MANAGEMENT'S REPORT

To the Shareholders of Tourmaline Oil Corp.

The accompanying financial statements of Tourmaline Oil Corp. [and all the information in the Annual Report] are the responsibility of management and have been approved by the Board of Directors. The financial statements have been prepared by management in accordance with generally accepted accounting principles. When alternative accounting methods exist, management has chosen those it deems most appropriate in the circumstances. Financial statements are not precise since they include certain amounts based on estimates and judgments. Management has determined such amounts on a reasonable basis in order to ensure that the financial statements are presented fairly, in all material respects. [The financial information contained elsewhere in this report has been reviewed to ensure consistency with the financial statements.]

Management has established systems of internal controls, which are designed to provide reasonable assurance that assets are safeguarded from loss or unauthorized use and to produce reliable accounting records for the preparation of financial information. The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal control. It exercises its responsibilities primarily through the Audit Committee. The Audit Committee has reviewed the financial statements with management and the auditors, and has reported to the Board of Directors. The Board of Directors has approved the financial statements.

The financial statements have been audited on behalf of the shareholders by KPMG LLP, the external auditors, in accordance with auditing standards generally accepted in Canada.

(Signed) Michael L. Rose
President and
Chief Executive Officer
Calgary, Alberta

(Signed) Brian G. Robinson
Vice-President, Finance and
Chief Financial Officer
Calgary, Alberta

March 22, 2011

AUDITOR'S REPORT

To the Shareholders of Tourmaline Oil Corp.

We have audited the accompanying consolidated financial statements of Tourmaline Oil Corp., which comprise the consolidated balance sheets as at December 31, 2010 and 2009, the consolidated statements of income (loss), comprehensive income (loss) and retained earnings (deficit), and cash flows for the years then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Tourmaline Oil Corp. as at December 31, 2010 and 2009, and the results of its consolidated operations and its consolidated cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

(Signed) "KPMG LLP"
Chartered Accountants
Calgary, Canada
March 22, 2011

CONSOLIDATED FINANCIAL STATEMENTS

CONSOLIDATED BALANCE SHEETS

(000s)	As at December 31 2010	2009
Assets		
Current assets:		
Cash and cash equivalents	$ **65,160**	$ 199,789
Accounts receivable	**58,669**	45,129
Prepaid expenses and deposits	**5,114**	3,210
Fair value of financial instruments (note 11)	**14,413**	324
	143,356	248,452
Investments (note 4)	**3,932**	632
Fair value of financial instruments (note 11)	**1,601**	—
Property, plant and equipment (note 3)	**1,637,960**	754,798
	$ **1,786,849**	$ 1,003,882
Liabilities and Shareholder's Equity		
Current liabilities:		
Accounts payable and accrued liabilities	$ **178,113**	$ 86,938
Future taxes (note 10)	**2,832**	—
	180,945	86,938
Asset retirement obligations (note 5)	**13,628**	7,208
Long-term obligation (note 7)	**14,589**	—
Future taxes (note 10)	**25,457**	780
Non-controlling interest (note 8)	**13,767**	13,526
Shareholder's equity:		
Share capital (note 9)	**1,517,675**	895,095
Contributed surplus (note 9)	**7,919**	2,018
Retained earnings (deficit)	**12,869**	(1,683)
	1,538,463	895,430
	$ **1,786,849**	$ 1,003,882

Commitments (note 12)
Subsequent events (note 11 and 13)
See accompanying notes to the consolidated financial statements.

(Signed) Michael L. Rose
Director

(Signed) Robert W. Blakely
Director

CONSOLIDATED STATEMENTS OF INCOME (LOSS), COMPREHENSIVE INCOME (LOSS) AND RETAINED EARNINGS (DEFICIT)

	For the Year Ended	
(000s) except per share amounts	**December 31, 2010**	December 31, 2009
Revenue:		
Oil and natural gas sales	**$ 194,928**	$ 36,927
Realized gain on financial instruments	**15,177**	—
Unrealized gain on financial instruments (note 11)	**15,950**	278
	226,055	37,205
Royalties	**(15,630)**	(4,779)
Other income	**1,535**	2,701
	211,960	35,127
Expenses:		
Operating	**41,352**	8,204
Transportation	**11,357**	1,769
General and administration	**6,831**	3,101
Stock-based compensation	**3,197**	1,009
Interest expense	**1,085**	53
Depletion, depreciation and accretion	**126,985**	23,023
	190,807	37,159
Income (loss) before taxes	**21,153**	(2,032)
Future taxes (note 10)	**6,360**	61
Net income (loss) before non-controlling interest	**14,793**	(2,093)
Non-controlling interest (note 8)	**241**	28
Net income (loss) and comprehensive income (loss)	**14,552**	(2,121)
Retained earnings (deficit), beginning of year	**(1,683)**	438
Retained earnings (deficit), end of year	**$ 12,869**	$ (1,683)
Income (loss) per share: (note 9)		
Basic	**$ 0.12**	$ (0.03)
Diluted	**$ 0.12**	$ (0.03)

See accompanying notes to the consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOW

	For the Year Ended	
(000s)	**December 31, 2010**	December 31, 2009
Cash provided by (used in):		
Operations:		
Net income (loss)	**$ 14,552**	$ (2,121)
Items not involving cash:		
Depletion, depreciation and accretion	**126,985**	23,023
Stock-based compensation	**3,197**	1,009
Future taxes	**6,360**	61
Unrealized gain on financial instruments (note 11)	**(15,950)**	(278)
Realized (gain) loss on sale of investments	**(45)**	—
Non-controlling interest	**241**	28
Changes in non-cash operating working capital	**9,517**	(22,236)
Cash flow from (used in) operating activities	**144,857**	(514)
Financing:		
Issue of common shares	**508,730**	348,404
Share issue costs	**(26,502)**	(13,819)
Increase (decrease) in bank debt (note 6)	**(6,550)**	(2,261)
Cash flow from financing	**475,678**	332,324
Investing:		
Exploration and development	**(494,152)**	(147,417)
Property acquisitions	**(343,234)**	(360,496)
Property dispositions	**24,647**	—
Corporate acquisitions	**(3,156)**	8,655
Proceeds from sale of investments	**255**	—
Repayment of long-term obligation	**(1,552)**	—
Change in non-cash investing working capital	**62,028**	55,098
Cash flow used in investing	**(755,164)**	(444,160)
Changes in cash	**(134,629)**	(112,350)
Cash, beginning of year	**199,789**	312,139
Cash, end of year	**$ 65,160**	$ 199,789

Cash is defined as cash and cash equivalents.

See accompanying notes to the consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the years ended December 31, 2010 and 2009

(tabular amounts in thousands of dollars, unless otherwise noted)

Incorporation:

Tourmaline Oil Corp. (the "Company") was incorporated under the laws of the Province of Alberta on July 21, 2008. The Company is engaged in the acquisition, exploration, development and production of petroleum and natural gas properties.

1. SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements of the Company have been prepared in accordance with Canadian generally accepted accounting principles. The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements, and revenues and expenses during the reporting period. Actual results could differ from those estimated.

Specifically, the amounts recorded for depletion and depreciation of property, plant and equipment and provision for asset retirement obligations are based on estimates. The ceiling test is based on estimates of reserves, production rates, oil and gas prices, future costs and other relevant assumptions. The amounts for stock-based compensation are based on estimates of risk-free rates, expected option life and volatility. Future income taxes are based on estimates as to the timing of the reversal of temporary differences and tax rates currently substantively enacted. The fair value of derivative contracts are based on the discounted value at the market for future commodity prices, interest rates and exchange rates between the United States and Canadian dollars. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future periods could be significant.

(a) Consolidation:

The consolidated financial statements include the accounts of Tourmaline Oil Corp. and its wholly-owned subsidiaries Pienza Petroleum Inc. and Vigilant Exploration Inc., and Exshaw Oil Corp. of which the Company owns 90.6% (note 8). All intercompany transactions and balances have been eliminated.

(b) Cash and cash equivalents:

Cash and cash equivalents are comprised of cash and all investments with a maturity date of three months or less.

(c) Investments:

Investments are classified as financial assets held for trading. Financial assets held for trading are initially recorded at their fair value with changes in their fair value recognized in net income.

(d) Petroleum and natural gas assets:

(i) Capitalized costs:

The Company follows the full cost method of accounting for petroleum and natural gas assets. Under this method, all costs related to the acquisition of, exploration for and development of petroleum and

natural gas reserves are capitalized. These costs include land acquisition costs, geological and geophysical expenditures, rentals and other carrying charges on undeveloped properties, costs of drilling both productive and nonproductive wells, oil and gas production equipment and facilities, asset retirement costs and administration expenses directly related to the acquisition, exploration and development activities. Proceeds from the disposition of oil and natural gas properties are accounted for as a reduction of capitalized costs, with no gain or loss recognized, unless such disposition would result in a change greater than 20% in the depletion or depreciation.

(ii) Depletion and depreciation:

Depletion of petroleum and natural gas assets and depreciation of production equipment are calculated using the unit-of-production method, based on production volumes before royalties in relation to estimated proven reserves as determined by an independent petroleum engineering firm. Natural gas reserves and production are converted to equivalent barrels of oil based upon the relative energy content of six thousand cubic feet of gas to one barrel of oil. The cost of acquisition and evaluation of unproved properties are initially excluded from the depletion calculation. 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.

Plant and facilities are amortized on a straight line basis over their estimated useful life. Other assets are amortized based on the declining balance method at a rate of 25%.

(iii) Ceiling test:

Petroleum and natural gas assets are evaluated in each reporting period to determine that the carrying amount is recoverable and does not exceed the fair value of the properties. The carrying amounts are assessed to be recoverable when the sum of the undiscounted cash flows expected from the production of proved reserves, cost less impairment of unproved properties and the cost of major development projects exceeds the carrying amount of the cost centre. When the carrying amount is not assessed to be recoverable, an impairment loss is recognized to the extent that the carrying amount of the cost centre exceeds the sum of the discounted cash flows expected from the production of proved and probable reserves, cost less impairment of unproved properties and the cost of major development projects of the cost centre. The cash flows are estimated using expected future product prices and costs and are discounted using a risk-free interest rate.

(e) Asset retirement obligations:

The Company recognizes the asset retirement obligations for the future cost associated with removal, site restoration and asset retirement costs. The fair value of the liability for the Company's asset retirement obligation is recorded in the period in which it is incurred, discounted to its present value using the Company's credit adjusted risk-free interest rate and the corresponding amount recognized by increasing the carrying amount of petroleum and natural gas assets. The asset recorded is depleted on a unit of production basis over the life of the reserves. The liability amount is increased each reporting period due to the passage of time and the amount of accretion is charged to earnings in the period. Revisions to the estimated timing of cash flows or to the original estimated undiscounted cost could also result in an increase or decrease to the obligation. Actual costs incurred upon settlement of the retirement obligation are charged against the obligation to the extent of the liability recorded.

(f) Joint interest operations:

Substantially all of the Company's exploration, development and production activities related to oil and gas operations are conducted jointly with others and, accordingly the accounts, reflect only the Company's proportionate interest in such activities.

(g) Revenue recognition:

Revenue from the sale of petroleum and natural gas is recognized during the month when title passes to a third party and collection is reasonably assured.

(h) Income taxes:

The Company uses the asset and liability method of tax allocation accounting. Under this method, future tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities, and measured using the substantially enacted tax rates and laws that will be in effect when the differences are expected to reverse.

(i) Flow-Through common shares:

The resource expenditure deductions for income tax purposes related to exploratory activities funded by flow-through common shares are renounced to investors in accordance with tax legislation. Future tax liabilities and share capital are adjusted by the estimated cost of the renounced tax deductions when the expenditures are renounced.

(j) Stock-based compensation plans:

The Company applies the fair value method for valuing stock option grants. Under this method, compensation cost attributable to all share options granted are measured at fair value at the grant date and expensed over the vesting period with a corresponding increase to contributed surplus. Upon the exercise of the stock options, consideration received together with the amount previously recognized in contributed surplus is recorded as an increase to share capital.

(k) Per share information:

Basic per share information is computed by dividing income by the weighted average number of common shares outstanding for the period. The treasury stock method is used to determine the diluted per share amounts, whereby any proceeds from the stock options, warrants or other dilutive instruments are assumed to be used to purchase common shares at the average market price during the period. The weighted average number of shares outstanding is then adjusted by the net change.

(l) Financial instruments:

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument to another entity. Upon initial recognition all financial instruments, including all derivatives, are recognized on the balance sheet at fair value. Subsequent measurement is then based on the financial instruments being classified into one of five categories: held for trading, held to maturity, loans and receivables, available for sale and other liabilities. The Company has designated its cash and cash equivalents, commodity risk management contracts and its investments as held for trading which are measured at fair value. Accounts receivable are classified as loans and receivables which are measured at amortized cost. Accounts payable and accrued liabilities and long-term bank debt are classified as other liabilities which are measured at amortized cost, which is determined using the effective interest method. The Company will assess at each reporting period whether a financial asset is impaired with any impairment recorded in net income. The Company is exposed to market risks resulting from fluctuations in commodity prices, foreign exchange rates and interest rates in the normal course of operations. A variety of derivative instruments may be used by the Company to reduce its exposure to fluctuations in commodity prices, foreign exchange rates, and interest rates. The Company does not use derivative instruments for trading or speculative purposes. The Company considers all of these transactions to be economic hedges; however, the Company's contracts have not been designated as hedges for accounting purposes. As a result, all derivative contracts are classified as held for trading and are recorded on the balance sheet at fair value, with changes in the fair value recognized in net income. The fair values of these derivative instruments are based on an estimate of the amounts that would have been received or paid to settle these instruments

prior to maturity given future market prices and other relevant factors. Proceeds and costs realized from holding the derivative contracts are recognized in net income at the time each transaction under a contract is settled.

The Company measures and recognizes embedded derivatives separately from the host contracts when the economic characteristics and risks of the embedded derivative are not closely related to those of the host contract, when it meets the definition of a derivative and when the entire contract is not measured at fair value. Embedded derivatives are recorded at fair value. The Company immediately expenses all transaction costs incurred in relation to the acquisition of a financial asset or liability. The Company applies trade-date accounting for the recognition of a purchase or sale of cash equivalents, investments and derivative contracts. The significance of inputs used in making fair value measurements are examined and classified according to a fair value hierarchy. Fair values of assets and liabilities included in Level 1 are determined by reference to quoted prices in active markets for identical assets and liabilities. Assets and liabilities in Level 2 include valuations using inputs other than quoted prices for which all significant outputs are observable, either directly or indirectly. Level 3 valuations are based on inputs that are unobservable and significant to the overall fair value measurement.

(m) Comparative amounts:

Certain comparative amounts may have been reclassified to conform with presentation adopted in the current year.

2. CHANGES IN ACCOUNTING POLICIES

(a) Adoption of International Financial Reporting Standards ("IFRS"):

On January 1, 2011 International Financial Reporting Standards ("IFRS"), as issued by the Accounting Standards Board, will become the generally accepted accounting principles in Canada. The transition from Canadian GAAP to IFRS will result in significant differences affecting financial position and results of operations. The Company will be reporting under IFRS for all periods beginning after January 1, 2011.

(b) Business combinations:

The CICA issued section 1582, Business Combinations which 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. Tourmaline has elected not to early adopt the requirements of this section. This section replaces Section 1581, Business Combination and harmonizes the Canadian standards with IFRS.

3. PROPERTY, PLANT AND EQUIPMENT

As at December 31, 2010	**Cost**	**Accumulated Depletion/ Depreciation**	**Net Book Value**
Petroleum and natural gas properties	**$ 1,785,346**	**$ 148,240**	**$ 1,637,106**
Furniture, fixtures and leasehold improvements	**1,204**	**350**	**854**
	$ 1,786,550	**$ 148,590**	**$ 1,637,960**

As at December 31, 2009	Cost	Accumulated Depletion/ Depreciation	Net Book Value
Petroleum and natural gas properties	$ 776,767	$ 22,616	$ 754,151
Furniture, fixtures and leasehold improvements	777	130	647
	$ 777,544	$ 22,746	$ 754,798

The costs of unproved properties, exploration expenditures and seismic costs at December 31, 2010 of $421.4 million (2009 – $233.0 million) have been excluded from the depletion calculation. Future development costs for the year ended December 31, 2010 of $609.8 million (2009 – $228.9 million) were included in the depletion calculation.

General and administrative expenditures for the year ended December 31, 2010 of $10.2 million (2009 – $3.2 million) have been capitalized and included as costs of petroleum and natural gas properties. Included in this amount are non-cash related stock-based compensation of $2.9 million (2009 – $0.9 million), and the associated future tax liability of $1.0 million (2009 – $0.3 million).

Tourmaline acquired significant producing assets in 2010 for total consideration of $388.2 million including cash of $343.2 million and 2.5 million common shares. As part of the property acquisitions, the Company assumed a long-term obligation of $19.9 million and $3.0 million of asset retirement obligations.

Tourmaline has also disposed of some producing and non-producing properties for proceeds of $27.9 million. Included in the proceeds was an investment in a private corporation valued at $3.25 million.

As at December 31, 2010, the Company applied a ceiling test to its property, plant and equipment and determined that no impairment has occurred. The ceiling test was calculated using the following expected future market prices of:

Year	WTI Oil ($US/bbl)	AECO Gas (CDN$/mmbtu)	US$/Cdn$ Exchange Rates
2011	88.00	4.16	0.98
2012	89.00	4.74	0.98
2013	90.00	5.31	0.98
2014	92.00	5.77	0.98
2015	95.17	6.22	0.98
2016	97.55	6.53	0.98
2017	100.26	6.76	0.98
2018	102.74	6.90	0.98
2019	105.45	7.06	0.98
Thereafter	+2.0%	+2.0%	0.98

Corporate Acquisitions

Altia Energy Ltd

On January 14, 2010, Tourmaline acquired all of the issued and outstanding shares of Altia Energy Ltd. ("Altia"). As consideration, Tourmaline paid cash of $2.7 million before transaction costs of $2.0 million and issued 6,411,670 shares at a price of $15.00 per share. The operations of Altia have been included with the results of the Company commencing January 14, 2010.

Pienza Petroleum Inc.

On September 15, 2009, Tourmaline acquired all of the issued and outstanding shares of Pienza Petroleum Inc. ("Pienza"). As consideration, Tourmaline paid cash of $6.0 million before transaction costs of $1.3 million and issued 3,553,063 shares at a price of $12.00 per share. The operations of Pienza have been included with the results of the Company commencing September 15, 2009.

Vigilant Exploration Inc.

On November 10, 2009, Tourmaline acquired all of the issued and outstanding shares of Vigilant Exploration Inc. ("Vigilant") by issuing 3,837,522 shares at a price of $12.00 per share and $149,000 in cash for total consideration of $46.2 million. The operations of Vigilant have been included with the results of the Company commencing November 10, 2009.

Exshaw Oil Corp.

On November 10, 2009, Tourmaline acquired 90.6 percent of the outstanding shares of Exshaw Oil Corp. ("Exshaw") by issuing 10,875,181 shares at a price of $12.00 per share for total consideration of $130.5 million. The operations of Exshaw have been included with the results of the Company commencing November 10, 2009.

Each of the corporate acquisitions has been accounted for by the purchase method based on fair values as follows:

	2010 Acquisition	2009 Acquisitions		
	Altia Energy Ltd.	Vigilant Exploration Inc.	Exshaw Oil Corp.	Pienza Petroleum Inc.
Net assets acquired:				
Property, plant and equipment	**$ 126,127**	$ 29,467	$ 163,847	$ 43,399
Cash	**1,516**	10,314	299	8,091
Working capital	**(461)**	(153)	(8,840)	652
Long-term investment	**—**	678	—	—
Long-term bank debt	**(6,550)**	—	(2,261)	—
Asset retirement obligations	**(612)**	(662)	(1,803)	(278)
Future taxes	**(19,173)**	7,834	(5,967)	(1,881)
Non-controlling interest	**—**	—	(13,498)	—
Total	**$ 100,847**	$ 47,478	$ 131,777	$ 49,983
Consideration:				
Cash	**$ 2,664**	$ 149	$ —	$ 6,000
Shares issued	**96,175**	46,050	130,502	42,637
Transaction costs	**2,008**	1,279	1,275	1,346
Total	**$ 100,847**	$ 47,478	$ 131,777	$ 49,983

4. INVESTMENTS

As part of an asset disposition in the second quarter of 2010, Tourmaline received common shares of a private corporation valued at $3.25 million. Tourmaline also owns common shares of a public junior oil and gas company which have been fair valued at $0.7 million based on the quoted market price at year end.

In February 2010 Tourmaline disposed of a portion of the common shares it holds in a public junior oil and gas company for proceeds of $0.3 million, and a realized gain of $45,000.

A reconciliation of the investments is provided below:

	2010	2009
Balance, beginning of year	$ 632	$ —
Acquired on corporate acquisition	—	678
Proceeds on disposition of shares (net of realized gain of $45,000)	(210)	—
Acquired on asset disposition	3,250	—
Unrealized gain (loss) on investments	260	(46)
Balance, end of year	$ 3,932	$ 632

5. ASSET RETIREMENT OBLIGATIONS

The Company's asset retirement obligations result from net ownership interests in petroleum and natural gas assets including well sites, gathering systems and processing facilities. The Company estimates the total undiscounted amount of cash flows required to settle its asset retirement obligations is approximately $53.2 million (2009 – $30.0 million), which will be incurred between 2021 and 2027. A credit-adjusted risk-free rate of 10% (2009 – 10%) and an inflation rate of 3% (2009 – 3%) were used to calculate the fair value of the asset retirement obligations.

A reconciliation of the asset retirement obligations is provided below:

	2010	2009
Balance, beginning of year	$ 7,208	$ —
Liabilities incurred	1,694	698
Liabilities incurred on corporate acquisitions (note 3)	612	2,743
Liabilities incurred on property acquisitions (note 3)	2,973	3,481
Accretion expense	1,141	286
Balance, end of year	$ 13,628	$ 7,208

6. BANK DEBT

The Company has a financing arrangement with two Canadian chartered banks for an extendible revolving term loan in the amount of $65 million, in addition to a $125 million operating line. The facility bears interest on a variable grid currently 250 basis points over the prevailing banker's acceptance rate. Security for the facility includes a general security agreement and a $500 million demand loan debenture secured by a first floating charge over all assets. On July 31, 2011, at the Company's discretion, the facility is available on a non-revolving basis for a period of 365 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 banks.

A subsidiary of the Company also has a financing arrangement with a Canadian chartered bank for an extendible revolving term loan in the amount of $5 million in addition to a $5 million operating line. The interest rate charged varies based on the amount outstanding. Security for the facility includes a general security agreement and a demand loan debenture secured by a first floating charge over all of the subsidiary's assets. The revolving term credit facility has a 364-day extendible period plus a one-year maturity.

The Company is required to meet certain financial-based covenants to maintain the facilities. The financial covenants include a requirement to ensure the total amount drawn on the facility does not

exceed the total borrowing base as defined in each facility's agreement, and that the ratio of earnings adjusted for interest, taxes and other non-cash items to interest expense does not exceed a predetermined amount, as determined by each facility's agreement. As at December 31, 2010 the company was in compliance with these covenants.

As at December 31, 2010, Tourmaline has a total amount of $4.0 million of letters of credit outstanding, and no amounts have been drawn down on existing facilities (2009 – nil).

7. LONG TERM OBLIGATION

As part of the June 2010 acquisition of petroleum and natural gas properties, the Company acquired a firm transportation agreement. A $19.9 million liability was recorded to account for the fair value of the agreement at the time of the acquisition. This amount was accounted for as part of the acquisition cost and will be charged as a reduction to transportation expenses over the life of the contracts as they are incurred, the charge for the year ended December 31, 2010 was $1.6 million. The current portion of this obligation is $3.7 million and has been included in accounts payable and accrued liabilities.

8. NON-CONTROLLING INTEREST

On November 10, 2009 Tourmaline acquired 90.6 percent of Exshaw Oil Corp., a private company engaged in oil and gas exploration in Canada.

A reconciliation of the non-controlling interest is provided below:

	2010	2009
Balance, beginning of year	**$ 13,526**	$ —
Recorded as of the acquisition date (note 3)	**—**	13,498
Share of subsidiary's net income for the year	**241**	28
Balance, end of year	**$ 13,767**	$ 13,526

9. SHARE CAPITAL

(a) Authorized:

Unlimited number of Common Shares without par value.

Unlimited number of non-voting Preferred Shares, issuable in series.

(b) Common Shares Issued:

		2010		2009
($'s in 000s)	**Number of Shares**	**Amount**	Number of Shares	Amount
Balance, beginning of year	**101,809,391**	**$ 895,095**	53,000,001	$ 319,858
For cash on Initial Public Offering (includes over-allotment option)	**11,500,000**	**241,500**	—	—
For cash on private placement of common shares	**10,350,000**	**188,850**	25,793,624	316,904
For cash on private placement of Flow-Through common shares	**3,600,000**	**78,220**	1,750,000	31,500
Issued for the acquisition of properties	**2,500,000**	**45,000**	3,000,000	24,000
Issued on corporate acquisitions	**6,411,670**	**96,175**	18,265,766	219,189
For cash on exercise of stock options	**20,000**	**160**	—	—
Contributed surplus on exercise of stock options	**—**	**188**	—	—
Share issue costs	**—**	**(26,502)**	—	(13,819)
Tax effect of share issue costs	**—**	**6,864**	—	3,713
Tax effect of Flow-Through renunciations	**—**	**(7,875)**	—	(6,250)
Balance, end of year	**136,191,061**	**$ 1,517,675**	101,809,391	$ 895,095

On January 14, 2010, the Company issued 6.4 million common shares, at $15.00 per share, as part of the consideration of a corporate acquisition (note 3).

On March 19, 2010, the Company issued 9.5 million common shares at $18.00 per share, for gross proceeds of $171 million, and 2.45 million flow-through common shares at $21.60 per share, for gross proceeds of $52.9 million. These issuances included a non-brokered component where insiders purchased 1.5 million common shares and 0.45 million flow-through common shares.

Tourmaline issued 2.5 million common shares at $18.00 per share as part of the consideration of a property acquisition which closed June 1, 2010.

On August 12, 2010, the Company issued 1.15 million flow-through common shares at $22.00 per share, for gross proceeds of $25.3 million. This issuance includes a non-brokered component of 300,000 common shares.

On November 23, 2010 the Company issued 10,850,000 common shares (including 850,000 issued on a private placement) as part of its Initial Public Offering for total gross proceeds of $227.85 million. Subsequently, on December 23, 2010 the Underwriters exercised their Over-allotment Option and purchased a further 1,500,000 shares at a price of $21.00 per share for total gross proceeds of $31.5 million.

(c) Stock options:

The Company has a rolling stock option plan. Under the employee stock option plan, the Company may grant options to its employees for up to 13,619,106 shares of common stock. The exercise price of each option equals the market price of the Company's stock on the date of grant and the option's maximum term is five years. Options are granted throughout the year and vest 1/3 on each of the first, second and third anniversaries from the date of grant.

	Number of options	Weighted average exercise price
Stock options outstanding, December 31, 2008	3,850,000	$ 7.00
Granted	4,935,000	12.24
Forfeited	(175,000)	7.43
Stock options outstanding, December 31, 2009	8,610,000	$ 9.99
Granted	3,407,000	17.88
Exercised	(20,000)	8.00
Stock options outstanding, December 31, 2010	11,997,000	$ 12.24

The following table summarizes stock options outstanding and exercisable at December 31, 2010.

Range of exercise price	Number outstanding at year end	Weighted average remaining contractual life	Weighted average exercise price	Number exercisable at year end	Weighted average exercise price
$7.00 – $8.00	3,995,000	2.90	$ 7.09	2,535,000	$ 7.04
$10.00 – $15.00	5,085,000	3.70	12.77	1,531,667	12.53
$16.68 – $20.68	2,917,000	4.86	18.37	—	—
	11,997,000	3.63	$ 12.24	4,066,667	$ 9.11

The fair value of options granted were estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions and resulting values:

	2010	2009
Fair value of options granted (weighted average)	**$ 5.52**	$ 1.16
Risk free interest rate	**2.43%**	2.48%
Estimated hold period prior to exercise	**5 years**	5 years
Expected volatility	**40%**	nil
Dividend per share	**$ 0.00**	$ 0.00

(d) Contributed surplus:

The following table reconciles contributed surplus:

	2010	2009
Balance, beginning of year	**$ 2,018**	$ 136
Capitalized stock-based compensation	**2,892**	873
Expensed stock-based compensation	**3,197**	1,009
Exercise of stock options	**(188)**	—
Balance, end of year	**$ 7,919**	$ 2,018

(e) Per share amounts:

The following summarizes the common shares used in calculating per share amounts:

	2010	2009
Weighted average shares outstanding:		
Basic	**120,786,535**	68,460,438
Diluted	**123,394,559**	68,460,438

10. TAXES

The provision for taxes in the consolidated financial statements differs from the result that would have been obtained by applying the combined federal and provincial tax rate to the Company's income before taxes. The difference results from the following items:

(000s)	2010	2009
Income/(loss) before taxes	**$ 21,153**	$ (2,032)
Combined federal and provincial tax rate	**28.0%**	29.0%
Computed "expected" tax (recovery) / expense	**$ 5,923**	$ (589)
Increase/(decrease) in taxes resulting from:		
Stock-based compensation	**895**	293
Effect of change in tax rate and other	**(458)**	357
Future taxes	**$ 6,360**	$ 61

The future tax liability/(asset) is comprised of the tax effect of temporary differences and future income tax reductions as follows:

(000s)	2010	2009
Petroleum and natural gas assets	**$ 64,044**	$ 17,549
Asset retirement obligation	**(3,405)**	(1,802)
Share issue costs	**(9,042)**	(5,436)
Non-capital loss carryforward	**(23,308)**	(9,531)
Balance, end of year	**$ 28,289**	$ 780

At December 31, 2010, the Company had non-capital losses in the amount of approximately $93 million. The non-capital losses expire between 2011 and 2029.

11. FINANCIAL RISK MANAGEMENT

The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework. The Board has implemented and monitors compliance with risk management policies.

The Company's risk management policies are established to identify and analyze the risks faced by the Company, to set appropriate risk limits and controls, and to monitor risks and adherence to market conditions and the Company's activities.

(a) Fair value of financial instruments:

Financial instruments comprise cash and cash equivalents, accounts receivable, investments, commodity price risk management contracts, accounts payable and accrued liabilities and bank debt. All of Tourmaline's commodity price risk management contracts and investments in public companies are transacted in active markets. Tourmaline classifies the fair value of these transactions according to the following hierarchy base on the amount of observable inputs used to value the instrument:

- Level 1 – Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions occur in sufficient frequency and volume to provide pricing information on an ongoing basis.

- Level 2 – Pricing inputs are other than quoted prices in active markets included in Level 1. Prices are either directly or indirectly observable as of the reporting date. Level 2 valuations are based on inputs, including quoted forward prices for commodities, time value and volatility factors, which can be substantially observed or corroborated in the marketplace.

- Level 3 – Valuations in this level are those with inputs for the asset or liability that are not based on observable market data.

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 investments held for trading had a fair value based on quoted market price at December 31, 2010 and were classified as Level 1.

The fair value of the risk management contracts (as presented on the balance sheet) are determined by discounting the difference between the contracted price and published forward price curves as at the balance sheet date, using the remaining contracted oil and natural gas volumes, and are considered Level 2.

Bank debt, when in existence, bears interest at a floating market rate and accordingly the fair value would approximate the carrying value.

(b) Credit risk:

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Company's receivables from joint venture partners and petroleum and natural gas marketers. As at December 31, 2010 Tourmaline's receivables consisted of $21.1 million from joint venture partners, $23.6 million from petroleum and natural gas marketers and $13.9 million from provincial governments. As of March 22, 2011 $47.0 million of the outstanding accounts receivable outstanding at December 31, 2010 has been collected.

Receivables from petroleum and natural gas marketers are normally collected on the 25th day of the month following production. The Company's policy to mitigate credit risk associated with these balances is to establish marketing relationships with creditworthy purchasers. The Company historically has not experienced any collection issues with its petroleum and natural gas marketers. Joint venture receivables are typically collected within one to three months of the joint venture bill being issued to the partner. The Company attempts to mitigate the risk from joint venture receivables by obtaining partner approval of significant capital expenditures prior to expenditure. However, the receivables are from participants in the petroleum and natural gas sector, and collection of the outstanding balances are dependent on industry factors such as commodity price fluctuations, escalating costs and the risk of unsuccessful drilling. In addition, further risk exists with joint venture partners as disagreements occasionally arise that increase the potential for non-collection. The Company 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.

The Company monitors the age of and investigates issues behind its receivables that have been past due for over 90 days. At December 31, 2010 the Company had $1.0 million (2009 – $0.3 million) over 90 days. The Company is satisfied that these amounts are substantially collectible.

The carrying amount of accounts receivable, cash and cash equivalents and commodity price risk management contracts represents the maximum credit exposure. The Company does not have an allowance for doubtful accounts as at December 31, 2010 (2009 – nil) and did not provide for any doubtful accounts nor was it required to write-off any receivables during the year ended December 31, 2010 (2009 – nil).

(c) Liquidity risk:

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they come due. The Company's approach to managing liquidity is to ensure, as far as possible, that it will have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions without incurring unacceptable losses or risking harm to the Company's reputation. Liquidity risk is mitigated by cash on hand and credit facilities.

The Company's accounts payable and accrued liabilities balance at December 31, 2010 is approximately $178.1 million (December 31, 2009 – $86.9 million). It is the Company's policy to pay suppliers within 45-75 days. These terms are consistent with industry practice. As at December 31, 2010 substantially all of the account balances were less than 90 days.

The Company prepares annual capital expenditure budgets, which are regularly monitored and updated as considered necessary. Further, the Company utilizes authorizations for expenditures on both operated and non-operated projects to further manage capital expenditures. The Company also attempts to match its payment cycle with collection of petroleum and natural gas revenues on the 25th of each month.

(d) Market risk:

Market risk is the risk that changes in market conditions, such as commodity prices, interest rates and foreign exchange rates will affect the Company's net income or value of financial instruments. The objective of market risk management is to manage and curtail market risk exposure within acceptable limits, while maximizing the Company's returns.

The Company utilizes both financial derivatives and physical delivery sales contracts to manage market risks. All such transactions are conducted in accordance with the risk management policy that has been approved by the Board of Directors.

Currency risk has minimal impact on the value of the financial assets and liabilities on the balance sheet at December 31, 2010. Changes in the US to Canadian exchange rate, however, could influence future petroleum and natural gas prices which could impact the value of certain derivative contracts. This influence cannot be accurately quantified.

Interest rate risk had minimal impact on the Company's balance sheet at December 31, 2010 as there was a nominal average amount of cash in short term investments and only small amounts drawn on the credit facilities over the fourth quarter of 2010.

Commodity price risk is the risk that the fair value or future cash flows will fluctuate as a result of changes in commodity prices. As at December 31, 2010, the Company has entered into certain financial derivative and physical delivery sales contracts in order to manage commodity risk. These instruments are not used for trading or speculative purposes. The Company has not designated its financial derivative contracts as effective accounting hedges, even though the Company considers all commodity contracts to be effective economic hedges. As a result, all such commodity contracts are recorded on the balance sheet at fair value, with changes in the fair value being recognized as an unrealized gain or loss on the consolidated statement of income.

The Company has entered into the following contracts as at December 31, 2010:

Type of Contract	Quantity	Time Period	Contract Price	Fair Value
AECO Fixed Price	3,000 gjs/d	April 2010 – March 2011	Cdn$5.77/gj	$ 553
AECO Fixed Price	2,000 gjs/d	April 2010 – March 2011	Cdn$5.72/gj	360
AECO Fixed Price	3,000 gjs/d	January – December 2011	Cdn$5.75/gj	2,132
AECO Fixed Price	3,000 gjs/d	January – December 2011	Cdn$5.84/gj	2,230
AECO Fixed Price	4,000 gjs/d	February 2010 – December 2011	Cdn$5.68/gj	2,727
AECO Fixed Price	2,000 gjs/d	February 2010 – December 2011	Cdn$5.72/gj	1,392
AECO Fixed Price	2,000 gjs/d	November 2010 – March 2011	Cdn$6.01/gj	413
AECO Fixed Price	2,000 gjs/d	March 2010 – March 2012	Cdn$5.72/gj	1,638
AECO Fixed Price	2,000 gjs/d	March 2010 – December 2011	Cdn$5.705/gj	1,388
AECO Fixed Price	3,000 gjs/d	March 2010 – March 2011	Cdn$5.89/gj	585
AECO Fixed Price	3,000 gjs/d	January 2011 – December 2012	Cdn$5.53/gj	3,279
AECO Call Option	3,000 gjs/d	January – December 2011	Cdn$6.50/gj strike price	(28)
AECO Call Option	3,000 gjs/d	January 2011 – December 2012	Cdn$6.00/gj strike price	(176)
AECO/Nymex Differential Swap	3,000 MMbtu/d	November 2010 – October 2011	Nymex less $0.475/MMbtu	65
AECO/Nymex Differential Swap	5,000 MMbtu/d	November 2010 – October 2012	Nymex less $0.62/MMbtu	(122)
AECO/Nymex Differential Swap	5,000 MMbtu/d	November 2010 – October 2011	Nymex less $0.485/MMbtu	88
AECO/Nymex Differential Swap	3,000 MMbtu/d	November 2010 – October 2012	Nymex less $0.535/MMbtu	104
AECO/Nymex Differential Swap	5,000 MMbtu/d	January – December 2011	Nymex less $0.475/MMbtu	128
Financial Swap	100 bbls/d	July 2011 – December 2012	USD$90.00/bbl	(221)
Financial Swap	100 bbls/d	January – December 2011	USD$87.85/bbl	(215)
Costless Collar	100 bbls/d	September 2010 – August 2012	US$75/bbl floor – US$96/bbl ceiling	(306)
Total fair value				$ 16,014

The following contracts were entered into subsequent to December 31, 2010:

Type of Contract	Quantity	Time Period	Contract Price
AECO Fixed Price	3,000 gjs/d	February 2011 –April 2012	Cdn$4.00/gj
Financial Swap	100 bbls/d	July – December 2011	USD$100.10/bbl
Financial Swap	100 bbls/d	July 2011 – June 2012	USD$101.40/bbl
Financial Swap	100 bbls/d	January 2012 – June 2013	USD$99.70/bbl
Financial Swap	100 bbls/d	September 2011 –December 2012	USD$101.00/bbl
Financial Swap	100 bbls/d	January – December 2012	USD$104.00/bbl

The following table provides a summary of the unrealized gains and losses on financial instruments for the year ended December 31, 2010:

	Year Ended	
(000s)	**December 31, 2010**	December 31, 2009
Unrealized gain on financial instruments	**$ 15,690**	$ 324
Unrealized gain (loss) on investments held for trading	**260**	(46)
Total	**$ 15,950**	$ 278

The unrealized gain on derivative contracts has been included on the balance sheet with changes in the fair value included in the unrealized gain on financial instruments on the statement of income. As at December 31, 2010, if the future strip prices for natural gas were $0.10 per mcf higher and prices for oil were $1.00 per bbl higher, with all other variables held constant, before tax earnings for the year would have been $1.5 million lower. An equal and opposite impact would have occurred to before-tax earnings and the fair value of the derivative contracts asset had natural gas prices been $0.10 per mcf lower and oil prices $1.00 per bbl lower.

(e) Capital management:

The Company's policy is to maintain a strong capital base to maintain investor, creditor and market confidence and to sustain the future development of the business. The Company considers its capital structure to include shareholders' equity, bank debt and working capital. In order to maintain or adjust the capital structure, the Company may from time to time issue shares and adjust its capital spending to manage current and projected debt levels. The annual and updated budgets are approved by the Board of Directors.

The key measures that the Company utilizes in evaluating its capital structure are net debt, which is defined as long-term bank debt plus working capital (adjusted for the fair value of financial instruments and future taxes), to annualized funds from operations, defined as cash flow from operating activities before changes in non-cash working capital, and the current credit available from its creditors in relation to the Company's budgeted capital program. Net debt to annualized funds from operations represents a measure of the time it is expected to take to pay off the debt if no further capital expenditures were incurred and if funds from operations in the next year was equal to the amount in the most recent quarter annualized.

The Company monitors this ratio and endeavours to maintain it at or below 2.0 to 1.0 in a normalized commodity price environment. This ratio may increase at certain times as a result of acquisitions or low commodity prices. As shown below, as at December 31, 2010, the Company's ratio of net debt to annualized funds from operations was 0.27 to 1.0.

(000s)	As at December 31 2010	2009
Net debt:		
Bank debt	$ —	$ —
Working capital (deficit)	(37,589)	161,514
Future taxes – short-term liability	2,832	—
Fair Value of financial instruments – short term asset	(14,413)	(324)
Net debt	$ (49,170)	$161,190
Annualized funds from operations:		
Cash flow from operating activities	$ 46,858	$ (9,388)
Change in non-cash working capital	(1,169)	23,957
Fourth quarter funds from operations	$ 45,689	$ 14,569
Annualized funds from operations	$182,756	$ 58,276
Net debt to annualized funds from operations	0.27	n/a

The Company has not paid or declared any dividends since the date of incorporation, nor are any contemplated in the foreseeable future. There were no changes in the Company's approach to capital management since December 31, 2009.

12. COMMITMENTS

At December 31, 2010 the Company has fully met the $31.5 million flow-through common share issue commitment undertaken in 2009. The renouncement of these CEE expenses, along with the related future tax effect of $7.9 million, was recognized in the first quarter of 2010.

On March 19, 2010 the Company issued 2.45 million flow-through common shares committing the Company to spend $52.9 million on eligible capital expenditures prior to December 31, 2011. Tourmaline has fully met this obligation at December 31, 2010.

On August 12, 2010, the Company issued 1.15 million flow-through common shares committing the Company to spend $25.3 million on eligible capital expenditures prior to December 31, 2011. Tourmaline has fully met this obligation at December 31, 2010.

In the normal course of business Tourmaline is obligated to make future payments. These obligations represent contracts and other commitments that are known and non-cancellable:

Payments due by year (000s)	2011	2012	2013	2014	2015
Operating leases	$ 2,348	$ 2,120	$ 1,758	$ 1,614	$ 404
Flow-Through obligations	—	47,400	—	—	—
Firm transportation agreements	20,354	18,235	16,498	9,506	6,676
	$ 22,702	$ 67,755	$ 18,256	$ 11,120	$ 7,080

13. SUBSEQUENT EVENT

On March 8, 2011 the Company issued 1.58 million common shares, including 0.38 million common shares to insiders in a non-brokered component of the issuance, on a flow-through basis at a price of $30.00 per share for total gross proceeds of $47.4 million.