# CANOEL INTERNATIONAL ENERGY INC.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

This Management's Discussion and Analysis ("**MD&A**") is provided by the management of Canoel Energy Inc. ("**Canoel**" or the "**Company**") and should be read in conjunction with the audited annual financial statements for the year ended March 31, 2009. This MD&A is dated as of May 14th, 2009.

### Basis of Presentation

All financial information is reported in Canadian dollars and is in accordance with Canadian generally accepted accounting principles ("**Canadian GAAP**") unless otherwise noted.

### Forward-Looking Information

Certain information in this MD&A, constitutes forward-looking statements or information (collectively referred to herein as "**forward-looking statements**") within the meaning of applicable securities legislation. Forward-looking statements are usually identified by the words "believe", "anticipate", "expect", "plan", "estimate", "target", "continue", "could", "intend", "may", "potential", "predict", "should", "will", "objective", "project", "forecast", "goal", "guidance", "outlook", "effort", "seeks", "schedule" or expressions of a similar nature suggesting future outcome or statements regarding an outlook. In particular, forward-looking statements include:

- management's belief that its option to increase its interest in the Tunisian exploration blocks will provide greater potential for financing or industry participation;
- the expected commencement date for drilling operations in on the Bazma exploration block and management's expectation that costs of drilling the well will be less than estimated;
- plans and timing for the drilling of exploratory wells on the Jorf and Sud Tozeur exploration blocks;
- management's expectation that general and administrative expenses will decline in future periods;
- management's expectation that permits for the Bazma and Sud Tozeur exploration blocks can be extended if necessary; and
- all of the statements under the heading "Outlook"

These forward-looking statements are subject to certain assumptions, including the assumptions that: the opportunity to participate the exploration and development of the Tunisian exploration blocks, whether directly, or through investment in the Company's shares, will be attractive to potential industry partners or investors; financing for the Company and other participants in proposed exploration activities will be available when required; the price of services and material required to carry-out exploration plans will be as expected; certain items of overhead incurred in the past year were one-time costs and management will be able to reduce and control overhead in subsequent periods; and that any required extensions of the exploration permits can be successfully negotiated with the Tunisian national oil company, ETAP. Forward-looking statements are not guarantees of future performance and the reader should not place undue reliance on these forward-looking statements as there can be no assurances that the assumptions, plans, initiatives or expectations upon which they are based will occur. In addition, forward-looking statements are subject to known and unknown risks, uncertainties and other factors that could cause the actual results, performance or achievements of the Company to be materially different from any future results, performance or achievements expressed or implied by forward-looking statements. Such factors include, among others: general economic and business conditions; the price of and demand for oil and natural gas and their effect on the economics of oil and gas exploration; fluctuations in currency and interest rates and their effect on projected profitability of the Company's operations; economic conditions in the countries and regions in which the Company will conduct its operations; political uncertainty; the ability of the Company to implement its business strategy, including exploration and development plans; the impact of competition; the availability and cost of seismic, drilling and other equipment; the Company’s ability to secure adequate transportation and markets for any oil or gas discovered; drilling and operating hazards and other difficulties inherent in the exploration for and production and sale of oil and natural gas; the availability and cost of financing; the success of any exploration and development undertaken; actions by governmental authorities; changes government regulations and the expenditures required to comply with them (including but not limited to the changes in taxes or the royalty or other share of production taken by governmental authorities). Should one or more of these risks or uncertainties materialize, or should any of the Company’s assumptions prove incorrect, actual results may vary in material respects from those projected in the forward-looking statements. Readers are cautioned that the foregoing list of risks, uncertainties and other factors is not exhaustive. Unpredictable or unknown factors not discussed could also have material adverse effects on forward-looking statements. The impact of any one factor on a particular forward-looking statement is not determinable with certainty as such factors are dependent upon other factors, and the Company’s course of action would depend upon its assessment of the future considering all information then available. All forward-looking statements in this MD&A are expressly qualified in their entirety by these cautionary statements. Except as required by law, the Company assumes no obligation to update forward-looking statements should circumstances or Management’s estimates or opinions change.

## OVERALL PERFORMANCE

The Company was incorporated under the British Columbia Business Corporations Act on September 20, 2007. In March, 2008, the Company raised $700,000 gross proceeds from an initial public offering of its common shares. The Company’s common shares were subsequently listed on the TSX Venture Exchange ("**TSXV**" or "**Exchange**") as a Capital Pool Company. As a Capital Pool Company, the Company was subject to policies of the Exchange that restricted its business to identifying and evaluating assets or businesses that, if acquired, would constitute the Company's "Qualifying Transaction" under applicable Exchange policies.

In July 2008, the Company entered into a Farm-out and Participation Agreement (the "**Farmout and Participation Agreement**") with Cygam Energy Inc. ("**Cygam**"), a Calgary based public oil and gas exploration company listed on TSXV. Under the Farmout and Participation Agreement the Company has the right to earn an 11% interest in three onshore oil and gas exploration blocks (Bazma, Jorf and Sud Tozeur) in the south-western part of Tunisia by paying between 15.4% and 18.7% of the costs of certain seismic programs previously conducted by Cygam and by paying a share of the costs of drilling the first well on each of the blocks. In order to have the Farmout and Participation Agreement accepted as the Company's Qualifying Transaction, additional funds were required to provide capital for some of the expenditures required to be made by the Company under the Farmout and Participation Agreement and to provide unallocated working capital. In November 2008 the Company raised gross proceeds of $2,305,400 through an offering of units by way of a Short Form Offering Document under Exchange policies and a Non Brokered Private Placement (collectively the "**Offerings**"). Each unit consisted of one common share of the Company and one common share purchase warrant. Each common share purchase warrant entitles the holder thereof to acquire one additional common share of the Company at a price of $0.40 until November 21, 2010 (subject to acceleration in certain circumstances).

Entering into the Farmout and Participation Agreement was subsequently accepted by the Exchange as the Company's Qualifying Transaction and the Corporation is now listed on the Exchange as a Tier 2 Oil and Gas issuer and is no longer subject to the restrictions applicable to Capital Pool Companies.

**TUNISIA**

During the year the Company incurred $921,212 of expenditures in relation to the Farmout and Participation Agreement, including $431,212 for its share of previously incurred seismic expenditures. The remaining $490,000 is held by Cygam, as operator of the exploration blocks, as a cash call against expenses to be incurred drilling a well on the Bazma block. The Company also paid $190,000 for an option to increase its interest in two of its three exploration blocks, Bazma and Sud Touzer, by 34% to 45%. The Company will require additional financing or an industry partner to complete its earning obligations under the Farmout and Participation Agreement. Management believes that the option to increase the Company's interest to 45% will provide greater potential for financing or industry participation because the opportunity to earn a larger interest is more likely to satisfy the acquisition criteria of a broader spectrum of financiers and industry participants.

***Bazma***

The Bazma exploration permit, in the center of Tunisia, covers an area of 1,616 square kilometres and carries a drilling commitment over a period of four years. The operator is Cygam. During the first quarter of 2008, Cygam completed a comprehensive geophysical interpretation of extensive seismic data on the Bazma permit. Several structures with similar characteristics as the nearby Tarfa and Bague l producing fields were mapped. One structure, initially called "W" and now renamed "Frida", less than 5 km from the Tarfa field, was selected as the first drilling location. In June, a new 2D seismic survey totalling 50 km was acquired in order to confirm the best drill location on the "Frida" structure and to further define additional structures. The Triassic Tagi, expected at a depth of approximately 2,200 metres, is the main target on the "Frida" structure. Drilling in Bazma was originally scheduled to occur in the final quarter of 2008; however, a hurricane, which struck the Houston area severely damaged the drilling rig scheduled to be moved to Tunisia and drilling operations had to be cancelled. Cygam is currently finalizing joint venture agreements and evaluating opportunities to contract a drilling rig. Long delivery time items, such as wellhead and casing have been purchased and have been delivered or are in transit in anticipation of this drilling. It is expected that drilling operations will commence in late 2009. Cygam has also signed a farm-out agreement with Timgad Energy, an Egyptian company, to participate as to a 10% working interest in Bazma and additional companies have expressed an interest in participating on a promoted basis.

***Jorf***

The Jorf exploration permit, located in the center of Tunisia covers an area of 3,768 square kilometres. The operator is Cygam. ETAP has agreed to extend the Jorf permit until August 6, 2011, by committing to drill a new well. Canoel concurs with the operator's geophysical interpretation which indicates that two middle Permian pinnacle reef prospects and one Triassic target are present in the northern portion of the permit. During August 2007, drilling of the shallow Bhayra Rigo 1 well at a location south east of the current Jorf permit confirmed the presence of good seal rocks and of an excellent dolomitized and porous Permian reef, as interpreted through seismic. Burial of potential pinnacle reefs at greater depth (over 3,500 metres) in the northern portion of the Jorf permit should improve the probability that such reefs may have trapped hydrocarbons generated by overlaying and underlying source rocks. An exploratory well is planned for the fourth quarter of 2010.

***Sud Tozeur***

Cygam completed a preliminary geophysical interpretation of the majority of seismic data on the Sud Tozeur permit in early 2008, inclusive of the 61 km 2-D delineation seismic acquired on the permit in 2007. Several structures have now been outlined, inclusive of two separate anomalies close to a well with Triassic and Ordovician reservoir potential which was drilled in late 1997 by a previous operator. Several additional undrilled structures have also been identified on the permit but they will require further evaluation.

The Sud Tozeur exploration permit, located near the Algerian border and in close proximity to the Sabria and El Franig producing fields, covers an area of 4,380 square kilometres (1,082,283 acres) and carries a drilling commitment over a period of four years. The operator is considering drilling a well at Sud Tozeur in 2011 pending final seismic evaluation and availability of a rig capable to drill a deep Ordovician test to approximately 4,500 metres.

## OTHER ACTIVITIES

In addition to its activities in Tunisia, the Company is actively pursuing the acquisition of oil and gas producing properties in Canada in order to provide cash flow to fund its operations, exploration prospects elsewhere in the world and financing for future acquisitions.

## SELECTED ANNUAL INFORMATION

| | March 31, 2009<br>$ | March 31, 2008<br>$ |
|---|---|---|
| Revenue | 7,394 | - |
| Net Loss | (467,158) | (12,000) |
| Per share – basic and diluted | (0.05) | (0.012) |
| Total assets | 2,508,481 | 898,530 |
| Total long-term liabilities | - | - |

### Income and Net Loss

The Company is an "exploration stage" oil and gas company and does not have any properties that produce revenue. During the year, the Company's only income was interest on funds held on deposit. General and administrative expenses for the year increased to $399,977 (2008 - $12,000), which were primarily related to professional fees of $182,286 and travel costs of $116,532. These increases in these expenses are primarily due to costs related to initiating and completing the Qualifying Transaction and the Offerings. The costs associated with these activities are beyond the normal operations of the Company, and in the absence of similar activities the general and administrative expenses are expected to decline in future periods. In addition, during the year the Company has grown in size to include additional directors and a full time management and has now offices in London and Calgary.

### Total assets

Total assets at year end were $2,508,481 (2008 - $898,530). The increase was the result of expenditures under the Farmout and Participation Agreement and cash from the Offerings.

## SUMMARY OF QUARTERLY INFORMATION

The following is a summary of selected financial information for the Company during the periods indicated.

| | Three Months Ended | | | |
|---|---|---|---|---|
| | March 31,<br>2009<br>$ | December 31,<br>2008<br>$ | September 30,<br>2008<br>$ | June 30,<br>2008<br>$ |
| Revenue | 1,267 | 469 | 1,652 | 4,006 |
| Net loss | 298,305 | 62,948 | 26,463 | 79,442 |
| Per share – basic and diluted | (0.03) | (0.008) | (0.004) | (0.012) |

## FOURTH QUARTER

As noted under "Selected Annual Information" and "Selected Quarterly Information" above, net loss for the year is due primarily to costs related to completion of the Company's Qualifying

Transaction and the growth of the Company, most of which were incurred during the three months ended March 31, 2009.

General and administrative costs for the three months ended March 31, 2009 increased due to remuneration paid for professional services of $118,420 (including geological engineering costs, legal costs, auditing costs and accounting costs), directors' fees of $18,810 and office expenses of $26,692 related to the Calgary and London offices.

During fiscal 2009, the Company completed its Qualifying Transaction and concurrent financing. In conjunction with these efforts, the Company incurred approximately $69,000 of expenditures, which were assessed in the quarter ending March 31, 2009 and management determined these expenditures were of an expense nature. These costs are related to the Company's efforts in completing the Qualifying Transactions and Offerings, and in the absence of similar activities they are not expected to reoccur in future periods.

## LIQUIDITY AND CAPITAL RESOURCES

The Company had a net working capital balance of $1,492,007 at March 31, 2009 consisting of cash on deposit ($1,094,065), prepaid expenditures and funds held by Cygam under a cash call for expenses to be incurred on the Bazma block, net of liabilities. Cash balances in excess of planned requirements were held in banks and highly liquid savings accounts. During the year, this excess cash generated $7,394 in interest income.

The Company is an exploration stage oil and gas Company that engages principally in the acquisition, exploration and development of oil and gas properties. None of the Company's properties currently produce revenue and accordingly the Company is currently unable to self finance all of its proposed operations. Capital expenditures on the Tunisian exploration blocks for the year ended March 31, 2010 are estimated to be approximately $594,000. The Company's ability to pay for these expenditures and satisfy its general and administrative expenses for the year will depend on its ability to raise additional funds from equity financings or find an industry partner to participate in exploration activities. Success will depend, among other things, on oil and gas industry conditions and capital market conditions. The Company has received expressions of interest from third parties to participate in an exploration program on some of the Tunisian permits, however there can be no assurance that an industry partner will be found or that additional equity financing will be available on reasonable terms, or at all.

## RELATED PARTY TRANSACTIONS

The Company entered into the following transactions with related parties during the year ended March 31, 2009. Transactions with related parties are recorded at the exchange amount, being the price agreed between the parties.

Aggregate expenses and fees of $105,071 (2008 – $nil) were charged by officers and directors of the Company and recorded in the statement of loss, comprehensive loss and deficit. Expenses and fees were primarily for services that resulted in the Company entering into Farmout and Participation Agreement and certain investors purchasing units in the non-brokered private placement that formed part of the Offerings.

Subsequent to entering into the Farmout and Participation Agreement and closing the Offerings, Andrea Cattaneo who acted as a consultant to assist in the completion of the aforementioned, joined the Board of Directors and was appointed President and Chief Operating Officer of the Company. At the time the contracts for these services were entered into, Mr. Cattaneo was at arm's length to the Company.

Aggregate directors fees of $18,810 (2008 - $nil) were charged by directors of the Company and recorded in the statement of loss, comprehensive loss and deficit.

Aggregate consulting fees of $21,740 (2008 - $nil) were charged by parties related to the Company and recorded in the statement of loss, comprehensive loss and deficit.

An aggregate of $921,212 was paid by the Company to the operator of the Tunisian oil and gas assets for capital spending. Of this amount $490,000 is included in accounts receivable as a cash call receivable and the remaining $431,212 is included in property plant and equipment. The operator has a 12.4% interest in the Company.

An option payment of $190,000 has been made to the operator of the Tunisian oil and gas assets. Under the option, the Company has the opportunity to increase their working interest on two Tunisian permits up to 45%.

**COMMITMENTS**

Pursuant to the terms of an agreement whereby the Company holds interest in oil and gas assets in Tunisia, the Company has future commitments to drill one well commencing in the third quarter of 2009 and two additional wells in the late part of 2010 or early 2011. The Company’s share of funding is estimated to be CAN $3,566,000 of which $490,000 has already been advanced to the operator. This amount, calculated pursuant to the parameters used in previous public documents, is deemed to reduce due to the continuing trend in the international and Tunisian market for the prices of the petroleum services, which lead cost of drilling down.

The terms of the agreements with the Tunisian government agency, ETAP, require Cygam and its farmees to drill one exploratory well under each of the Jorf, Bazma and Sud Touzer permits by August 2011, end of 2016 and end of 2017 respectively. The operator can apply to extend the Bazma and Sud Touzer permits after such renewal date for another period of exploration activity, involving a working program that will be determined as a result of appropriate negotiations with ETAP.

The Company may at any time withdraw its commitment to move ahead with any one of the three permits with the sole consequence of losing its previously paid capital expenses for that particular block. A withdrawal for one block does not affect the Company’s rights under any other of the Blocks.

## CHANGES IN ACCOUNTING POLICIES

*Future accounting and reporting changes*

The CICA issued the new Handbook Section 3064, "Goodwill and Intangible Assets", which will replace Section 3062, "Goodwill and Other Intangible Assets". The new standard establishes revised standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. The new standard also provides guidance for the treatment of preproduction and start up costs and requires that these costs be expensed as incurred. The new standard applies to annual and interim financial statements relating to fiscal years beginning on or after October 1, 2008.

*International Financial Reporting Standards ("IFRS")*

In 2006, the Canadian Accounting Standards Board ("AcSB") published a new strategic plan that will significantly affect financial reporting requirements for Canadian companies. The AcSB strategic plan outlines the convergence of Canadian GAAP with IFRS over an expected five year transitional period. In February 2008 the AcSB announced that 2011 is the changeover date for publicly listed companies to use IFRS, replacing Canada's own GAAP. The date is for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The transition date of January 1, 2011 will require the restatement for comparative purposes of amounts reported by the Company for the year ended December 31, 2010. PricewaterhouseCoopers has been engaged by the Company to assist with diagnostic review. The primary objective of the diagnostic review in the planning phase of the IFRS conversion project is to understand, identify and assess the overall effort required to produce financial information under IFRS.

*Business Combinations, Consolidated Financial Statements and Non Controlling Interest*

In January 2009, the CICA issued CICA Handbook Section 1582, Business Combinations, Section 1601, Consolidations, and Section 1602, Non-controlling Interest. These sections replace the former CICA Handbook Section 1581, Business Combinations and Section 1600, Consolidated Financial Statements and establish a new section for accounting for a non control ling interest in a subsidiary. CICA Handbook Section 1582 establishes standards for the accounting for a business combination, and states that all assets and liabilities of an acquired business will be recorded at fair value. Obligations for contingent considerations and contingencies will also be recorded at fair value at the acquisition date. The standard also states that acquisition related costs will be expensed as incurred and that restructuring charges will be expensed in the periods after the acquisition date. It provides the Canadian equivalent to IFRS 3, Business Combinations (January 2008). The section applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2011.

CICA Handbook Section 1601 establishes standards for the preparation of consolidated financial statements.

CICA Handbook Section 1602 establishes standards for accounting for a non controlling interest in a subsidiary in the preparation of consolidated financial statements subsequent to a business combination. It is equivalent to the corresponding provisions of IFRS IAS 27, Consolidated and Separate Financial Statements (January 2008).

CICA Handbook Section 1601 and Section 1602 apply to interim and annual consolidated financial statements relating to fiscal years beginning on or after January 1, 2011. Earlier adoption of these sections is permitted as of the beginning of a fiscal year.

All three sections must be adopted concurrently. The Company is current evaluating the impact of the adoption of these sections.

## ISSUED SHARES AND CONVERTIBLE, EXERCISABLE AND EXCHANGEABLE SECURITIES

The Company is authorized to issue an unlimited number of common shares and an unlimited number of preferred shares issuable in series. As of the date hereof, the Company's issued share capital and the outstanding securities that are convertible into or exercisable or exchangeable for any voting or equity securities of the Company is as follows

| | |
|---|---|
| Common Shares | 15,801,600 |
| Preferred Shares | Nil |
| Warrants | 9,399,330 |
| Stock Options | 1,550,000 |

Notes:
1. 9,221,600 of the Warrants entitle the holder to acquire one additional common share at $0.40 until November 21, 2010 (subject to acceleration in certain events). 177,730 of the Warrants entitle the holder to acquire one common share at $0.25 until November 21, 2010 (subject to acceleration in certain events).
2. 300,000 of the Stock Options entitle the holders to acquire an equal number of common shares at $0.20 per share until April 8, 2013 and the remaining 1,250,000 Stock Options entitle the holders to acquire an equal number of common shares at $0.10 per share until March 13, 2014, in each case subject to earlier termination in certain events.

## OUTLOOK

The Company plans to continue to focus largely on international oil and natural gas exploration opportunities. Management intends to focus its efforts toward large exploration permits which offer high exploration potential and the opportunity to act as operator at least for the initial exploration period.

In addition the company will continue its search for smaller producing assets in North America.

In Tunisia, the Company intends to conduct a two phase, success based, initial exploration program. The first phase will involve seismic acquisition and interpretation plus the drilling, testing and potential completion of one well on each of the exploration blocks. The second phase will involve the drilling, testing and potential completion of additional wells if and when the Company determines it is warranted. The Company's plans for the remainder of 2009 and for 2010 include:

(a) **Bazma Permit**. Drilling of an initial well in Q3, 2009. Drilling is subject to the company obtaining additional financing or finding an industry partner and to rig availability.

(b) **Jorf Permit**. Drilling one initial well expected to occur in late 2010 on a target identified by interpretation of approximately 200 kilometres of new 2-D seismic on the northern portion of the block.

(c) **Sud Tozeur Permit**. Continue the geophysical interpretation of seismic data. Any drilling is unlikely to be proposed prior to 2011.

**OTHER**

Additional information related to the Company's business and activities can be found on SEDAR at www.sedar.com