	144	139	637	551
<b>Net G&amp;A</b>	<b>\$ 1,108</b>	\$ 1,156	\$ 1,036	<b>\$ 4,060</b>	\$ 4,844
<b>Cash G&amp;A (\$/boe)</b>	<b>\$ 5.63</b>	\$ 6.42	\$ 5.38	<b>\$ 5.19</b>	\$ 6.40
Stock-based compensation (\$/boe)	1.39	0.91	0.83	0.96	0.82
<b>Net G&amp;A (\$/boe)</b>	<b>\$ 7.02</b>	\$ 7.33	\$ 6.21	<b>\$ 6.15</b>	\$ 7.22

## Depletion, Depreciation and Accretion

For 2009, depletion, depreciation and accretion ("DD&A") was \$21.8 million compared to \$21.5 million for 2008. Midnight has excluded \$16.2 million (2008 - \$23.1 million) from the depletion base related to unproved properties in Q4 2009 and has added \$30.2 million (2008 - \$13.7 million) to its base for future development capital related to proved reserves. On a per boe basis, Midnight's charge increased 3% year over year to \$33.01/boe in 2009 from \$31.98/boe in 2008. Q4 2009 DD&A was \$29.99/boe, a 12% decrease from both Q4 2008 and Q3 2009. The 2009 charges are higher than 2008 as the disposition of the West Central assets in Q4 2008 had a higher historical carrying cost than the reduction to the depletable base of \$20.26/boe, causing an increase in the Company's go forward DD&A rate. The Company has continued to reduce the impact of the disposition by adding reserves at a lower finding and development cost rate. The finding and development cost for proved reserves including the changes in future development costs is \$21.41/boe in 2009 which is lower than our historical carrying cost and, without the promoted capital, would be reduced further to \$19.42/boe. Going forward, the Company's drilling program will be focused in the Deep Basin where historically the Company has been able to add reserves

at a lower finding and development cost. The Company anticipates that its DD&A rate will decrease with continued drilling in this area and increased recognition of reserves from the tight gas formations. The components of DD&A are as follows:

<b>Depletion, Depreciation and Accretion</b> (000's)	<b>Q4 2009</b>	Q4 2008	Q3 2009	<b>2009</b>	2008
Depletion and Depreciation	\$ 4,688	\$ 5,305	\$ 5,631	\$ 21,622	\$ 21,265
Accretion	45	44	45	180	203
<b>Total</b>	<b>\$ 4,733</b>	\$ 5,349	\$ 5,676	<b>\$ 21,802</b>	\$ 21,468
Depletion and Depreciation (\$/boe)	\$ 29.70	\$ 33.64	\$ 33.77	\$ 32.74	\$ 31.68
Accretion (\$/boe)	0.29	0.28	0.27	0.27	0.30
<b>Total (\$/boe)</b>	<b>\$ 29.99</b>	\$ 33.92	\$ 34.04	<b>\$ 33.01</b>	\$ 31.98

## Investments and Other Income

Investments were comprised of the Daylight Resources Trust Units (TSX-DAY.UN) received from the disposition of the West Central assets. At December 31, 2008 Midnight held 2,690,200 Trust Units with a fair value of \$21.0 million based on Daylight's closing price on December 31, 2008 of \$7.81 per unit. In January 2009, the Company disposed of the remaining Trust Units for \$21.5 million and recorded a gain of \$0.5 million. The proceeds from the sale were used to reduce long-term debt. In Q4 2008, the Company recorded \$1.4 million of distribution income from the Trust Units in other income; no distributions were recorded for Q1 2009. Seismic sales make up the balance of other income in all of the corresponding periods.

## Taxes

For 2009, the Company had a reduction in future taxes of \$3.4 million compared to a future tax expense of \$2.0 million in 2008. The Company had a before tax loss of \$14.2 million in 2009 compared to before tax income of \$6.5 million in 2008. The difference between the expected rate of 29.0% and the effective rate for 2009 relates primarily to the tax rate differences of the expected rate and the rate when temporary differences are expected to reverse and from the permanent differences arising from stock-based compensation. The Q4 2009 future tax reduction was \$0.6 million compared to an expense of \$0.5 million in Q4 2008 and a reduction of \$1.0 million in Q3 2009.

The future income tax effect and reduction of share capital of approximately \$2.8 million will be recorded during the first quarter of 2010 when the Company files the renouncement documents with tax authorities.

Midnight does not expect to become taxable on an income tax basis in 2010 and has approximately \$142.6 million in tax pools to shelter taxable income in the future before the renunciation of \$11 million of exploration expenses in Q1 2010. These tax pool balances are subject to change as tax returns are completed, annual claims are made, and reclassification of items between categories may occur.

<b>Tax Pools</b> (000's)	<b>2009</b>
Canadian exploration expense & non-capital losses	\$ 71,200
Canadian development expense	19,600
Canadian oil and gas property expense	26,300
Undepreciated capital cost	23,600
Share issue costs	1,900
<b>Total</b>	<b>\$ 142,600</b>

## Funds from Operations and Net Income

For 2009, funds from operations totalled \$7.7 million or \$0.13 per basic and diluted share. Funds from operations for 2008 totalled \$26.5 million or \$0.56 per basic and diluted share. For Q4 2009, funds from operations totalled \$2.3 million or

\$0.03 per basic and diluted share. Funds from operations for Q4 2008 totalled \$4.7 million or \$0.10 per basic and diluted share and \$1.6 million or \$0.03 per basic and diluted share for Q3 2009.

For 2009 the Company had a net loss of \$10.8 million (\$0.18 loss per basic and diluted share) compared to a net income of \$4.6 million (\$0.10 per basic and diluted share) for 2008. The net loss for Q4 2009 was \$2.1 million (\$0.03 loss per basic and diluted share) compared to net income of \$0.8 million (\$0.02 per basic and diluted share) in Q4 2008 and a net loss of \$3.2 million (\$0.06 loss per basic and diluted share) in Q3 2009.

The changes in non-cash working capital and abandonment expenditures are added back to cash flow from operations to arrive at funds from operations.

The following table summarizes the net income on a barrel of oil equivalent basis for the periods indicated:

(\$/boe)	Q4 2009	Q4 2008	Q3 2009	2009	2008
Sales price	\$ 38.96	\$ 49.65	\$ 33.02	\$ 35.09	\$ 73.87
Royalties	7.19	9.61	8.03	7.70	16.08
Operating expenses	10.33	10.67	8.83	9.52	11.41
Transportation expenses	0.20	0.41	0.26	0.27	0.69
<b>Operating netback</b>	<b>\$ 21.24</b>	<b>\$ 28.96</b>	<b>\$ 15.90</b>	<b>\$ 17.60</b>	<b>\$ 45.69</b>
General and administration	5.63	6.42	5.38	5.19	6.40
Interest	0.84	1.63	1.04	0.77	2.05
Other income	-	(8.78)	-	(0.06)	(2.28)
<b>Cash flow netback</b>	<b>\$ 14.77</b>	<b>\$ 29.69</b>	<b>\$ 9.48</b>	<b>\$ 11.70</b>	<b>\$ 39.52</b>
Depletion, depreciation and accretion	29.99	33.92	34.04	33.01	31.98
Stock-based compensation	1.39	0.91	0.83	0.96	0.82
Gain on investments	-	(12.92)	-	(0.73)	(3.03)
Future tax (reduction)	(3.49)	2.96	(6.26)	(5.14)	2.91
<b>Net income (loss)</b>	<b>\$ (13.12)</b>	<b>\$ 4.82</b>	<b>\$ (19.13)</b>	<b>\$ (16.40)</b>	<b>\$ 6.84</b>

The following table provides reconciliations to the change in funds from operations and net income for Q4 2009 to Q4 2008 and for the 2009 year to the 2008 year:

Change in Funds from Operations and Net Income (Loss) (000's)	Q4 2009 to Q4 2008		2009 Year to 2008 Year	
	Funds from Operations	Net Income (Loss)	Funds from Operations	Net Income (Loss)
Comparative period	\$ 4,682	\$ 760	\$ 26,526	\$ 4,589
Increase (decrease) in revenue:				
Change in production volumes	7	7	(790)	(790)
Change in prices	(1,687)	(1,687)	(25,614)	(25,614)
Change in royalties	381	381	5,707	5,707
Change in other income	(1,385)	(1,385)	(1,488)	(1,488)
(Increase) decrease in expenses:				
Operating	52	52	1,368	1,368
Transportation	33	33	286	286
Interest	125	125	863	863
Cash general and administration	123	123	870	870
Stock-based compensation	-	(75)	-	(86)
Depletion, depreciation and accretion	-	616	-	(334)
Gain on investments	-	(2,037)	-	(1,558)
Taxes	-	1,016	-	5,351
Current period	<b>\$ 2,331</b>	<b>\$ (2,071)</b>	<b>\$ 7,728</b>	<b>\$ (10,836)</b>

## Capital Expenditures

2009 capital expenditures totalled \$37.5 million and were focused on drilling, completing, equipping and tie-in in gas resource targets in the Deep Basin to establish a premium land position to support the future growth of the Company.

Midnight's 2009 capital program included farm-ins and farmouts and the net wells presented reflect the Company's after earned interest. Midnight drilled 10 gross (3.6 net) wells in 2009 including 9 gross (3.4 net) Deep Basin wells. The Company spud its 7<sup>th</sup> and last earning well on its Bilbo farm-in in Q4 2009 and with the completion of this well, concluded its earning obligations during the first quarter of 2010. During 2009, the Company drilled 3 gross (1.4 net) horizontal wells with the remaining 7 gross (2.2 net) wells being drilled as vertical wells. Drilling costs accounted for 46% of capital expenditures in the year with completions accounting for an additional 28% and related facilities accounting for 17%. In 2009, Midnight incurred a net \$5.0 million of promote capital to earn our farmin lands and to establish our current play portfolio. Promote capital occurs when a company pays a larger portion of the drilling and completion costs to earn a promoted working interest. At Bilbo, the Company paid/incurred 50% of the costs to drill and complete 7 gross (3.5 net) wells to earn 2.1 net working interest wells and a 30% working interest in 42 sections of land. At Elsworth, the Company paid/incurred 25% of the costs to drill and complete 3 gross (0.75 net) wells to retain 1.65 net working interest wells and a 55% working interest in 6 sections of land. Capital expenditures in 2009 were similar to 2008 and increased 4% year over year. Q4 2009 capital expenditures totalled \$5.1 million which was less than originally anticipated as the timing of some projects were delayed until later in Q4 2009 and were ongoing into the first quarter of 2010. During Q4 2009, the Company spud two wells including 1 gross (0.55 net) horizontal Cadomin well at Elsworth and 1 gross (0.25 net) vertical Nikanassin test well in Chinook Ridge. The Company also finished three completion operations in the quarter on its Bilbo wells and expects to finish facility and pipelining operations in this area in March 2010. For the remainder of its winter program Midnight plans to drill/deepen three Cadomin/Nikanassin wells at Chinook Ridge/West Wapiti, drill a well in Red Earth, as well as carry out the completions and tie-in of these wells.

As at December 31, 2009, Midnight has earned approximately \$0.8 million of drilling credits under the Alberta government incentive program (see "Royalties" above) which have been recognized as a reduction to capital spending.

In addition to the cash capital expenditures discussed above, we have capitalized \$0.4 million of stock-based compensation and the related future tax liability of \$0.1 million for 2009 consistent with the exploration salaries that we have added to our property base. Midnight had approximately 109,000 net acres of undeveloped land at December 31, 2009, which excludes unearned lands on farm-ins.

The following table highlights the breakdown of expenditures by category for the periods indicated:

<b>Capital Expenditures</b> (000's)	<b>Q4 2009</b>	Q4 2008	Q3 2009	<b>2009</b>	2008
Land	\$ 159	\$ 55	\$ 349	\$ 817	\$ 1,220
Geological and geophysical	598	620	614	2,460	3,922
Drilling	2,845	5,691	308	17,229	13,588
Completions	835	4,665	1,797	10,457	10,733
Facilities, pipelines and equipment	653	2,216	974	6,434	6,508
Office and other	1	176	1	103	196
Total expenditures	\$ 5,091	\$ 13,423	\$ 4,043	\$ 37,500	\$ 36,167
Property disposition	-	(30,371)	-	-	(30,371)
Total net expenditures	\$ 5,091	\$ (16,948)	\$ 4,043	\$ 37,500	\$ 5,796

## Equity

On September 30, 2009, the Company closed a "bought deal" financing with a syndicate of underwriters and issued 10,600,000 common shares at a price of \$0.95 per common share and 6,850,000 flow-through common shares at a price of \$1.10 per flow-through common share to raise gross proceeds of approximately \$17.6 million. The offering was done by way of short form prospectus.

On April 9, 2009, the Company closed a "bought deal" financing with a syndicate of underwriters and issued 8.0 million common shares at a price of \$0.77 per common share and 3.71 million flow-through common shares at a price of \$0.94 per flow-through common share to raise gross proceeds of approximately \$9.6 million. Management participated in this issue,

acquiring 210,000 flow-through common shares at \$0.94 per flow-through common share. The offering was done by way of short form prospectus.

During 2009, the Company granted 1,528,500 options, 72,500 options were forfeited and 2,640,000 options expired. No options were exercised or cancelled. In Q4 2009, at the Board of Directors discretion and within the terms of the Company's stock option plan, Midnight adjusted all of its options to a three year life so all of its outstanding options had consistent terms. No options were cancelled and no option terms were extended. Midnight's remaining stock options vest one third every nine months and expire after three years. Under the terms of Midnight's stock option plan, during the fourth quarter, 2,640,000 options expired without being exercised. At December 31, 2009, the Company had 2,958,500 options outstanding with a weighted average exercise price of \$1.19/option and a weighted average remaining life of 1.9 years.

On October 15, 2007, Midnight filed notice with the Toronto Stock Exchange (the "TSX") to make a normal course issuer bid to purchase its outstanding common shares on the open market. The TSX authorized Midnight to purchase up to 4,320,826 common shares during this bid and Midnight purchased and cancelled a total of 232,700 shares in 2007 and 172,500 shares in 2008 at an average price of \$1.12 per share. On November 7, 2008, Midnight filed a second notice with the TSX to make a normal course issuer bid "NCIB". The TSX authorized Midnight to purchase up to 4,081,619 common shares during the period from November 12, 2008 to November 11, 2009. Under this bid, Midnight purchased and cancelled 1,247,500 shares at an average price of \$0.80 per share. All of the shares were purchased and cancelled in 2008 and the bid expired in 2009 with no additional purchases.

At March 11, 2010, the Company had 75,335,129 common shares and 4,516,000 stock options outstanding. The average exercise price of stock options outstanding is \$1.14/option.

<b>Share Information</b> (000's)	<b>Q4 2009</b>	Q4 2008	Q3 2009	<b>2009</b>	2008
Shares outstanding					
Basic	<b>75,335</b>	46,175	75,335	<b>75,335</b>	46,175
Diluted	<b>78,294</b>	50,318	80,634	<b>78,294</b>	50,318
Weighted average shares outstanding					
Basic	<b>75,335</b>	46,867	57,885	<b>59,107</b>	47,291
Diluted	<b>75,335</b>	46,867	57,885	<b>59,107</b>	47,291

## Liquidity and Capital Resources

Midnight Oil Exploration Ltd. is listed as a senior issuer on the Toronto Stock Exchange trading under the symbol "MOX". The Company's market capitalization at December 31, 2009 was approximately \$75.3 million. At March 11, 2009 the market capitalization was approximately \$84 million.

<b>Trading History on the TSX</b>	<b>Q4 2009</b>	Q4 2008	Q3 2009	<b>2009</b>	2008
High	<b>\$ 1.17</b>	\$ 1.40	\$ 1.18	<b>\$ 1.60</b>	\$ 2.49
Low	<b>\$ 0.95</b>	\$ 0.60	\$ 0.90	<b>\$ 0.67</b>	\$ 0.60
Close	<b>\$ 1.00</b>	\$ 0.75	\$ 1.00	<b>\$ 1.00</b>	\$ 0.75
Volume (000's)	<b>10,135</b>	13,404	8,534	<b>26,858</b>	41,847

At December 31, 2009, Midnight had drawn \$8.9 million on its \$35 million credit facility and had a working capital deficit of \$3.8 million for a net debt position of \$12.7 million. In May 2009, Midnight's borrowing base was increased 25% to \$35 million and remained at this level with the semi-annual review conducted in November 2009. The Company used the net proceeds from its two equity offerings of approximately \$25.5 million to reduce its bank debt and fund its capital program in 2009. Midnight's credit facility is available on a revolving basis until May 29, 2010. On this date and at the Company's discretion, the facility is available on a non-revolving basis for a period of 366 days, at which time the facility would be due and payable. Alternatively, the facility may be extended for a further 364-day period at the request of the Company and

subject to approval by the bank. On this basis, the bank debt is considered long-term debt for financial reporting purposes. The credit facility bears interest at the bank's prime rate plus a stamp or Bankers' Acceptances plus a stamp based on the Company's net debt to cash flow ratio, calculated using the two most recent fiscal quarters. The credit facility is based solely on the drawn amount and does not have a covenant relating to the Company's net debt which includes working capital. The facility is secured by a \$50 million first floating charge debenture and a general securities agreement. The \$35 million borrowing base is subject to a semi-annual and annual review by the bank. These reviews are based primarily on the reserves and using commodity prices estimated by the bank, as well as other factors and therefore there can be no assurance that the credit facility available upon the next scheduled review will not be reduced. The last review was performed effective November 29, 2009. The Company will continue to utilize its credit facility as needed to fund the Company's ongoing exploration and development activities.

The nature of the oil and gas industry requires significant cash outlays to fund capital programs necessary to maintain and increase production and reserves and to acquire strategic oil and gas assets. At certain times, the Company may enter into agreements with third parties to either farm-in or farm-out properties. These arrangements often require one party to incur costs on behalf of the other party in order to earn an interest in mineral rights. Midnight entered into a farm-in agreement in Bilbo with two major oil and gas companies where the Company agreed to drill and complete seven wells including an option well. The Company completed this obligation in the first quarter of 2010. As part of the Company's equity issuances on April 9, 2009 and September 30, 2009, the Company issued a total of 10,560,000 flow-through common shares for approximately \$11.0 million and has committed to spend this amount on qualifying exploration expenditures. At December 31, 2009, the Company had spent \$6.5 million of qualifying expenditures completing its commitment on the April 9, 2009 financing of \$3.5 million and incurring \$3.0 million towards the September 30, 2009 commitment. The Company has an active drilling program for 2010 and does not anticipate issues in fulfilling the balance of its commitment of \$4.5 million in 2010 with funds available on its credit facility and from operating cash flows.

The global economic downturn has caused uncertainty in the capital markets which has in turn limited access to both debt and equity in all industries. As a result, Midnight anticipates that junior oil and gas companies will be faced with restricted access to capital at certain times; an increased cost of capital and an increased cost of borrowing. Accordingly, operating results and capital investment decisions will be impacted. Despite the tougher economic times, Midnight had access to the equity markets and executed an active and successful 2008/09 winter program and a successful start to its 2009/10 program. The Company drilled 14 gross (5.2 net) gas wells and increased its reserve and production base and significantly expanded its opportunity base from Q4 2008 to Q4 2009 inclusive. The Company delayed putting wells on production until after April 1, 2009 to take advantage of the royalty incentives legislated by the Alberta Government for new wells and limited its production optimization due to low gas prices. The successful drilling program allows the Company, when the price environment dictates, to increase production growth and corresponding cash flow from new production. It is anticipated that this will increase shareholder value and support larger and more extensive capital investment. Midnight anticipates that it will have adequate liquidity to fund future working capital and forecasted capital expenditures in 2010 through a combination of cash flow and additional use of its existing credit facility. Further increases to its capital expenditure program may be funded through a combination of farm-outs, increased credit facilities, property dispositions or future share issuances. The Company has the ability to modify its capital program in response to economic conditions. Actual funding alternatives will be influenced by the then current market environment and the ability to access capital on reasonable terms, balanced with any investment opportunities presented.

### **Off Balance Sheet Transactions**

There were no off balance sheet transactions entered into during the period, nor are there any outstanding as of the date of this MD&A.

## Contractual Obligations

The contractual obligations for which the Company is responsible are as follows:

<b>Contractual Obligations</b> (000's)	Total	Less than 1 Year	1-3 Years	4-5 Years	After 5 Years
Long-term debt	\$ 8,907	\$ -	\$ 8,907	\$ -	\$ -
Asset retirement obligations	4,904	118	262	269	4,255
<b>Total Contractual Obligations</b>	<b>\$ 13,811</b>	<b>\$ 118</b>	<b>\$ 9,169</b>	<b>\$ 269</b>	<b>\$ 4,255</b>

Midnight enters into many contractual obligations in the course of conducting its day to day business. Material contractual obligations consist of our long-term debt with a major bank and our asset retirement obligations. The payment terms on the asset retirement obligations are based on estimates of expenditures to be made in future periods. Actual amounts and the year in which they occur may differ materially than presented above. Midnight has not entered into any firm transportation commitments to date.

Midnight enters into commitments for capital expenditures in advance of the expenditures being made. The Company also enters into farm-in agreements where it commits to capital expenditures in order to earn and retain certain lands. These are considered routine in nature and form part of the normal course of operations for active oil and gas companies and therefore are not included in the table above.

As part of the Company's equity issuances on April 9, 2009 and September 30, 2009, the Company issued a total of 10,560,000 flow-through common shares for approximately \$11.0 million and has committed to spend this amount on qualifying exploration expenditures. At December 31, 2009, the Company had spent \$6.5 million of qualifying expenditures. The Company has budgeted to spend the remaining \$4.5 million in 2010.

### Relationship with Daylight Energy Ltd. ("Daylight")

Midnight and Daylight are considered related, as Daylight's Chairman is a director and officer of Midnight and a director and officer of Daylight is also a director of Midnight. Although this relationship is deemed to exist, Midnight operates independently from Daylight. Operating, financing and investing decisions are conducted independently without the advice or influence of the other party and each company's strategic direction is set by their respective Board's, both of which have a majority of independent directors. Midnight and Daylight are joint venture partners in certain properties, and, as a result, revenues and costs related to these properties are allocated to each partner under standard joint venture billing arrangements. Each partner's costs and revenues are based on the exchange amounts which reflect actual third party costs incurred and revenue received. All transactions are conducted under standard business terms and are considered within the normal course of Midnight's business activities and operations.

On October 31, 2008, Midnight sold its West Central assets to Daylight in exchange for \$1.9 million net of purchase price adjustments, and 3,750,000 Daylight Resource Trust Units. This transaction was valued at the exchange amount as determined and agreed to by the related parties.

In 2009, Daylight charged Midnight \$0.6 million (2008 - \$1.1 million) for administrative services and premise costs. At December 31, 2009, Midnight had a receivable balance of approximately \$4.8 million due from Daylight (2008 - \$2.8 million) which includes amounts for joint venture and commodity marketing. At December 31, 2009, Midnight also had \$3.2 million (2008 - \$3.9 million) due to Daylight for unexpended cash calls.

## **Outlook**

Over the past few years the oil and gas industry in North America has changed dramatically. The application of new technologies has brought quantum shifts to our business opening up new areas and marginalizing other areas. Midnight was very much an “early mover” on identifying the potential of these technologies and positioning ourselves in the Deep Basin area of the Peace River Arch where we saw significant potential from these new technologies. We were very successful through a program of land sales, farm-in and acreage swaps assembling a very large and highly prospective acreage holding in this area. The Deep Basin is a top tier resource area in all of North America that has and is being aggressively pursued and developed by major international energy companies. In each of our Deep Basin areas, we are partnered with and/or surrounded by the aggressive drilling activities of these multinational energy companies. We are at the early stages of our development but in each of these areas (Elmworth, Bilbo and Chinook Ridge) our partners have evolved to full scale exploitation and development including downspacing to multiple wells per sections and horizontal drilling into the Cadomin and Nikanassin.

During 2009, Midnight's activities focused on building and developing knowledge and expertise regarding the tight gas plays and the application of advanced drilling and completion technologies in the Deep Basin area to prove the significant productive capability of tighter gas reservoirs and to establish this area as the key to adding natural gas production and reserves for the Company. Our results from the Deep Basin program have substantiated the upside of this multi-zone sweet gas resource play. We have tested and validated significant resource potential in the Cadomin and the Nikanassin together with numerous uphole zones, and are now positioned to move to the exploitation phase. Our results from this program have been strong and getting better, however, with continued volatility of the natural gas markets, the Company slowed and deferred a number of operations throughout the year, choosing to pace its investment and withhold capital. Slowing tie-ins and keeping behind pipe production offline resulted in the forecasted Q4 2009 production to decline. We have had a successful Q1 2010, and have enhanced and expanded our resource opportunity base in the high potential Chinook Ridge area. Despite challenges in access and timing of oilfield services, including drilling and completion crews, coupled with the earlier than anticipated spring break-up, we expect to meet our forecasted production exit rate of over 2,500 boe/d by March 31, 2010. Our current capital program is expected to be approximately \$30 to \$35 million for 2010 while production is anticipated to average 2,500 boe/d. Average Q1 2010 production is expected to be approximately 1,800 boe/d to 1,900 boe/d as new production will come on-stream in the latter part of March. Midnight's results from its Deep Basin Tight Gas initiative have validated our thesis of the resource potential of this area and put in place a solid foundation for long-term growth.

## **Financial Instruments**

Financial instruments comprise cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities and long-term debt. The fair values of cash and cash equivalents, accounts receivable and accounts payable and accrued liabilities approximate their carrying amounts due to their short-term maturities. The Company's long-term debt bears interest at a floating market rate and accordingly the fair market value approximates the carrying value. The Company is exposed to credit, liquidity and market risk from its use of financial instruments. A description of these risks as they relate to Midnight is disclosed in Note 9 of the Consolidated Financial Statements.

## **Disclosure Controls and Procedures**

Disclosure controls and procedures have been designed to ensure that information required to be disclosed by Midnight is accumulated and communicated to the Company's management as appropriate to allow timely decisions regarding required disclosure. Midnight's Chief Executive Officer and Chief Financial Officer have concluded, based on their evaluation as of the end of the period covered by the annual filings, that the Company's disclosure controls and procedures are effective to provide reasonable assurance that material information related to Midnight, including its consolidated subsidiaries, is made

known to them by others within those entities. There were no changes made to the disclosure controls and procedures during the year ended December 31, 2009.

### **Internal Control over Financial Reporting (“ICFR”)**

Midnight's Chief Executive Officer and Chief Financial Officer have designed, or caused to be designed under their supervision, internal controls over financial reporting related to the Company to provide reasonable assurance regarding the reliability of Midnight's financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP. The control framework the officers used to design Midnight's ICFR is the Internal Control- Integrated Framework (COSO Framework) published by the Committee of Sponsoring Organizations of the Treadway Commission. As at December 31, 2009, Midnight's Chief Executive Officer and Chief Financial Officer have evaluated, or caused to be evaluated under their supervision, the effectiveness of the Company's internal controls over financial reporting and have concluded that these controls are operating effectively.

There were no changes in the Company's internal controls or weaknesses noted in controls during the year ended December 31, 2009 that have materially affected, or are reasonably likely to affect, the Company's internal controls over financial reporting.

It should be noted that while Midnight's Chief Executive Officer and Chief Financial Officer believe that the Company's disclosure and internal control procedures provide a reasonable level of assurance that they are effective, they do not expect that the disclosure and internal control procedures will prevent all errors and fraud. A control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met.

### **Application of Critical Accounting Estimates**

The significant accounting policies used by Midnight are disclosed in note 1 to the audited Consolidated Financial Statements for the years ended December 31, 2009 and 2008. Certain accounting policies require that management make appropriate decisions with respect to the formulation of estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Management reviews its estimates on a regular basis. The emergence of new information and changed circumstance may result in actual results or changes to estimated amounts that differ materially from current estimates. The following discussion identifies the critical accounting policies and practices of the Company and helps assess the likelihood of materially different results being reported.

#### ***Reserves***

Under the National Instrument 51-101 (“NI 51-101”), “Proved” reserves are defined as those reserves that can be estimated with a high degree of certainty to be recoverable. The level of certainty should result in at least a 90 percent probability that the quantities actually recovered will equal or exceed the estimated Proved reserves. It does not mean that there is a 90% probability that the Proved reserves will be recovered; it means there must be at least a 90% probability that the given amount or more will be recovered.

“Proved plus Probable” reserves are the most likely case and are based on a 50 percent certainty that they will equal or exceed the reserves estimated.

These oil and gas reserve estimates are made using all available geological and reservoir data, as well as historical production data. All of the Company's reserves were evaluated and reported on by an independent qualified reserves evaluator. However, revisions can occur as a result of various factors including: actual reservoir performance, changes in price and cost forecasts or, a change in the Company's plans. Reserve changes will impact the financial results as reserves are used in the calculation of depletion and are used to assess whether asset impairment occurs. Reserve changes also

affect other non-GAAP measurements such as finding and development costs, recycle ratios and net asset value calculations.

### ***Depletion and Depreciation***

The Company follows the full cost method of accounting for oil and natural gas properties. Under this method, all costs related to the acquisition of, exploration for and development of oil and natural gas reserves are capitalized whether successful or not. Depletion of the capitalized oil and natural gas properties and depreciation of production equipment which includes estimated future development costs less estimated salvage values are calculated using the unit-of-production method, based on production volumes in relation to estimated proven reserves.

An increase in estimated proved reserves would result in a reduction in depletion expense. A decrease in estimated future development costs would also result in a reduction in depletion expense.

### ***Unproved Properties***

The cost of acquisition and evaluation of unproved properties are initially excluded from the depletion calculation. An impairment test is performed on these assets to determine whether the carrying value exceeds the fair value. Any excess in carrying value over fair value is an impairment. When proved reserves are assigned or a property is considered to be impaired, the cost of the property or the amount of the impairment will be added to the capitalized costs for the calculation of depletion.

### ***Ceiling Test***

The ceiling test is a cost recovery test intended to identify and measure potential impairment of the value of assets relative to the cost of those assets as carried on the Company's balance sheet. An impairment loss is recorded if the sum of the undiscounted cash flows (assuming certain commodity prices, operating costs, royalty rates and other deductions) expected from the production of the proved reserves and the lower of cost and market of unproved properties does not exceed the values of the petroleum and natural gas assets as carried in the Company's balance sheet. An impairment loss is recognized to the extent that the carrying value exceeds the sum of the discounted cash flows expected from the production of proved and probable reserves and the lower of cost and market of unproved properties. The cash flows are estimated using the future product prices and costs and are discounted using the risk free rate. By their nature, these estimates are subject to measurement uncertainty and the impact on the financial statements could be material. Any impairment as a result of this ceiling test will be charged to operations as additional depletion and depreciation expense.

A ceiling test was performed quarterly by the Company and at each testing period, the Company had sufficient value of the Company's proved and probable reserves under the formula to cover the value of the petroleum and natural gas assets as carried on the Company's balance sheet.

### ***Asset Retirement Obligations***

The Company records a liability for the fair value of legal obligations associated with the retirement of petroleum and natural gas assets. The liability is equal to the discounted fair value of the obligation in the period in which the asset is recorded with an equal offset to the carrying amount of the asset. The liability then accretes to its fair value with the passage of time and the accretion is recognized as an expense in the financial statements. The total amount of the asset retirement obligation is an estimate based on the Company's net ownership interest in all wells and facilities, the estimated costs to abandon and reclaim the wells and facilities and the estimated timing of the costs to be incurred in future periods. The total amount of the estimated cash flows required to settle the asset retirement obligation, the timing of those cash flows and the discount rate used to calculate the present value of those cash flows are all estimates subject to measurement uncertainty. Any change in these estimates would impact the asset retirement liability and the accretion expense.

### ***Income Taxes***

The determination of income and other tax liabilities requires interpretation of complex laws and regulations. All tax filings are subject to audit and potential reassessment after the lapse of considerable time. In addition, the Company estimates when its temporary differences are expected to reverse and recognizes its tax assets and liabilities based on the legislated tax rate in those periods. Accordingly, the actual income tax liability may differ significantly from that estimated and recorded by management.

### ***Stock-Based Compensation***

The Company applies the fair value method for valuing stock option grants. This method requires the Company to make estimates of expected stock volatility, the expected hold period prior to exercising options, expected forfeitures of options and expected dividends to be declared by the Company. The calculation of the fair value of stock based compensation is not adjusted for the value actually received by the optionees. The stock-based compensation expense will not represent the actual fair value received by the optionees as the fair value is estimated at the time of grant and is not adjusted. Due to the time period and the number of estimates involved, it is likely that the actual value of the options will differ from what has been recorded in the financial statements.

### ***Other Estimates***

The accrual method of accounting requires management to incorporate certain estimates including estimates of revenues, royalties and operating costs as at a specific reporting date, but for which actual revenues and costs have not yet been received. In addition, estimates are made on capital projects which are in progress or recently completed where actual costs have not been received by the reporting date. The Company obtains the estimates from the individuals with the most knowledge of the activity and from all project documentation received. The estimates are reviewed for reasonableness and compared to past performance to assess the reliability of the estimates. Past estimates are compared to actual results in order to make informed decisions on future estimates.

## **Financial Reporting Update**

### ***International Financial Reporting Standards ("IFRS")***

In October 2009, the Accounting Standards Board ("AcSB") issued a third and final IFRS Omnibus Exposure Draft confirming that publicly accounting enterprises will be required to apply IFRS, in full and without modification, for financial periods beginning on January 1, 2011. The adoption date of January 1, 2011 will require Midnight to restate amounts reported in 2010 including its opening balance sheet at January 1, 2010 for comparative purposes.

Midnight has started the process to transition from Canadian GAAP to IFRS. The Company has completed a high level review of the major differences between Canadian GAAP and IFRS and has commenced the detailed assessment of individual differences, policy choices and the impacts to the Company's financial statements and business processes. The project is being managed by internal staff who have received IFRS training through various workshops and conferences attended in 2009. As the Company completes its analysis, management will recommend accounting policy choices to be approved by the audit committee. Once the accounting policy choices are made, the changes will be implemented. Implementation of the changeover will not only impact the financial statements, it will impact the Company's business processes and will require training of staff and may result in the modification of agreements. As the Company has not yet finalized its accounting policy choices, it is unable to quantify the impact on the financial statements at this time. In addition, due to anticipated changes to IFRS and International Accounting Standards prior to adoption of IFRS, management's plans are subject to change based on new facts and circumstances that arise after the date of this MD&A.

The transition from Canadian GAAP to IFRS is a significant undertaking that will change the way we report our results and our financial position. One of the key differences between IFRS and Canadian GAAP is that IFRS does not have full cost accounting and accounting for property, plant and equipment will have some major changes. Upon transition to IFRS, the Company will reclassify Exploration and Evaluation ("E&E") expenditures that are currently included in the petroleum and natural gas assets balance on the Consolidated Balance Sheet. This will consist of the book value for undeveloped land that

relates to exploration properties and the geological and seismic expenditures that relate to those properties. E&E assets will not be depleted and must be assessed for impairment when indicators suggest the possibility of impairment. The Company will continue to use the unit of production method to deplete assets whose useful lives are tied to the reserves but IFRS does not specifically state which reserve category to use whereas under Canadian GAAP only proved reserves are used. At this time, the Company has not concluded which reserve category it expects to use but expects to use the same category as the majority of its peers to ensure comparability of financial information. Impairment testing for petroleum and natural gas assets under IFRS will be performed for each cash generating unit of the Company and any impairments recognized may be recovered in future periods if it is determined that the loss has decreased or no longer exists. Impairment tests are based on the fair value of the assets or value in use. The Company expects to base these assessments on its reserve values and expected cash flows but these amounts will be affected by discounting at the then current market rate which may vary materially from one reporting period to another. There will be more cash generating units than the single Canadian full cost pool.

Another key difference to Midnight will be the accounting for Asset Retirement Obligations (“ARO”). Under IFRS, the ARO or a decommissioning liability provision as referred to in IFRS is likely to increase as a result of the change from a credit adjusted risk free rate to a risk free rate (government bond) in the discounting of the cash flows. In addition, any change in the discount rate would affect the entire liability and not just the current additions. The accretion expense will also now be a finance cost in the Income Statement rather than being part of DD&A. Also, under IFRS – Stock Based Compensation, our options that vest in three instalments must be accounted for as though each instalment is a separate option issue. This will result in front end loading of compensation expense. In addition, an estimate of forfeitures must be taken into consideration in the expense.

In addition to accounting policy differences, the transition to IFRS will impact the internal controls over financial reporting (“ICFR”), the disclosure controls and procedures and IT systems. The Company has started documenting the potential impact of IFRS on these components and will ensure that policies and procedures are in place to ensure they are compliant. The Company has started reviewing its material agreements to ensure that changing to IFRS will not have a negative impact to the Company or its operations. Although the Company expects minor changes to its agreements, including its credit facility definitions, it is not anticipating that the changeover will have a material impact. In its initial review of its IT systems, the Company is not expecting to require any material changes or upgrades other than in the normal course of business.

For 2010, the Company is planning on using “top side” entries to track the differences in GAAP and believes that its current IT systems will be sufficient to handle the changeover. The Company plans to have an opening January 1, 2010 balance sheet, which will be in accordance with IFRS.

#### ***Business combinations***

In December 2008, the CICA issued Section 1582, Business Combinations. This section is effective January 1, 2011 and applies prospectively to business combinations for which the acquisition date is on or after the first annual reporting period beginning on or after January 1, 2011 for the Company. Early adoption is permitted. Under this standard, the purchase price used in a business combination is based on the fair value of shares exchanged at the market price of the shares at the closing date. Under the current standard, 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 announced. In addition, the new standard requires all acquisition costs to be expensed while the current standard allows for the capitalization of certain of these costs as part of the purchase price. This section replaces Section 1581, Business Combination and harmonizes the Canadian standards with IFRS.

#### ***Consolidated financial statements and non-controlling interest***

In 2009, Section 1601 and Section 1602 were issued which replace the existing guidance under section 1600, Consolidated Financial Statements. These standards provide guidance for preparing consolidated financial statements and for accounting

for non-controlling interest in a subsidiary subsequent to a business combination. These standards are effective for business combinations occurring on or after January 1, 2011, with early adoption permitted.

## **Risk Factors**

There are a number of risk factors facing companies that participate in the Canadian oil and gas industry. A summary of certain risk factors relating to our business are disclosed below, a more exhaustive list is provided in the Risk Factors Section of our Annual Information Form filed on SEDAR at [www.sedar.com](http://www.sedar.com).

### ***Global Financial Crisis***

Recent market events and conditions, including disruptions in the international credit markets and other financial systems and the deterioration of global economic conditions, have caused significant volatility to commodity prices. These conditions worsened in 2008 and continued in 2009, causing a loss of confidence in the broader United States and global credit and financial markets and resulting in the collapse of, and government intervention in major banks, financial institutions and insurers and creating a climate of greater volatility, less liquidity, widening of credit spreads, a lack of price transparency, increased credit losses and tighter credit conditions. Notwithstanding various actions by governments, concerns about the general condition of the capital markets, financial instruments, banks, investment banks, insurers and other financial institutions caused the broader credit markets to further deteriorate and stock markets to decline substantially. Although economic conditions improved towards the latter portion of 2009, these factors have negatively impacted company valuations and may impact the performance of the global economy going forward.

### **Risks to Midnight's Revenues**

#### ***Prices, Markets and Marketing of Crude Oil and Natural Gas***

Oil and natural gas are commodities whose prices are determined based on world demand, supply and other factors, all of which are beyond the control of Midnight. World prices for oil and natural gas have fluctuated widely in recent years. Any material decline in prices could result in a reduction of net production revenue. Certain wells or other projects may become uneconomic as a result of a decline in world oil prices and natural gas prices, leading to a reduction in the volume of Midnight's oil and gas reserves. Midnight might also elect not to produce from certain wells at lower prices. All of these factors could result in a material decrease in Midnight's future net production revenue, causing a reduction in its oil and gas acquisition, exploration and development activities. In addition, bank borrowings available to Midnight are expected to be determined in part by the borrowing base of Midnight. A sustained material decline in prices from historical average prices could limit Midnight's borrowing base, therefore reducing the bank credit available to Midnight, and could require that a portion of any existing bank debt of Midnight be repaid.

In addition to establishing markets for its oil and natural gas, Midnight must also successfully market its oil and natural gas to prospective buyers. The marketability and price of oil and natural gas which may be acquired or discovered by Midnight will be affected by numerous factors beyond its control. Midnight will be affected by the differential between the price paid by refiners for light quality oil and the grades of oil produced by Midnight. The ability of Midnight to market its natural gas may depend upon its ability to acquire space on pipelines which deliver natural gas to commercial markets. Midnight will also likely be affected by deliverability uncertainties related to the proximity of its reserves to pipelines and processing facilities and related to operational problems with such pipelines and facilities and extensive government regulation relating to price, taxes, royalties, land tenure, allowable production, the export of oil and natural gas and many other aspects of the oil and natural gas business.

Midnight continually monitors the movement of commodity prices, interest rates and adjusts its capital expenditure program accordingly. The Company's portfolio consists of light quality crude and the majority of its gas is sweet liquids rich natural gas which produces higher netback production helping to mitigate commodity price exposure. Midnight is currently exposed to the natural gas commodity risk as the majority of its production and reserves are natural gas weighted.

### ***Third Party Credit Exposure***

Midnight may be exposed to third party credit risk through its contractual arrangements with its current or future joint venture partners, marketers of its petroleum and natural gas production and other parties. In the event such entities fail to meet their contractual obligations to the Company, such failures may have a material adverse effect on the Midnight's business, financial condition, results of operations and prospects. In addition, poor credit conditions in the industry and of joint venture partners may impact a joint venture partner's willingness to participate in the Company's ongoing capital program, potentially delaying the program and the results of such program until the Company finds a suitable alternative partner. We mitigate these increased risks through diversification and a review process of the credit worthiness of our counterparties.

Midnight's policy to mitigate credit risk associated with product sales is to maintain marketing relationships with large, established and reputable purchasers that are considered creditworthy. Midnight has not experienced any collection issues with its petroleum and natural gas marketers. Joint venture receivables are typically collected within two to three months of the joint venture bill being issued to the partner. Midnight attempts to mitigate the risk from joint venture receivables by obtaining partner approval of significant capital and operating expenditures prior to expenditure and in certain circumstances may require cash deposits in advance of incurring financial obligations on behalf of joint venture partners. Joint venture receivables are from partners in the petroleum and natural gas industry who are subject to the risks and conditions of the industry. Significant changes in industry conditions and risks that negatively impact partners' ability to generate cash flow will increase the risk of not collecting receivables. Midnight does not typically obtain collateral from petroleum and natural gas marketers or joint venture partners; however the Company does have the ability to withhold production from joint venture partners in the event of non-payment or may be able to register security on the assets of joint venture partners.

### ***Substantial Capital Requirements, Liquidity***

The Company anticipates making substantial capital expenditures for the acquisition, exploration, development and production of oil and natural gas reserves in the future. If the Company's revenues or reserves decline, it may not have access to the capital necessary to undertake or complete future drilling programs. In addition, uncertain levels of near term industry activity coupled with the present global credit crisis exposes the Company to additional access to capital risk. There can be no assurance that debt or equity financing, or cash generated by operations will be available or sufficient to meet these requirements or for other corporate purposes or, if debt or equity financing is available, that it will be on terms acceptable to the Company. The inability of the Midnight to access sufficient capital for its operations could have a material adverse effect on the Company's business financial condition, results of operations and prospects.

The Company's cash flow from its reserves may not be sufficient to fund its ongoing activities at all times. From time to time, the Company may require additional financing in order to carry out its oil and gas acquisition, exploration and development activities. Failure to obtain such financing on a timely basis could cause the Company to forfeit its interest in certain properties, miss certain acquisition opportunities and reduce or terminate its operations. If the Company's revenues from its reserves decrease as a result of lower oil and natural gas prices or otherwise, it will affect the Company's ability to expend the necessary capital to replace its reserves or to maintain its production. If the Company's cash flow from operations is not sufficient to satisfy its capital expenditure requirements, there can be no assurance that additional debt or equity financing will be available to meet these requirements or, if available, on terms acceptable to the Company. Continued uncertainty in domestic and international credit markets could materially affect the Company's ability to access sufficient capital for its capital expenditures and acquisitions, and as a result, may have a material adverse effect on the Company's ability to execute its business strategy and on its business, financial condition, results of operations and prospects.

Midnight has a standard banking arrangement with its lender Canadian Imperial Bank of Commerce (CIBC). Midnight's lender has been provided with security over substantially all of the assets of Midnight. If Midnight becomes unable to pay

its debt service charges or otherwise commits an event of default, such as bankruptcy, the lender may foreclose on or sell Midnight's properties. The proceeds of any such sale would be applied to satisfy amounts owed to Midnight's lenders and other creditors and only the remainder, if any, would be available to Midnight.

Midnight monitors and updates its cash projection models on a regular basis which assists in the timing decision of capital expenditures. Farm-outs of projects may be arranged if capital constraints are an issue or if the risk profile dictates that we wish to hold a lesser working interest position. Equity, if available and if on reasonable terms, may be utilized to help fund our capital program.

## **Operational Risks**

### ***Exploration, Development and Production Risks***

Oil and natural gas exploration involves a high degree of risk, for which even a combination of experience, knowledge and careful evaluation may not be able to overcome. There is no assurance that expenditures made on future exploration by Midnight will result in new discoveries of oil or natural gas in commercial quantities. It is difficult to project the costs of implementing an exploratory drilling program due to the inherent uncertainties of drilling in unknown formations, the costs associated with encountering various drilling conditions such as over-pressured zones, tools lost in the hole and changes in drilling plans and locations as a result of prior exploratory wells or additional seismic data and interpretations thereof.

The long-term commercial success of Midnight will depend on its ability to find, acquire, develop and commercially produce oil and natural gas reserves. No assurance can be given that Midnight will be able to locate satisfactory properties for acquisition or participation. Moreover, if such acquisitions or participations are identified, Midnight may determine that current markets, terms of acquisition and participation or pricing conditions make such acquisitions or participations uneconomic.

Future oil and gas exploration may involve unprofitable efforts, not only from dry wells, but from wells that are productive but do not produce sufficient net revenues to return a profit after drilling, operating and other costs. Completion of a well does not assure a profit on the investment or recovery of drilling, completion and operating costs. In addition, drilling hazards or environmental damage could greatly increase the cost of operations, and various field operating conditions may adversely affect the production from successful wells. These conditions include delays in obtaining governmental approvals or consents, shut-ins of connected wells resulting from extreme weather conditions, insufficient storage or transportation capacity or other geological and mechanical conditions. While diligent well supervision and effective maintenance operations can contribute to maximizing production rates over time, production delays and declines from normal field operating conditions cannot be eliminated and can be expected to adversely affect revenue and cash flow levels to varying degrees.

In addition, oil and gas operations are subject to the risks of exploration, development and production of oil and natural gas properties, including encountering unexpected formations or pressures, premature declines of reservoirs, blow-outs, sour gas releases, fires and spills. Losses resulting from the occurrence of any of these risks could have a materially adverse effect on future results of operations, liquidity and financial condition.

Midnight attempts to minimize exploration, development and production risks by utilizing a high-end technical team with extensive experience and multidisciplinary skill sets to assure the highest probability of success in its drilling efforts. Our collaboration of a team of seasoned veterans in the oil and gas business, each with a unique expertise in the various upstream to downstream technical disciplines of prospect generation to operations, provides the best assurance of competency, risk management and drilling success. A full cycle economic model is utilized to evaluate all hydrocarbon prospects. Detailed geological and geophysical techniques are regularly employed including 3D seismic, petrography, sedimentology, petrophysical log analysis and regional geological evaluation. Midnight utilizes not only the publicly available sources of subsurface data and information, but also employs its own proprietary data set of rock core and drill cuttings

descriptions to enhance the quality and probability of success of its internally generated plays and prospects. Where possible prospects have multi-zone potential and activity is focused in regions where Midnight's expertise and experience can provide a competitive advantage.

### ***Project Risks***

Midnight manages a variety of small and large projects in the conduct of its business. Project delays may delay expected revenues from operations. Significant project cost over-runs could make a project uneconomic. Midnight's ability to execute projects and market oil and natural gas depends upon numerous factors beyond Midnight's control, including:

- the availability of processing capacity;
- the availability and proximity of pipeline capacity;
- the availability of storage capacity;
- the supply of and demand for oil and natural gas;
- the availability of alternative fuel sources;
- the effects of inclement weather;
- the availability of drilling and related equipment;
- unexpected cost increases;
- accidental events;
- currency fluctuations;
- changes in regulations;
- the availability and productivity of skilled labour; and
- the regulation of the oil and natural gas industry by various levels of government and governmental agencies.

Because of these factors, Midnight could be unable to execute projects on time, on budget or at all, and may not be able to effectively market the oil and natural gas that it produces.

### ***Availability of Drilling Equipment and Access***

Oil and natural gas exploration and development activities are dependent on the availability of drilling and related equipment (typically leased from third parties) in the particular areas where such activities will be conducted. Demand for such limited equipment or access restrictions may affect the availability of such equipment to Midnight and may delay exploration and development activities. To the extent Midnight is not the operator of Midnight's oil and gas properties, Midnight will be dependent on such operators for the timing of activities related to such properties and will be largely unable to direct or control the activities of the operators.

### ***Seasonality***

The level of activity in the Canadian oil and gas industry is influenced by seasonal weather patterns. Wet weather and spring thaw may make the ground unstable. Consequently, municipalities and provincial transportation departments enforce road bans that restrict the movement of rigs and other heavy equipment, thereby reducing activity levels. Also, certain oil and gas producing areas are located in areas that are inaccessible other than during the winter months because the ground surrounding the sites in these areas consists of swampy terrain. Seasonal factors and unexpected weather patterns may lead to declines in exploration and production activity and corresponding declines in the demand for the goods and services of Midnight.

### ***Reserve Estimates***

There are numerous uncertainties inherent in estimating quantities of oil, natural gas and NGLs reserves and the future cash flows attributed to such reserves. The reserve and associated cash flow information set forth herein are estimates only. In general, estimates of economically recoverable oil and natural gas reserves and the future net cash flows therefrom are based upon a number of variable factors and assumptions, such as historical production from the properties, production rates, ultimate reserve recovery, timing and amount of capital expenditures, marketability of oil and natural gas, royalty

rates, the assumed effects of regulation by governmental agencies and future operating costs, all of which may vary materially from actual results. For those reasons, estimates of the economically recoverable oil and natural gas reserves attributable to any particular group of properties, classification of such reserves based on risk of recovery and estimates of future net revenues associated with reserves prepared by different engineers, or by the same engineers at different times may vary. Midnight's actual production, revenues, taxes and development and operating expenditures with respect to its reserves will vary from estimates thereof and such variations could be material.

Estimates of proved reserves that may be developed and produced in the future are often based upon volumetric calculations and upon analogy to similar types of reserves rather than actual production history. Recovery factors and drainage areas were estimated by experience and analogy to similar producing pools. Estimates based on these methods are generally less reliable than those based on actual production history. Subsequent evaluation of the same reserves based upon production history and production practices will result in variations in the estimated reserves and such variations could be material.

In accordance with applicable securities laws, Midnight's independent reserves evaluator has used forecast prices and costs in estimating the reserves and future net cash flows as summarized herein. Actual future net cash flows will be affected by other factors such as actual production levels, supply and demand for oil and natural gas, curtailments or increases in consumption by oil and natural gas purchasers, changes in governmental regulation or taxation and the impact of inflation on costs.

Actual production and cash flows derived from Midnight's oil and gas reserves will vary from the estimates contained in the engineering report, and such variations could be material. The engineering report is based in part on the assumed success of activities Midnight intends to undertake in future years. The reserves and estimated cash flows to be derived therefrom contained in the engineering report will be reduced to the extent that such activities do not achieve the level of success assumed.

Further, the reserves and recovery information contained in the engineering report is only an estimate and the actual production and ultimate reserves from the properties may be greater or less than the estimates in the engineering report. The engineering report has been prepared using certain commodity price assumptions which are described in the notes to the reserves tables. If Midnight realizes lower prices for crude oil, natural gas liquids and natural gas and they are substituted for the price assumptions utilized in the engineering report, the present value of estimated future funds from operations for Midnight's reserves would be reduced and the reduction could be significant.

### ***Insurance***

Midnight's involvement in the exploration for and development of oil and gas properties may result in Midnight becoming subject to liability for pollution, blow-outs, property damage, personal injury or other hazards. Although Midnight has insurance in accordance with industry standards to address such risks, such insurance has limitations on liability that may not be sufficient to cover the full extent of such liabilities. In addition, such risks may not, in all circumstances be insurable or, in certain circumstances, Midnight may elect not to obtain insurance to deal with specific risks due to the high cost of premiums associated with such insurance or other reasons. The payment of such uninsured liabilities would reduce the funds available to Midnight. The occurrence of a significant event that Midnight is not fully insured against, or the insolvency of the insurer of such event, could have a material adverse effect on Midnight's financial position, results of operations or prospects.

### ***Competition***

Midnight actively competes for reserve acquisitions, exploration leases, licenses and concessions and skilled industry personnel with a substantial number of other oil and gas companies, many of which have significantly greater financial and

personnel resources than Midnight. Midnight's competitors include major integrated oil and natural gas companies and numerous other independent oil and natural gas companies and individual producers and operators.

Certain of Midnight's customers and potential customers are themselves exploring and/or developing oil and natural gas, and the results of such activities could affect Midnight's ability to sell or supply oil or gas to these customers in the future. Midnight's ability to successfully bid on and acquire additional property rights, to discover reserves, to participate in drilling opportunities and to identify and enter into commercial arrangements with customers will be dependent upon developing and maintaining close working relationships with its future industry partners and joint operators and its ability to select and evaluate suitable properties and to consummate transactions in a highly competitive environment.

## **Risks Associated with Government Regulation**

### ***Regulatory***

Oil and natural gas operations (exploration, production, pricing, marketing and transportation) are subject to extensive controls and regulations imposed by various levels of government, which may be amended from time to time. Governments may regulate or intervene with respect to price, taxes, royalties and the exportation of oil and natural gas. Such regulations may be changed from time to time in response to economic or political conditions. The implementation of new regulations or the modification of existing regulations affecting the oil and natural gas industry could reduce demand for natural gas and crude oil and increase Midnight's costs, any of which may have a material adverse effect on Midnight's business, financial condition, results of operations and prospects. In order to conduct oil and gas operations, the Company will require licenses from various governmental authorities. There can be no assurance that Midnight will be able to obtain all of the licenses and permits that may be required to conduct operations that it may wish to undertake.

### ***Health, Safety and Environment***

All phases of the oil and natural gas business present environmental risks and hazards and are subject to environmental regulation pursuant to a variety of federal, provincial and local laws and regulations. Environmental legislation provides for, among other things, restrictions and prohibitions on spills, releases or emissions of various substances produced in association with oil and natural gas operations. The legislation also requires that wells and facility sites be operated, maintained, abandoned and reclaimed to the satisfaction of applicable regulatory authorities. Compliance with such legislation can require significant expenditures and a breach of applicable environmental legislation may result in the imposition of fines and penalties, some of which may be material. Environmental legislation is evolving in a manner expected to result in stricter standards and enforcement, larger fines and liability and potentially increased capital expenditures and operating costs. The discharge of oil, natural gas or other pollutants into the air, soil or water may give rise to liabilities to governments and third parties and may require the Company to incur costs to remedy such discharge.

There are potential risks to the environment inherent in the business activities of the Company. Midnight has developed and implemented policies and procedures to mitigate health, safety and environment (HS&E) risks. These policies and procedures include the corporate HS&E policy, the emergency response plans (ERP), the HS&E manual, the pipeline operating and maintenance manual and a process for auditing both safety and environmental compliance. Midnight mitigates HS&E risks by maintaining its facilities and complying with all regulations. Regular field inspections are also carried out to ensure that all field personnel and third party contractors comply with all Company and regulatory guidelines. An action plan has been developed to ensure inactive wells are suspended properly and abandoned in a timely fashion. The above noted policies and procedures are designed to protect and maintain the environment and to ensure that the employees, contractors, subcontractors and the public at large are kept safe at all times.

## **Additional Information**

Additional information relating to Midnight is filed on SEDAR and can be viewed at [www.sedar.com](http://www.sedar.com). Information can also be obtained by contacting the Company at Midnight Oil Exploration Ltd., 2500, 144 4th Ave S.W., Calgary, Alberta T2P 3N4 or by email to [ir@midnightoil.ca](mailto:ir@midnightoil.ca) or by accessing the website at [www.midnightoil.ca](http://www.midnightoil.ca).