



Management's  
Discussion and Analysis

**For the Three Months Ended  
March 31, 2009  
(Unaudited)**

## MANAGEMENT'S DISCUSSION AND ANALYSIS

### Financial Overview

	THREE MONTHS ENDED MARCH 31		
	2009	2008	% CHANGE
	\$	\$	
Oil and gas revenue (3)	916,727	1,890,363	(52)
Royalties	(70,688)	(189,813)	(63)
Interest and other	10,295	-	100
	856,334	1,700,550	(50)
Operating expense	(506,793)	(344,161)	47
	349,541	1,356,389	(74)
Interest	(136,533)	(163,604)	(17)
General and administrative expense	(207,177)	(204,571)	1
Funds from operations (1)	5,831	988,214	(99)
Cash flow from operating activities	225,177	725,359	(69)
Net loss and comprehensive loss	(670,704)	48,842	(1,473)
Per share-basic and diluted	(0.02)	-	(100)

### Operating Overview

	THREE MONTHS ENDED MARCH 31		
	2009	2008	% CHANGE
Sales production (BOE)	27,391	32,396	(15)
Daily production (BOE/D)	304	356	(15)
<b>\$/BOE</b>			
Oil and gas revenue	33.47	58.35	(43)
Royalties	(2.58)	(5.86)	(56)
Interest and other	.37	-	100
	31.26	52.49	(40)
Operating expense	(18.50)	(10.62)	74
Operating netback (2)	12.76	41.87	(69)
Interest less accretion	(4.99)	(5.05)	(1)
General and administrative	(7.56)	(6.31)	20
	0.21	30.51	(99)

*Notes:*

- (1) Funds from operations is a non-GAAP measure that represents cash provided from operating activities before changes in non-cash operating working capital. See further discussion under Non-GAAP Measures in the Management's Discussion and Analysis.
- (2) Operating netback is a non-GAAP measure that represents specific revenue and expenses on a per unit of production basis. Natural gas has been converted to boe's at a ratio of 6 mcf: 1 BOE.
- (3) Royalty income is included in Oil and Gas Revenue and prior periods are restated for consistent presentation.

The following analysis and discussion is provided by the management of Solara Exploration Ltd. ("Solara" or the "Corporation") should be read in conjunction with the audited financial statements and notes thereto as at December 31, 2008.

This management's discussion and analysis of financial condition and results of operations ("MD&A") was prepared by management and reviewed and approved by the Board of Directors of Solara Exploration Ltd. The discussion and analysis is a review of Solara's operational and financial results based on Canadian generally accepted accounting principles ("GAAP"). Its focus is primarily a discussion of the operational and financial performance for the period ended March 31, 2009 and should be read in conjunction with the audited financial statements and accompanying notes for the year ended December 31, 2008. The discussion and analysis has been prepared as of May 28, 2009.

### Non-GAAP Measurements

Solara evaluates its performance using several criteria including funds from operations. Funds from operations is a non-GAAP term that represents cash provided by operating activities before changes in non-cash working capital. Funds from operations is a key measure of the Corporation. It demonstrates the Corporation's ability to generate cash necessary to fund future growth through capital investment, and allows the Corporation to evaluate operating performance, leverage and liquidity. The following table reconciles funds from operations to cash flow from operating activities which is the most directly comparable measure calculated in accordance with GAAP:

	THREE MONTHS ENDED MARCH 31		
	2009	2008	% CHANGE
	\$	\$	
Cash flows from operating activities	225,177	725,359	(69)
Changes in non-cash operating working capital	(219,346)	262,855	(183)
Funds from (used in) operations	5,831	988,214	(100)

Solara also assesses its performance utilizing operating and cash netbacks. Operating netbacks are the gross margin associated with the production and sale of crude oil, natural gas and natural gas liquids, and is calculated as revenues less royalties, interest and other income and operating costs on a barrel of oil equivalent basis. Cash netbacks represent the net amount retained per barrel of oil equivalent after the deduction of all cash costs, and is calculated as funds from operations on a barrel of oil equivalent basis.

These non-GAAP measures are not standardized and therefore may not be comparable to similar measures utilized by other entities.

### BOE Presentation

Barrels of oil equivalent (BOE) may be misleading, particularly if used in isolation. The BOE conversion ratio used in this report is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. All BOE conversions in this report are derived by converting gas to oil in the ratio of six thousand cubic feet of natural gas to one barrel of oil equivalent (6 Mcf = 1 BOE).

### Forward Looking Statements

The information herein contains forward looking statements and assumptions, relating but not limited to, risks associated with the oil and gas industry in general such as operational risks in development, exploration and production; delays or changes in plans with respect to exploration or development projects or capital expenditures; the uncertainty of reserves estimates; the uncertainty of estimates and projections relating to production, costs and expenses; and health, safety and environmental risks, commodity prices, financing sources and exchange rate fluctuations. By their nature, forward looking statements are subject to numerous risks and uncertainties that could significantly affect anticipated

results in the future, and accordingly, actual results may differ materially from those predicted. Some of the risks and other factors that could cause results to differ materially from those expressed in the forward looking statements contained in this MD&A include, but are not limited to, the lack of precision around estimates of reserves, performance of the Corporation's oil and gas properties, volatility in market prices for oil and gas, estimations of future costs, geological, technical, drilling and processing problems, changes in income tax laws or changes in tax laws and incentive programs relating to the oil and gas industry, and such other risks and uncertainties described from time to time in the reports and filings made with securities regulatory authorities by the Corporation. The material assumptions in making these forward looking statements are disclosed in this analysis under the headings "Royalties", "Operating Expenses", "Ceiling Test", "Capital Expenditures", and "Liquidity and Capital Resources". Readers are cautioned that the foregoing list of important factors are not comprehensive. Readers are cautioned that the assumptions used in the preparation of such information, although considered reasonable at the time of preparation, may prove to be imprecise, and as such, undue reliance should not be placed on forward looking statements. These statements are relevant only as of the date of this MD&A. Unless required by law, the Corporation does not undertake any intention or obligation to update or revise these forward looking statements, whether as a result of new information, future events or otherwise. The forward looking statements contained in this MD&A are expressly qualified by this cautionary statement.

### Financial Strategy in Current Economic Environment

The current economic environment is challenging and uncertain amidst a global recession, lower commodity prices, volatile financial markets and limited access to capital markets.

In this environment, the Corporation is highly focused on the key business objectives of reducing its cost of doing business in the current low commodity pricing environment, generating free cash flow and optimizing capital investments. This measured capital deployment approach is sustained by unused available lines of credit. In addition, the Corporation has no significant capital commitments, giving it flexibility in the investment of its funds from operations in reducing its overall debt.

The Corporation will continue to monitor expenses and defer capital programs. In light of the current market situation, the Corporation has planned a measured, flexible approach to 2009 investment, with a program that has the ability to be quickly adjusted depending on how economic circumstances evolve during the year

### Selected Quarterly Information

	THREE MONTHS ENDED		
	MARCH 31		
	2009	2008	2007
	\$	\$	\$
Oil and gas income	<b>916,727</b>	1,890,363	1,269,598
Funds flow from operations	<b>5,831</b>	988,214	594,783
Per share basic and diluted	-	0.03	0.03
Cash flow from operating activities	<b>225,177</b>	725,359	(59,839)
Per share basic	<b>0.01</b>	0.02	-
Per share diluted	<b>0.01</b>	0.02	-
Net loss and comprehensive loss	<b>(670,704)</b>	48,842	(110,002)
Per share basic and diluted	<b>(0.02)</b>	-	-
Capital expenditures	<b>407,157</b>	1,593,937	1,850,312
Total assets	<b>26,534,954</b>	26,464,792	31,373,371
Total long-term liabilities	<b>7,066,448</b>	7,417,746	8,575,017

In the first quarter of 2009 the Corporation's average production was 304 BOE/d compared to 356 BOE/d in 2008, and 291 BOE/d in 2007. Solara's selling prices for oil and natural gas decreased by 43% from 2008 and 31% from 2007. The combined production volume decrease and lower commodity selling prices resulted in the decrease in revenues, funds generated from operations and cash flow from operating activities compared to the quarter ended 2008 and 2007.

### Oil and Gas Revenue

Oil and gas revenue decreased by 52% to \$916,727 for the quarter ended March 31, 2009 compared to \$1,890,363 in 2008. The decrease in oil and gas revenue between the two fiscal periods is mainly attributable to decreased production and lower oil and gas pricing for the quarter ended March 31, 2009 compared to 2008. Average selling prices per BOE decreased by 43% from \$58.35/BOE for the quarter ended March 31, 2008 to \$33.47/BOE for 2009. The Corporation sells all of its production on a spot market basis with the exception of a few geographical based Pan Alberta physical delivery gas contracts. The Corporation had approximately 12 days of production downtime on key operated assets during the three months ended March 31, 2009 due to unavoidable interruptions from mechanical break downs, plant turnarounds and extreme cold weather which negatively impacted on production and oil and gas revenue for the period.

	THREE MONTHS ENDED MARCH 31		
	2009	2008	% CHANGE
Oil & Gas Revenues (\$)	<b>916,727</b>	1,890,363	(52)
Oil & NGL Production (bbls)	<b>10,741</b>	12,018	(11)
Oil Price (\$/bbl)	<b>43.14</b>	82.61	(48)
Gas Production (Mcf)	<b>99,901</b>	122,268	(18)
Gas Price (\$/Mcf)	<b>4.57</b>	7.32	(38)
BOE Production	<b>27,391</b>	32,396	(15)
BOE/D	<b>304</b>	356	(15)

### Royalties

Royalties on oil and gas production were \$70,688 (\$2.58/BOE) for the quarter ended March 31, 2009, compared to \$189,813 (\$5.86/BOE) representing a decrease of 56% on a barrel of oil equivalent basis. The Corporation pays both Alberta Crown and freehold royalties on its oil, NGL and natural gas sales depending on its mineral ownership in its lands and wells. The royalty expense decreased in 2009 compared to the comparative period in 2008 primarily due to a decrease in Crown royalty expenses. This decrease is a result of lower selling prices for oil and gas and the impact of the NRF.

On October 25, 2007, the Alberta Government announced a new royalty framework ("NRF") to take effect January 1, 2009. The Corporation is realizing a reduction in Crown royalties on its lower productivity wells as a result of the NRF.

On March 3, 2009, the Alberta Government released an incentive program designed to stimulate oil and gas activity in the province. The first part of the plan includes a one year drilling royalty credit of \$200 per meter drilled based on a sliding scale dependent on 2008 corporate production in Alberta. Part two of the plan includes a one year new well royalty incentive that is capped at 5% for the first year to a maximum of 50,000 barrels for oil wells and 500 million cubic feet for gas wells. Thirdly, to encourage the cleanup of inactive oil and gas wells, the province will invest \$30 million in a fund committed to abandoning and reclaiming well sites. In 2009 and 2010 Solara is expected to benefit from these programs based on management's assessment.

## THREE MONTHS ENDED MARCH 31

	2009	2008	% CHANGE
	\$	\$	
Crown Royalties	18,513	128,510	(86)
Freehold Royalties	33,233	48,253	(31)
Gross Overriding Royalties	18,942	13,050	45
Royalties	70,688	189,813	(63)
Royalties per BOE (6:1)	2.58	5.86	(56)

**Operating Expense**

Operating expenses increased from \$344,161 (\$10.62/BOE) in 2008 to \$506,793 (\$18.50/BOE) for the quarter ended March 31, 2009. The increase on a barrel of oil equivalent basis in operating expenses relates to an increased cost of service for contractors, third party processing increases, the number of operated wells, higher mechanical repairs, costs relating to prior periods and significant production down time during the period. Operating costs reflect a general industry increase which has continued irrespective of recessionary pressures.

## THREE MONTHS ENDED MARCH 31

	2009	2008	% CHANGE
	\$	\$	
Total	506,793	344,161	47
Per BOE (\$/BOE)	18.50	10.62	74

**Depletion, Depreciation and Accretion**

Depletion, depreciation and accretion (DD&A) was \$907,022 for the quarter ended March 31, 2009 (\$33.11 per BOE) compared to \$1,020,423 (\$31.50 per BOE) for the quarter ended March 31, 2008. Depletion expense on oil and gas properties declined 12% from \$975,963 for 2008 to \$860,588 in 2009 due to increased proved reserves, lower production and lower capital expenditures incurred quarter over quarter.

## THREE MONTHS ENDED MARCH 31

	2009	2008	% CHANGE
	\$	\$	
Depletion of oil and gas properties	860,588	975,963	(12)
Property plant, equipment impairment	-	-	
Accretion of asset retirement obligations	42,804	39,300	9
Depreciation of office equipment and leasehold	3,630	5,160	(30)
Total	907,022	1,020,423	(11)
Per BOE (\$/BOE)			
DD&A	33.11	31.50	5
Ceiling Test	-	-	
Total	33.11	31.50	5

## Ceiling Test

The Corporation calculates a ceiling test quarterly and annually whereby the carrying amount of petroleum and natural gas properties is compared to estimated future cash flows. In the period ended March 31, 2009 the ceiling test was performed in accordance with the requirements of the CICA AcG-16 "Oil and Gas Accounting-Full Cost." No impairment was recorded as the Corporation satisfied its ceiling test for the period. No impairment was recorded in the period ended March 31, 2008. The price forecast used in the reserve evaluation prepared by the independent engineering firm retained by the Corporation for the year ended December 31, 2008 is outlined in the table below and is adjusted for quality differentials and location. The Corporation performed a sensitivity analysis from the year end engineering reserve report to reflect the lower published prices at the end of the quarter.

## Price Forecast – January 1, 2009

	Oil CDN\$/Bbl	Gas AECO C CDN\$/mmbtu
2009	68.61	7.58
2010	78.94	7.94
2011	83.54	8.34
2012	90.92	8.70
2013	95.91	8.95
2014	97.84	9.14
2015	99.82	9.34
2016	101.83	9.54
2017	103.89	9.75
2018	105.99	9.95

Future prices incorporate a US/CDN exchange rate of 2009 – 0.825, 2010 – 0.85, 2011 – 0.875, 2012 – 0.925 thereafter, escalated at 2% per year thereafter.

## General and Administrative

General and administrative expenses (G&A) for the quarter ended March 31, 2009 were \$207,177 (\$7.56/BOE) compared to \$204,571 (\$6.31/BOE) for the quarter ended March 31, 2008. Total G&A expenses remained relatively constant compared to the first quarter in 2008 but increased on a per BOE basis due to lower production volumes in the most recent quarter. As part of its cost reduction initiative in 2009, general and administrative expense reduction measures were taken in the first quarter of 2009 that are expected to impact the remainder of the year.

	THREE MONTHS ENDED MARCH 31		
	2009	2008	% CHANGE
	\$	\$	
Gross G&A	329,247	346,707	(5)
Capitalized Overhead	(122,070)	(142,136)	(14)
Net G&A	207,177	204,571	1
Per BOE (\$/BOE)	7.56	6.31	20

## Contributed Surplus

Stock based compensation expense was calculated using the Black-Scholes Option Pricing Model, using a risk free interest rate of 3.62% (2007-3.88%), expected life of five years, expected average

volatility factor of 117% (2007-61%) and no dividends. The convertible debentures are convertible into Class A Shares of the Corporation at a price of \$1.50 (2007-\$1.50).

	THREE MONTHS ENDED MARCH 31 2009 \$	THREE MONTHS ENDED MARCH 31 2008 \$
Balance - beginning of period	1,487,968	323,016
Stock based compensation expense	11,987	65,109
Stock based compensation capitalized	9,807	-
Shares purchased for cancellation	51,512	149,747
Balance - end of period	<u>1,561,274</u>	<u>537,872</u>

The increase in the adjustment for shares purchased for cancellation results from the Corporation's ability to purchase shares of both Class A Shares and Class B Shares on the open market for prices lower than the historic average previously issued prices.

#### **Stock Based Compensation Expense**

Current employee compensation includes salary and stock options. The purpose of the stock option plan is to retain and attract employees, to reward and encourage performance, and to focus employees on operating and financial performance that results in higher shareholder return. On January 4, 2008 the Corporation issued 950,000 stock options, on June 9, 2008 the Corporation issued 185,000 stock options and on August 9, 2008, the Corporation issued 55,000 stock options. One third of the options at \$0.30 per Class A Share under the plan vest immediately. The balance of the expense will be amortized over the next two years.

#### **Future Income Tax Reduction and Future Tax Liability**

The Corporation has a future tax liability of \$2,702,447 at March 31, 2009 (2008 - \$2,938,516). The decrease in the future tax liability from year end relates to recording the effect of the loss on the future tax liability from the renouncement of tax benefits on flow through shares issued in the prior year and recording the accounting loss for tax purposes for the period ended March 31, 2009.

#### **Funds Flow from Operations**

Cash flow from operating activities was \$225,177 for the quarter ended March 31, 2009, compared to \$725,359 for the quarter ended March 31, 2008.

Funds from operations were \$5,831 in 2009 or \$NIL per basic and diluted share down from \$988,214 or \$0.03 per basic and diluted share for 2008. The decrease resulted primarily from decreased production and lower oil and gas commodity prices quarter over quarter.

#### **Operating Netbacks**

Comparing the quarter ending March 31, 2009 to the same period in 2008, operating netbacks decreased 69% from \$41.87/BOE to \$12.76/BOE. This decrease is a result of lower production levels and significantly lower commodity prices in 2009 compared to the prior period.

## Capital Expenditures

For the quarter ended March 31, 2009, capital expenditures totaling \$407,157 were incurred on acquisitions, land, geophysical activities, drilling, completion and tie in of wells. During the quarter ended March 31, 2008, capital expenditures totaling \$1,593,937 were incurred on land, acquisitions, exploration and development activities. Capitalized general and administrative expenses were \$122,070 and capitalized stock base compensation was \$ 9,807 for the quarter ended March 31, 2009, compared to \$142,136 and \$NIL for the quarter ended March 31, 2008. Capital expenditures for the first quarter 2009 were 74% lower than the comparable period in 2008 when the Corporation acquired the Craigend property.

THREE MONTHS ENDED MARCH 31			
	2009	2008	% CHANGE
	\$	\$	
Land	29,010	16,673	74
Seismic	157,635	173,265	(9)
Drilling and Completions	26,964	197,334	(86)
Facilities	182,496	68,484	166
Property Acquisition	11,052	1,136,091	(99)
Corporate	-	2,090	(100)
Total	407,157	1,593,937	(74)

Solara has identified a number of drilling opportunities on its undeveloped lands, some of which it may undertake in 2009 depending on the availability of capital and commodity prices recovering.

## Asset Retirement Obligations

The total future asset retirement obligation was estimated by management based on the Corporation's net ownership interest in the wells and facilities, estimated costs to reclaim and abandon the wells and facilities, and the estimated timing of the costs to be incurred in future periods. The expected cost of site reclamations was estimated by the Corporation's management using the Alberta Energy Utilities Board guidelines for certain areas and actual well abandonment costs for Alberta. Note that all of the Corporation's assets are located in Alberta. The Corporation expects the obligation to occur on average over 6 years and will be funded from general corporate resources at the time of abandonment. During 2008 the overall liability increased due to the acquisition of wells from the asset purchases in Alberta.

## Convertible Debentures

In July, 2006, the Corporation raised \$2,756,000 through the issue of 8.5% fixed rate unsecured subordinated convertible debentures which mature on July 7, 2011. The fair value of the conversion feature, calculated using the effective interest method, was estimated to be \$404,808, has been classified as equity. The convertible debenture debt component is classified as a liability and recorded as the present value of the obligation to make future interest payments in cash. The convertible debentures are subordinated to the fixed and floating debenture in favor of the Corporation's lender. (see note 4)

The carrying value of the convertible debenture debt component is accreted to the original face value of the instruments over their useful life. Accretion expense of \$ 24,795 (March 31, 2008 - \$24,795) has been recorded during the quarter ended March 31, 2009.

## Shareholders' Equity

Capital stock as at March 31, 2009 was \$15,574,187 compared to \$15,665,049 at December 31, 2008. As at March 31, 2009, there were outstanding stock options to acquire 2,351,661 Class A Shares at various prices between \$0.30 and \$ 0.95 of which all but 170,000 Class A Shares has been issued at

\$0.30 or \$0.35. The Corporation repurchased 110,000 (2008 – 64,500) Class A Shares pursuant to its normal course issuer bid during the three months ended March 31, 2009. At March 31, 2009 there were 24,510,937 Class A Shares, and 986,700 Class B Shares issued and outstanding.

### **Related Party Transactions**

The President, CEO and Director of the Corporation is the President of a private Alberta Corporation that provides management consulting services to the Corporation. During the three months ended March 31, 2009, the Corporation paid \$25,000 in various fees compared to \$27,500 for the period ended March 31, 2008. The Corporation also provided a demand loan in the amount of \$85,000 to the President, CEO, and Director to purchase 340,000 Class A Shares in November, 2005 as part of the CEO's incentive and compensation package. The loan is secured by the Class A Shares and a demand promissory note bearing interest at the bank prime rate plus one quarter of one percent.

Consulting services were provided by a company controlled by a vice president of engineering and operations of the Corporation for \$15,000 for the period ended March 31, 2009 (\$45,000 for the three months ended March 31, 2008).

The Corporate Secretary of the Corporation is counsel in a law firm that provided legal services to the Corporation in the amount of \$15,989 during the three months ended March 31, 2009 compared to \$42,936 for the three months ended March 31, 2008.

### **Commitments**

As at March 31, 2009 the Corporation is committed to office lease payments totalling \$179,168 through March 1, 2011 and includes current operating costs. These obligations are as follows: 2009 - \$70,109, 2010 - \$93,479, 2011 - \$15,580.

The Corporation has an obligation to incur \$120,000 in qualifying expenditures by December 31, 2009, resulting from the private placement of flow through shares completed during December 2008.

### **Liquidity and Capital Resources**

The working capital deficiency at March 31, 2009 was \$8,870,653 compared to \$6,594,449 at March 31, 2008. Bank debt of \$8,361,155 comprised the majority of the working capital deficiency at March 31, 2009. The Corporation had an unutilized operating line of \$638,845 on its \$9,000,000 demand revolving line of credit with its major lender. The credit facility was renewed on February 17, 2009 at a rate equal to the prime rate plus 1.25% per annum. The Corporation was compliant with its debt covenants at March 31, 2009. The next scheduled review is in June 2009. On an ongoing basis the Corporation will utilize three sources of funding to finance its capital expenditure program: (1) funds from operations; (2) debt when deemed favorable; and (3) raise additional investment capital, if deemed appropriate. As of the date of this report the Corporation has not committed any capital for exploration and drilling activities for the balance of 2009.

### **Subsequent Events**

The Corporation has entered into a commodity price contract with its lender which provides for a minimum price of \$5.21 per gigajoule (GJ) on 350 GJs per day for the period commencing on April 1, 2009 until December 31, 2009, and a ceiling price of \$7.50 per GJ commencing on January 1, 2010 and ending March 31, 2011.

The Corporation has entered into a second commodity price contract with its lender which provides for a minimum price of \$5.00 per GJ on 200 GJs per day for the period commencing on April 1, 2009 until December 31, 2009, and a ceiling price of \$6.675 per GJ commencing on January 1, 2010 and ending March 31, 2011.

Both these contracts were purchased to provide a floor price for 550 GJs per day during this period of uncertainty.

## Selected Quarterly Information

	2009		2008				2007	
	Q1	Q4	Q3	Q2	Q1	Q4	Q3	Q2
	\$	\$	\$	\$	\$	\$	\$	\$
Oil & Gas Revenue <sup>(3)</sup>	<b>916,727</b>	1,073,860	1,782,447	2,291,820	1,890,363	1,434,688	1,465,477	1,337,781
Royalties	<b>(70,688)</b>	(107,448)	(170,215)	(80,910)	(189,813)	(150,247)	(194,789)	(198,734)
Other Income	<b>10,295</b>	7,477	8,496	4,943	-	4,687	2,807	1,682
	<b>856,334</b>	973,889	1,620,728	2,215,853	1,700,550	1,289,128	1,273,495	1,140,729
Operating Expense	<b>(506,793)</b>	(567,885)	(495,628)	(570,455)	(344,161)	(580,595)	(440,686)	(289,002)
	<b>349,541</b>	406,004	1,125,100	1,645,398	1,356,389	708,533	832,809	851,727
Interest	<b>(136,533)</b>	(154,883)	(147,998)	(147,929)	(163,604)	(137,686)	(130,545)	(96,103)
G&A Expense	<b>(207,177)</b>	(304,253)	(213,462)	(229,105)	(204,571)	(294,190)	(101,990)	(198,180)
Funds from Operations (1)	<b>5,831</b>	(53,132)	763,640	1,268,364	988,214	276,657	600,274	557,444
Net (Loss) Income	<b>(700,206)</b>	(688,879)	(87,343)	93,900	48,842	(5,124,428)	(125,120)	(238,864)
Per share-basic and diluted	<b>(.02)</b>	(0.02)	-	-	-	(0.16)	-	(0.01)
Sales Production (BOE)	<b>27,391</b>	24,494	27,692	27,819	32,396	21,678	30,084	28,301
Daily Production (BOE/D)	<b>304</b>	266	301	306	356	236	327	311
<b>\$/BOE</b>								
Oil & Gas Revenue	<b>33.47</b>	43.84	64.37	82.38	58.35	66.18	48.71	42.27
Royalties	<b>(2.58)</b>	(4.39)	(6.15)	(2.91)	(5.86)	(6.93)	(6.47)	(7.02)
Other Income	<b>.37</b>	0.31	0.31	0.18	-	0.22	0.09	0.06
	<b>31.26</b>	39.77	58.52	79.66	52.49	59.47	42.33	40.31
Operating Expense	<b>(18.50)</b>	(23.18)	(17.90)	(20.51)	(10.62)	(26.78)	(14.65)	(10.21)
Operating Netback (2)	<b>12.76</b>	16.59	40.62	59.15	41.87	32.69	27.68	30.10
Interest	<b>(4.99)</b>	(6.32)	(5.34)	(5.32)	(5.05)	(6.25)	(4.34)	(3.40)
G&A Expense	<b>(7.56)</b>	(12.42)	(7.71)	(8.24)	(6.31)	(13.57)	(3.39)	(7.00)
Funds from Operations (1)	<b>(0.21)</b>	(2.15)	27.57	45.59	30.51	12.87	19.95	19.70

*Notes:*

(1) *Funds from operations is a non-GAAP measure that represents cash provided from operating activities before changes in non-cash operating working capital. See further discussion under Non-GAAP Measures in the Management's Discussion and Analysis*

(2) *Operating netback is a non-GAAP measure that represents specific revenue and expenses on a per unit of production basis. Natural gas has been converted to boe's at a ratio of 6 mcf: 1 bbl.*

(3) *Royalty income is included in Oil and Gas Revenue and prior periods are restated for consistent presentation.*

## Financial Risk Management

### Overview

Solara has exposure to the following risks from its use of financial instruments:

- Credit risk, liquidity risk and market risk.

This note presents information about Solara's exposure to each of the above risks, the Corporation's objectives, policies and processes for measuring and managing risk, and the Corporation's

management of capital. Further quantitative disclosures are included throughout these financial statements. The Board of Directors has overall responsibility for the establishment and oversight of the Corporation's risk management framework. The Board is in the process of implementing risk management policies. Solara's risk management policies will be designed to identify and analyze the risks faced by the Corporation, to set appropriate risk limits and controls, and to monitor risks and adherence to market conditions and the Corporation's activities.

### Credit Risk

Credit risk is the risk of financial loss to the Corporation if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from Solara's receivables from joint interest partners and petroleum and natural gas marketers. As at March 31, 2009, Solara's receivables consisted of \$385,156 from joint interest partners and \$349,305 of receivables from petroleum and natural gas marketers. Receivables from petroleum and natural gas marketers are normally collected on the 25th day of the month following production. Solara's policy to mitigate credit risk associated with these balances is to establish marketing relationships with large purchasers. The Corporation historically has not experienced any collection issues with its petroleum and natural gas marketers, and currently has no such collection issues. Joint interest receivables are typically collected within one to three months of the joint interest bill being issued to the partner. Solara attempts to mitigate the risk from joint interest receivables by obtaining partner approval of significant capital expenditures prior to expenditure, and obtaining cash call funds on operated projects. However, the receivables are from participants in the petroleum and natural gas sector, and collection of the outstanding balances is dependent on industry factors, such as commodity price fluctuations, escalating costs and the risk of unsuccessful drilling. In addition, further risk exists with joint interest partners as disagreements occasionally arise that increase the potential for non-collection. Solara does not typically obtain collateral from petroleum and natural gas marketers. Solara has the ability to withhold production from joint interest partners in the event of non-payment and to take its share of production in kind. The carrying amount of accounts receivable represents the maximum credit exposure. Solara did not have an allowance for doubtful accounts as at March 31, 2009 and did not provide for any doubtful accounts nor was it required to write-off any receivables during the three months ended March 31, 2009.

As at March 31, 2009 and December 31, 2008, Solara considers its trade receivables to be aged as follows:

	<b>March 31, 2009</b>	December 31, 2008
	\$	\$
Not past due (less than 90 days)	<b>539,210</b>	674,878
Past due (91 - 120 days)	<b>195,251</b>	134,874
	<b>734,461</b>	809,752

As of May 28, 2009, the Corporation had collected \$70,748 of the past due trade receivables. The remaining \$124,503 relates to prior period gross overriding royalties which are owed to the Corporation by various joint venture partners. Solara is currently working with these accounts to resolve payment of the outstanding royalties. The Corporation has the right of offset with respect to approximately \$65,000 of royalty revenue from one of the parties.

### Liquidity Risk

Liquidity risk is the risk that the Corporation will not be able to meet its financial obligations as they are due. Solara'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 Corporation's reputation. Solara prepares annual capital expenditure budgets, which are regularly monitored and updated as considered necessary. Further, the Corporation utilizes authorizations for expenditures on both operated and non-operated projects to further manage capital expenditures, and cash call partners for their share of capital activities on operated projects. To facilitate the capital expenditure program, Solara has a revolving reserves based credit facility that is reviewed at least annually by the lender.

## **Market Risk**

Market risk is the risk that changes in market prices, such as foreign exchange rates, commodity prices and interest rates, will affect the Corporation's net earnings or the value of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable limits, while maximizing returns. The Corporation may utilize 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.

### **(a) Foreign Currency Exchange Rate Risk**

Foreign currency exchange rate risk is the risk that the fair value or future cash flows will fluctuate as a result of changes in foreign exchange rates. Although substantially all of Solara's oil and natural gas sales are denominated in Canadian dollars, the underlying market prices in Canada for oil and natural gas are impacted by changes in the exchange rate between the Canadian and United States dollar. The Corporation had no forward exchange rate contracts in place during the year ended December 31, 2008 or as at March 31, 2009.

### **(b) Commodity Price Risk**

Commodity price risk is the risk that the fair value or future cash flows will fluctuate as a result of changes in commodity prices. Commodity prices for oil and natural gas are impacted by not only the relationship between the Canadian and United States dollar, as outlined above, but also world economic events that dictate the levels of supply and demand. The Corporation did not have any commodity price contract outstanding during the year ended December 31, 2008 and none during the period ended March 31, 2009. (see comments regarding subsequent events)

### **(c) Interest Rate Risk**

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. Solara is exposed to interest rate fluctuations on its bank debt, which bears a floating rate of interest. For the three months ended March 31, 2009, if interest rates had been 1 % lower with all other variables held constant, after tax net earnings for the period would have been \$44,425 higher, due to lower interest expense. An equal and opposite impact would have occurred to net earnings had interest rates been 1% higher. The Corporation had no interest rate swap or financial contracts in place as at or during the year ended December 31, 2008 or as at March 31, 2009.

### **d) Current Market Conditions**

General adverse economic conditions globally, including the possibility of a recession in Canada and a worldwide economic slowdown, recent disruptions to the credit and financial markets in Canada and worldwide and local economic turmoil may adversely affect the value of the Corporation's business and value of its securities.

## **Capital Management**

General adverse economic conditions globally, including the possibility of a recession in Canada and a worldwide economic slowdown, recent disruptions to the credit and financial markets in Canada and worldwide and local economic turmoil may adversely affect the value of the Corporation's business and value of its securities.

The Corporation's policy is to maintain a sufficient capital base to sustain the future development of the business and to maintain investor, creditor and market confidence. The Corporation manages its capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying petroleum and natural gas assets. The Corporation considers its capital structure to include shareholders' equity and bank debt. In order to maintain or adjust the capital structure, the Corporation may, from time to time, issue shares and adjust its capital spending

to manage current and projected debt levels. The Corporation monitors capital based on the ratio of bank debt to funds from operations for the most recent 12 month period. Funds from operations is calculated based on cash provided by operating activities before changes in non-cash working capital and expenditures on asset retirement obligations. The Corporation's strategy is to endeavor to maintain a ratio of bank debt to annual funds from operations of approximately 2.5 to 1 or lower. This ratio may increase at certain times as a result of acquisitions and/or large capital projects. As at March 31, 2009, the Corporation's ratio of net debt to annual funds from operations was approximately 3.4 to 1. The Corporation anticipates that the ratio will exceed the target range by a significant margin throughout 2009 due to reduced funds from operations affected by lower commodity prices relative to 2008. The Corporation's share capital is not subject to external restrictions; however, the bank debt facility is based on petroleum and natural gas reserves (see note 4), and contains certain financial covenants. The Corporation has not paid or declared any dividends since the date of incorporation, nor are any contemplated in the foreseeable future. Management is reviewing all of its field operating and general and administrative expenses and has deferred all major capital projects until such time that funds from operations warrant capital investments. Our corporate emphasis is on trade debt reduction and retiring a portion of the bank line of credit for the balance of 2009.

### **Fair Value of Financial Instruments**

Solara's financial instruments as at March 31, 2009 and December 31, 2008 include accounts receivable, an amount due from share holder, accounts payable and accrued liabilities, and bank debt. The fair value of these amounts excluding bank debt approximate their carrying amounts due to their short terms to maturity. Bank debt is payable on demand and bears interest at a floating market rate, and accordingly, the fair market value approximates the carrying value.

### **Business Risks and Uncertainties**

The Corporation's production and exploration activities are concentrated in the Western Canadian Sedimentary Basin where activity is highly competitive and includes companies ranging from smaller junior producers to the much larger integrated petroleum companies. The Corporation is subject to various types of business risks and uncertainties, including:

- Finding and developing oil and natural gas reserves at economic costs
- Production of oil and natural gas in commercial quantities
- Marketability of oil and natural gas produced
- Substantial capital requirements and access to capital markets
- Environmental risks
- Insurance
- Reliance on operators and key employees
- Third party credit risk
- Changes in legislation and incentive programs

In order to reduce exploration risk, the Corporation strives to employ highly qualified and motivated professional employees with a demonstrated ability to generate quality proprietary geological and geophysical prospects. To help maximize drilling success, the Corporation combines exploration in areas that afford multi-zone prospect potential, targeting a range of low to moderate risk prospects with some exposure to select high risk, high reward opportunities. The Corporation also explores in areas where it has significant drilling experience.

The Corporation mitigates its risk related to producing hydrocarbons through the utilization of the most appropriate technology and information systems. In addition, the Corporation seeks to maintain operational control of the majority of its prospects.

Oil and gas exploration and production can involve environmental risks such as pollution of the environment and destruction of natural habitat, as well as safety risks such as personal injury. In order to mitigate such risk, the Corporation conducts its operations at high standards and follows safety

procedures intended to reduce the potential for personal injury to employees, contractors and the public at large. The Corporation maintains current insurance coverage for general and comprehensive liability as well as limited pollution liability. The amount and terms of this insurance are reviewed on an ongoing basis and adjusted as necessary to reflect changing corporate requirements as well as industry standards and government regulations. The Corporation may periodically use financial or physical delivery commodity price contracts to reduce its exposure against the potential adverse impact of commodity price volatility, as governed by formal policies approved by senior management subject to controls established by the Board of Directors. At December 31, 2008, the Corporation had no fixed price contracts in place. During the first quarter of 2009 the Corporation entered into two contracts (see the discussion under “subsequent events”).

### **Critical Accounting Estimates and Policies**

The Corporation’s significant accounting policies are outlined in note 1 to the audited financial statements at December 31, 2008. The following summarizes certain accounting estimates that are integral to the determination of reported financial results during the first quarter of 2009.

#### **Proved Petroleum and Natural Gas Reserves**

Proved reserves, the estimated quantities of natural gas, crude oil and natural gas liquids that can be recovered in future years under future economic and operating conditions, are critical to many aspects of the Corporation’s financial statements. These estimates are made with reasonable certainty using all available geological and reservoir data as well as historical production data and are subject to revisions based on changes in reservoir performance and the pricing environment.

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

Solara uses the full cost method of accounting for exploration and development activities whereby all costs associated with these activities are capitalized, whether successful or not. The aggregate of capitalized costs, net of certain costs related to unproved properties, and estimated future development costs are amortized using the unit-of-production method based on estimated proved reserves. Changes in estimated proved reserves or future development costs have a direct impact on depletion and depreciation expense. Certain costs related to unproved properties and major development projects may be excluded from costs subject to depletion until proved reserves have been determined or their value is impaired. These properties are reviewed quarterly to determine if proved reserves should be assigned, at which point they would be included in the depletion calculation, or for impairment, for which any write-down would be charged to depletion and depreciation expense.

#### **Full Cost Accounting Ceiling Test**

Oil and gas assets are evaluated at least annually to determine that the costs are recoverable and do not exceed the fair value of the properties. The costs are assessed to be recoverable if the sum of the undiscounted cash flows expected from the production of proved reserves and the lower of cost and market of unproved properties exceed the carrying amount of the oil and gas assets. If the carrying value of the oil and gas assets is not assessed to be recoverable, an impairment loss is recognized to the extent that the carrying amount exceeds the sum of the discounted cash flows expected from the production of proved and probable reserves and the lower of costs 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 would be charged as additional depletion and depreciation expense.

## Stock-Based Compensation

The Corporation follows the fair value method of accounting for stock options granted to employees, directors and certain service providers. Stock-based compensation expense is recorded for all options granted with the corresponding amount recorded as contributed surplus. Stock based compensation expense for employees is based on the estimated fair value of the related stock option at the time of the grant and is expensed on a straight line basis over the vesting period of the option. The stock based compensation expense for certain service providers is based on the estimated fair value of the related stock option at the end of each reporting period and the appropriate amount expensed in that period. In determining fair value of the stock options granted, the Black-Scholes model is used and assumptions regarding interest rates. Underlying validity of the Corporation's shares and the expected life of the options are made. When options are exercised, the amounts previously accumulated as contributed surplus and the consideration received are recorded as an increase to share capital.

## Asset Retirement Obligations

Solara records a liability for the fair value of legal obligations associated with the retirement of long-lived tangible assets in the period in which they are incurred, normally when the asset is purchased or developed. On recognition of the liability, there is a corresponding increase in the carrying amount of the related asset known as the asset retirement cost. The total future asset retirement obligation is an estimate based on Solara'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 undiscounted amount of the estimated cash flows required to settle the asset retirement obligation is an estimate that is subject to measurement uncertainty and any change would impact the liability.

## Income Taxes

The determination of Solara's income and other tax liabilities require interpretation of complex laws and regulations often involving multiple jurisdictions. All tax filings are subject to audit and potential reassessment after the lapse of considerable time. Accordingly, the actual income tax liability may differ significantly from that estimated and recorded.

## Changes in Accounting Policies

### Financial Instruments - Disclosures and Presentation

On January 1, 2008 the Corporation adopted the new standards for, "Financial Instruments – Disclosure and Presentation." The new standards outline the disclosure requirements for financial instruments and non-financial derivatives. This guidance prescribes an increased importance on risk disclosures associated with recognized and unrecognized financial instruments and how such risks are managed. Specifically, it requires disclosure of the significance of financial instruments for a company's financial position. In addition, the guidance outlines revised requirements for the disclosure of qualitative and quantitative information regarding exposure to risks arising from financial instruments (see note 10).

### Capital Disclosures

On January 1, 2008 new standards were issued on, "Capital Disclosures" requiring disclosures regarding an entity's objectives, policies and processes for managing capital. These disclosures include a description of what the Corporation manages as capital, the nature of externally imposed capital requirements, how the requirements are incorporated into the Corporation's management of capital, whether the requirements have been complied with, or consequences of non-compliance and an explanation of how the Corporation is meeting its objective for managing capital. In addition,

quantitative data about capital and whether the Corporation has complied with all capital requirements are also required (see note 10).

### **New Accounting Pronouncements**

#### Goodwill and intangible assets

On January 1, 2009 the Corporation will be required to adopt a new accounting standard for Goodwill and Intangible Assets, which defines the criteria for the recognition of intangible assets.

#### Business combinations

On January 1, 2011, the Corporation will be required to adopt a new accounting standard for Business Combinations, which harmonizes existing Canadian standards with International Financial Reporting Standards (“IFRS”). Early adoption of the new standard is permitted.

#### Convergence with IFRS

On January 1, 2011, the Corporation will be required to adopt IFRS. The transition from current GAAP to IFRS is a significant undertaking that may materially affect the Corporation’s reported financial position and results of operations amendments and exemptions to IFRS 1. One such exemption relating to full cost oil and gas accounting is expected to reduce the administrative burden in the transition from the current Canadian Accounting Guideline 16 to IFRS. It is anticipated that this exposure draft will not result in an amended IFRS 1 standard until late 2009. The amendment will potentially permit the Corporation to apply IFRS prospectively to its full cost pool, rather than the retrospective assessment of capitalized exploration and development expenses, with the proviso that an impairment test under IFRS standards be conducted at the transition date.

The Corporation has not completed development of its IFRS changeover plan, which will include project structure and governance, resourcing and training, analysis of key difference between IFRS and GAAP, as well as a phased plan to assess accounting policies under IFRS and any potential IFRS 1 exemptions. The Corporation anticipates the completion of its project scoping, which will include a timetable for assessing the impact on data system, internal controls over financial reporting, and business activities, such as financing and compensation arrangements, by late 2009.

### **Additional Information**

Additional information regarding the Corporation and its business and operations is available on the Corporation’s company profile at [www.sedar.com](http://www.sedar.com). Copies of the information can also be obtained by contacting the Corporation at Solara Exploration Ltd., #1800, 444 – 5<sup>th</sup> Avenue S.W., Calgary, Alberta T2P 2T8 (Phone: 403-537-0458) or by e-mail at [don\\_solaralexploration@shaw.ca](mailto:don_solaralexploration@shaw.ca).