

# WCSB

ROYALTY INCOME INVESTMENTS



## WCSB OIL & GAS ROYALTY INCOME 2010 LIMITED PARTNERSHIP

Management Discussion & Analysis  
September 30, 2011

## **WCSB OIL & GAS ROYALTY INCOME 2010 LIMITED PARTNERSHIP**

### **Management Discussion and Analysis**

### **For the period ended September 30, 2011**

This Management's Discussion and Analysis ("MD&A") should be read in conjunction with the unaudited interim financial statements dated September 30, 2011 and the audited annual financial statements dated December 31, 2010 of WCSB Oil & Gas Royalty Income 2010 Limited Partnership (the "Partnership"). The MD&A has been prepared as of November 28, 2011. You can get a copy of this MD&A, the interim or the annual financial statements at your request, and at no cost, by calling 1.866.688.5750, by writing the general partner, WCSB Oil & Gas Royalty Income 2010 Management Corp. (the "General Partner"), 609 Granville Street, Suite 808, PO Box 10357 Vancouver, BC V7Y 1G5 or by visiting our website at [www.wcsb.ca](http://www.wcsb.ca) or SEDAR at [www.sedar.com](http://www.sedar.com).

This MD&A has been prepared by management and reviewed and approved by the Board of Directors of WCSB Oil & Gas Royalty Income 2010 Management Corp. the general partner of the Partnership (the "General Partner"). The discussion and analysis is a review of the financial position and results of operations of the Partnership. Its focus is primarily a comparison of the financial performance for the nine months ended September 30, 2011 and 2010 and should be read in conjunction with Note 12 of the unaudited interim financial statements for the nine months ended September 30, 2011 and the audited financial statements and accompanying notes for the period ended December 31, 2010. The interim financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") including International Accounting Standard 34 "Interim Financial Reporting". Previously the Partnership prepared its interim and annual financial statements in accordance with Canadian generally accepted accounting principles. The reporting currency is the Canadian dollar.

#### **FORWARD-LOOKING INFORMATION**

This MD&A contains forward-looking information and statements relating, but not limited to, anticipated or prospective financial performance and results of operations of the Partnership. Any statements that are contained herein that are not statements of historical fact may be deemed to be forward-looking information. Without limiting the foregoing, the words "believes", "anticipates", "plans", "intends", "will", "should", "expects", "projects", and similar expressions are intended to identify forward-looking information.

The General Partner believes the forecasts or projections herein are reasonable, however readers are cautioned not to place undue reliance on such forward-looking information and readers should review the prospectus filed with Canadian securities regulatory authorities. Actual results may differ materially from management expectations as projected in such forward-looking statements for a variety of reasons including, but not limited to, market and general economic conditions, interest rates, regulatory and statutory developments, the effects of competition in the geographic and business areas in which the Partnership may invest and the risks detailed in the prospectus of the Partnership. We caution that the foregoing list of factors is not exhaustive.

The forward-looking information is given as of the date of this Interim MD&A, and the General Partner undertakes no obligation to update publicly or revise any forward-looking information, whether as a result of new information, future events or otherwise.

#### **INVESTMENT OBJECTIVES AND STRATEGY**

The Partnership intends to achieve its investment objectives by investing in flow-through shares of its wholly owned subsidiary, WCSB Oil & Gas 2010 Corp. ("WCSB Corp."). WCSB Corp. was incorporated on January 20, 2010, with the sole purpose of entering into one or more joint ventures with established oil and gas companies, the terms of which will provide the WCSB Corp. with a gross overriding royalty. The objectives of each joint venture will be to achieve a gross overriding royalty from all production (if any) earned from each program and to satisfy the investment objectives outlined in the prospectus.

The Partnership intends to maximize returns and tax deductions for investors through the application of intensive fundamental and technical analysis, both at the company and industry level in selecting joint ventures with oil and gas companies that: (i) have proven, experienced and reputable management teams with a defined track record of

growing production and generating shareholder value – through the drill bit; (ii) have in place attractive and preferably multi-zone potential assets with well defined low to medium risk development and in the opinion of the General Partner represent lower risk exploration programs; (iii) have readily available processing and pipeline infrastructures in place or the necessary capital available and the commitment to develop all required infrastructure on a timely basis; (iv) offer Joint Venture terms that, in the opinion of the General Partner, represent good value and the potential for income distributions and attractive capital appreciation; and (v) meet certain other criteria set out in the investment guidelines of the Partnership.

The Partnership has invested in programs with limited exposure to higher risk exploration programs. Target areas predominantly include “drill ready development prospects” and suspected bypassed hydrocarbons situated in active production areas with existing infrastructure.

## RESULTS OF OPERATIONS

The Partnership commenced operations on January 22, 2010 and, as at September 30, 2011, had royalty interests in 27 oil and natural gas wells for \$18,386,909. As at September 30, 2011, 23 wells were producing, 1 well was shut-in, 2 wells were temporarily off production and 2 wells were ready to spud or were drilling (September 30, 2010 – invested in 21 wells and 6 wells were producing).

## SELECTED INFORMATION

The following table sets forth certain information of the Partnership for the initial seven quarters of operations.

	Sep. 30, 2011	Jun. 30, 2011	Mar. 31, 2011	Dec. 31, 2010	Sep. 30, 2010	Jun. 30, 2010	Mar. 31, 2010
<b>Production Royalties</b>							
Barrels of oil equivalent (Boe/d)	189.40	200.80	297.16	216.10	149.98	39.13	-
<b>Financial</b>							
Royalty revenue	888,839	947,926	1,207,719	963,832	692,720	233,332	-
Funds from (used by) operations	576,219	482,918	891,682	(61,483)	204,231	(417,912)	317,901
Per unit – basic and fully diluted	2.66	2.23	4.11	(0.29)	0.94	(1.93)	1.47
Net earnings (loss)	(683,976)	(181,121)	(182,969)	(716,939)	(261,741)	(132,708)	(84,037)
Loss per unit – basic and fully diluted	(3.15)	(0.84)	(0.84)	(3.39)	(1.21)	(0.61)	(0.39)
		<b>For the three months ended September 30, 2011</b>	<b>For the three months ended September 30, 2010</b>	<b>For the nine months ended September 30, 2011</b>	<b>For the nine months ended September 30, 2010</b>	<b>For the period ended December 31, 2010</b>	
<b>Consolidated Statement of Operations</b>							
Net loss for the period		(683,976)	(261,741)	(1,048,066)	(478,485)	(1,195,425)	
Basic and fully diluted loss per unit		(3.15)	(1.21)	(4.83)	(2.21)	(5.60)	
Weighted average basic and fully diluted units		216,876	216,876	216,876	216,876	213,217	
<b>Consolidated Statement of Cash Flows</b>							
Funds flow from (used in) Operations		576,219	204,231	1,950,819	123,620	42,737	
Cash distributions		474,958	162,707	1,515,963	162,707	416,452	
Cash distributions per unit		2.19	0.75	6.99	0.75	1.92	

	As at September 30, 2011	As at September 30, 2010	As at December 31, 2010
<b>Consolidated Balance Sheet</b>			
Royalty interests	13,939,699	12,920,737	15,182,784
Total Assets	15,149,067	19,255,302	19,227,087

	For the three months ended September 30, 2011	For the three months ended September 30, 2010	For the nine months ended September 30, 2011	For the nine months ended September 30, 2010	For the period ended December 31, 2010
<b>Royalty Income</b>					
Royalty income	888,839	692,720	3,044,484	926,042	1,889,884
Per Boe	51.00	66.21	48.43	66.21	48.65
<b>Depletion</b>					
Depletion	898,892	664,967	3,000,601	827,838	1,964,643
Per Boe	51.58	45.73	47.74	45.73	50.58
<b>Other Expenses:</b>					
General and administrative expenses	79,203	7,907	216,655	42,467	236,541
Management fees	121,451	121,451	364,352	299,581	421,031
Professional fees	21,222	5,600	41,318	17,276	43,800
Registrar and transfer agent	1,593	1,341	4,587	3,674	4,937
Software licensing	6,478	-	18,268	-	6,090
Royalties	88,884	69,272	304,449	92,604	188,988

## FINANCIAL POSITION, LIQUIDITY AND CAPITAL RESOURCES

The Partnership completed its initial public offering on February 26, 2010, issuing 216,876 units at \$100 per unit for gross proceeds of \$21,687,600. The net proceeds to the Partnership were \$19,589,301, after deducting agents' commissions of \$1,463,913 and expenses of \$634,386. As at September 30, 2011, the Partnership had \$745,509 in cash for general and operating expenses. As at September 30, 2011 the Partnership has fulfilled all remaining flow-through share commitments.

## ASSET RETIREMENT OBLIGATIONS

As at September 30, 2011 the Partnership had no asset retirement obligations.

## RELATED PARTY TRANSACTIONS

The General Partner is entitled to an annual management fee of 2.0% of the gross proceeds of the initial public offering, calculated and payable monthly, which totalled \$364,352 for the period ended September 30, 2011 (September 30, 2010 - \$299,581). The General Partner was paid \$157,500 for administrative services which is included in general and administrative expense (September 30, 2010 - \$6,300). The General Partner will also be entitled to a performance bonus of 20% of all distributions made by the Partnership once limited partners have received, in total, cumulative distributions equal to 100% of their aggregate capital contribution to the Partnership. No royalties or performance bonus was paid or payable to the General Partner for the period ended September 30, 2011.

Pursuant to the LPA, the Partnership has granted the General Partner a General Partner's Share, which entitles the General Partner to a 10% share of WCSB Corp.'s gross over-riding royalty and also entitles the General Partner to 10% of the consideration received by WCSB Corp. on divestiture of assets. The royalty totalled \$304,449 for the period ended September 30, 2011 (September 30, 2010 - \$92,604).

## **FINANCIAL INSTRUMENTS AND RISK MANAGEMENT**

The Partnership is engaged in the business of participating in the drilling, completing and managing oil and natural gas wells to earn royalties. The Partnership is exposed to a variety of financial risks, including commodity price risk, foreign exchange risk, credit risk and liquidity risk. The Board of Directors has overall responsibility for identifying the principal risks of the Partnership and ensuring policies and procedures are in place to appropriately manage these risks.

### **Fair values**

Fair value represents the price at which a financial instrument could be exchanged in an orderly market, in an arm's length transaction between knowledgeable and willing parties who are under no compulsion to act. The Partnership classifies the fair value of the financial instruments according to a hierarchy based on the amount of observable inputs used to value the instrument.

### **Financial risks**

The Partnership's activities expose it to a variety of financial risks: credit risk, liquidity risk and market risk (currency fluctuations, interest rates and commodity prices). The Partnership's overall risk management program focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the Partnership's financial performance.

### **Credit Risk**

Credit risk is the risk of financial loss to the Partnership if an investor or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from cash, and cash equivalents trade and other receivable. The maximum credit risk exposure is \$1,514,600 (December 31, 2010 - \$3,117,371). The receivables are due from a small number of oil & gas companies and were received subsequent to period end. The Partnership believes the credit risk associated with the cash and cash equivalents is limited due to the credit quality of the financial institution where the funds are held.

### **Liquidity risk**

Liquidity risk is the risk that the Partnership will not be able to meet its obligations as they are due. The Partnership prepares an annual budget and updates forecasts for operating, financing and investing activities on an ongoing basis to ensure it will have sufficient liquidity to meet its liabilities when due. The Partnership has sufficient cash to fund its obligations as they become due under normal operating conditions. All of the Partnership's financial liabilities are due within 12 months.

### **Market risk**

Market risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: currency risk, interest rate risk and other price risk. The Partnership is exposed to market risks resulting from fluctuations in foreign exchange rates, commodity prices and interest rates in the normal course of operations.

### **Foreign exchange risk**

Foreign currency exchange rate risk is the risk that the fair value of future cash flows will fluctuate as a result of changes in foreign exchange rates. While all of the Partnership's sales are denominated in Canadian dollars, the market prices in Canada for oil and natural gas are impacted by changes in the exchange rate between the Canadian and United States dollar. A strengthening Canadian dollar compared to the United States dollar negatively impacts the Partnership. The Partnership had no forward exchange contracts in place as at September 30, 2011.

**Commodity price risk**

Commodity price risk is the risk that the fair value of future cash flows will fluctuate as a result of changes in commodity prices. Commodity prices for oil and natural gas are impacted not only by the relationship between the Canadian and United States dollar, as mentioned above, but also world economic events that dictate the levels of supply and demand. There were no financial instruments in place to manage commodity prices during the period ended September 30, 2011.

**Interest rate risk**

Interest rate risk is the risk that the fair value of future cash flows will fluctuate as a result of changes in market interest rates. The Partnership is exposed to interest rate risk on its cash and cash equivalents that have a floating interest rate. The Partnership had no interest rate swaps or hedges as at September 30, 2011.

**CAPITAL MANAGEMENT**

The Partnership considers partners' interests as the component of capital to be managed. The Partnership's main objective when managing capital is to execute on its capital investment program to provide a reasonable return for Limited Partners while ensuring capital protection. The Partnership monitors expenditures as required to ensure capital is successfully deployed based on general industry conditions.

The Partnership is not exposed to externally imposed capital requirements. The Partnership has sufficient capital resources to carry out its exploration and development plans and operations in the coming year.

**INTERNAL CONTROLS OVER FINANCIAL REPORTING**

The Chief Executive Officer and Chief Financial Officer of the Partnership are responsible for designing internal controls over financial reporting or causing them to be designed under their supervision in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS. We have assessed the design of our internal control over financial reporting and during this process we have identified certain weaknesses in internal controls over financial reporting which are as follows:

- Due to a limited number of staff at the Partnership, it is not possible to achieve complete segregation of duties; and
- Due to the size of the Partnership and the limited number of staff, the Partnership does not have the technical accounting expertise and knowledge to address all complex and non-routine accounting transactions that may arise.

These weaknesses in the Partnership's internal controls over financial reporting result in a remote likelihood that a material misstatement would not be prevented or detected. Management and the Board of Directors work to mitigate the risk of material misstatement in financial reporting. In addition, when complex accounting and technical issues arise during preparation of the quarterly, financial statements outside consulting expertise is engaged. In spite of management's best efforts, there can be no such assurance that this risk can be reduced to a remote likelihood of material misstatement.

**DISCLOSURE CONTROLS AND PROCEDURES**

Disclosure controls and procedures have been designed to ensure that the information required to be disclosed by the Partnership is accumulated and communicated to management as appropriate to allow timely decisions regarding required disclosure. The Partnership's Chief Executive Officer and Chief Financial Officer have concluded, based on their evaluation as of September 30, 2011, that the Partnership's disclosure controls and procedures are effective to provide reasonable assurance that material information related to the Partnership, is made known to them by others within the entity. It should be noted that while the Chief Executive Officer and Chief Financial Officer

believe that disclosure controls and procedures provide a reasonable level of assurance and that they are effective, they do not expect that the disclosure controls and procedures will prevent all errors and fraud. A control system, no matter how well conceived or operated, can only provide reasonable, not absolute, assurance that the objectives of the control system are met.

## **EXPLANATION OF TRANSITION TO IFRS**

The condensed interim financial statements for the period ended September 30, 2011 are the Partnership's third consolidated financial statements prepared under IFRS. For all accounting periods prior to this, the Partnership prepared its consolidated financial statements under Canadian GAAP. In accordance with IFRS 1 'First time adoption of IFRS', certain disclosures relating to the transition to IFRS are given in this note. These disclosures are prepared under IFRS as set out in the basis of preparation in Note 3.

IFRS 1 allows first time adopters to IFRS to take advantage of a number of voluntary exemptions from the general principal of retrospective restatement. The Partnership has taken the following exemptions:

### **IFRS 6 - Exploration for and Evaluation of Mineral Resources**

The Partnership has elected to apply the exemption from full retrospective application of IFRS 6. As such the Partnership has at January 1, 2010, measured the exploration and evaluation assets at the amount determined under Canadian GAAP and measured the development and production assets by allocating the amount determined under Canadian GAAP to the underlying assets on a pro rata basis using reserve values at that date. As a result of using the IFRS 1 optional exemption, the exploration and evaluation assets and the development and production assets have been subjected to an impairment test.

## **RECENT ACCOUNTING PRONOUNCEMENTS**

Certain new standards, interpretations, amendments and improvements to existing standards were issued by the IASB or International Financial Reporting Interpretations Committee ("IFRIC") that are mandatory for accounting periods beginning after January 1, 2010 or later periods. The standards impacted that are applicable to the Partnership are as follows:

- a) IFRS 9, 'Financial Instruments' was issued in November 2009 as the first step in its project to replace IAS 39 'Financial Instruments: Recognition and Measurement'. IFRS 9 introduces new requirements for classifying and measuring financial assets that must be applied starting January 1, 2013, with early adoption permitted. The IASB intends to expand IFRS 9 during the intervening period to add new requirements for classifying and measuring financial liabilities, de-recognition of financial instruments, impairment and hedge accounting. The Partnership is currently assessing the impact of this standard.
- b) IFRS 10, 'Consolidated Financial Statements' was issued in May 2011 and will supersede the consolidation requirements in SIC-12 'Consolidation – Special Purpose Entities' and IAS 27 'Consolidated and Separate Financial Statements' effective for annual periods beginning on or after January 1, 2013, with early application permitted. IFRS 10 builds on existing principles by identifying the concept of control as the determining factor in whether an entity should be included within the consolidated financial statements of the parent company. The standard also provides additional guidance to assist in the determination of control where this is difficult to assess. The Partnership is currently assessing the impact of this standard.
- c) IFRS 11, 'Joint Arrangements' was issued in May 2011 and will supersede existing IAS 31, 'Joint Ventures' effective for annual period beginning on or after January 1, 2013, with early application permitted. IFRS 11 provides for the accounting of joint arrangements by focusing on the rights and obligations of the arrangement, rather than its legal form (as is currently the case). The standard also eliminates the option to account for jointly controlled entities using the proportionate consolidation method. The Partnership is currently assessing the impact of this standard.
- d) IFRS 12, 'Disclosure of Interests in Other Entities' was issued in May 2011 and is a new and comprehensive standard on disclosure requirements for all forms of interests in other entities, including subsidiaries, joint arrangements, associates and unconsolidated structured entities. IFRS 12 is effective for annual periods beginning on or after January 1, 2013, with earlier application permitted. The Partnership is currently assessing the impact of this standard.

- e) IFRS 13, 'Fair Value Measurement' was issued in May 2011 and sets out in a single IFRS a framework for measuring fair value. IFRS 13 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This definition of fair value emphasizes that fair value is a market-based measurement, not an entity-specific measurement. In addition, IFRS 13 also requires specific disclosures about fair value measurement. IFRS 13 is effective for annual periods beginning on or after January 1, 2013, with earlier application permitted. The Partnership is currently assessing the impact of this standard.



*For further information on the Partnership  
please visit [www.wcsb.ca](http://www.wcsb.ca)*

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