

## Exploring and Servicing Onshore Brazil

Management Discussion and Analysis  
Three Months Ended September 30, 2008

December 1, 2008

## CAUTIONARY NOTE

This Management's Discussion and Analysis ("MD&A") of financial results and related data is reported in Canadian dollars, has been prepared in accordance with Canadian Generally Accepted Accounting Principles ("GAAP"), and should be read in conjunction with interim financial statements for the months ended September 30, 2008 as well as the audited consolidated financial statements for the year ended June 30, 2008 and the respective notes thereto. Additional information relating to the Corporation is on SEDAR at [www.sedar.com](http://www.sedar.com) or on the Corporation's web site at [www.brazalta.com](http://www.brazalta.com).

Information provided herein in respect of barrels of oil equivalent ("boe") may be misleading, particularly if used in isolation. A boe conversion ratio of 6 Mcf: 1 bbl is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.

Certain information set forth in this document contains forward-looking statements. All statements other than historical fact contained herein are forward-looking statements, including, without limitation, statements regarding the future financial position, business strategy, production rates and plans and objectives of or involving the Corporation. By their nature, forward-looking statements are subject to numerous risks and uncertainties, some of which are beyond the Corporation's control, including the impact of general economic conditions, industry conditions, governmental regulation, volatility of commodity prices, currency fluctuations, imprecision of reserve estimates, environmental risks, competition from other industry participants, the lack of availability of qualified personnel or management, stock market volatility and ability to access sufficient capital from internal and external sources. In particular to forward-looking comments in this MD&A readers are cautioned that there can be no assurance that: the Corporation will fully realize all the expected revenue on Petrobras drilling contracts expected; the Corporation will be able to increase production in Brazil and achieve expected variable cost efficiencies and an overall reduction of costs on a per barrel basis; that hydrocarbon based royalties assessed by the Brazilian government will remain the same and will continue to be applied on a sliding scale basis downward as production increases on any one block; or the Corporation will be successful in streamlining and reducing costs in the drilling services subsidiary resulting in reduced operating losses and future potential profits. Readers are also 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. The Corporation's actual results, performance or achievement could differ materially from those expressed in, or implied by, these forward-looking statements and, accordingly, no assurance can be given that any of the events anticipated by the forward-looking statements will transpire or occur, or if any of them do so, what benefits the Corporation will derive there from. Readers are further cautioned not to place undue reliance on any forward-looking information. Unless otherwise stated, amounts presented in this MD&A are in thousands of Canadian dollars (unaudited).

As At and For the Three Ended	Three Months Ended September 30,			
	2008		2007	
<b>FINANCIAL RESULTS</b>				
<i>(\$000s), except share data</i>				
Petroleum and natural gas sales, net				
Brazil	1,313		806	
Canada	37		56	
	<u>1,350</u>		<u>862</u>	
Drilling services revenue	9,089		1,003	
Interest and other	33		122	
	<u>10,472</u>		<u>1,987</u>	
Cash used in operating activities	(839)		(1,024)	
Per share - basic and diluted	(0.01)		(0.01)	
Net loss	(7,188)		(2,722)	
Per share - basic and diluted	0.08		(0.03)	
Capital expenditures				
Brazil	1,746		4,772	
Canada	(675)		91	
Northern Ireland	31		-	
Brazil drilling services	1,015		18,800	
	<u>2,117</u>		<u>23,663</u>	
Total assets	116,056		61,754	
Total long-term liabilities	51,482		15,668	
Weighted average shares outstanding				
Basic and diluted (000s)	90,085		79,575	
<b>OPERATING RESULTS</b>				
	Three Months Ended September 30,			
	2008		2007	
Production	<u>Brazil</u>	<u>Canada</u>	<u>Brazil</u>	<u>Canada</u>
Crude oil and NGLs (bbl/d)	141	1	132	1
Natural gas (mcf/d)	-	34	-	125
Total (boe per day)	141	7	132	22
Average prices				
Crude oil (\$/bbl)	120.90		78.70	
Oil equivalent (\$/boe)	120.90	64.14	78.70	43.48
Operating netback (\$/boe)				
Commodity revenue	120.90	64.14	78.70	43.48
Non-refundable sales taxes	(9.98)	-	(6.88)	-
Realized loss on financial derivatives	(21.83)	-	(0.52)	-
Royalties	(9.82)	(6.85)	(5.13)	(14.68)
Transportation & processing	(13.03)	-	(13.00)	-
Well workover & repair	(1.64)	-	(7.43)	-
MEP work unit provision	(4.38)	-	-	-
Operating expenses	(32.19)	(18.08)	(31.68)	(16.28)
Netback <sup>(1)</sup>	28.03	39.21	14.06	12.52

<sup>(1)</sup> "Netback" per boe is calculated as revenues net of sales taxes and royalties, less transportation & processing charges, well workover and repair, operating expenses and then divided by boe produced. Netbacks do not have a standard meaning prescribed by GAAP and therefore may not be comparable to similar measures used by other companies. Management feels this is a useful metric as it is a common metric used by other companies operating in the oil and gas industry.



### HIGHLIGHTS FROM FQ1-2009

- On August 25, 2008 BrazAlta entered into a definitive amalgamation agreement for the arm's length acquisition of all of the issued and outstanding common shares and warrants of a private oil and gas exploration company, Canacol Energy Inc. ("Canacol") (the "Transaction"). The agreed aggregate consideration for all of the Canacol common shares and warrants is a total of 40,000,000 common shares in the capital of BrazAlta. Subsequent to the end of the quarter, on October 30, 2008, the Transaction was successfully completed.
- On August 29, 2008, BrazAlta in conjunction with Canacol, closed the acquisition of a private Colombian exploration and production company, Rancho Hermoso S.A. for gross proceeds of US\$28,600.
- On August 29, 2008, a debt facility was jointly put in place by BrazAlta and Canacol in order to finance the acquisition of Rancho Hermoso S.A. by Canacol. BrazAlta (through a subsidiary) and Canacol jointly borrowed from Standard Bank Plc. ("Standard Bank"), the sum of US\$25,600 as co-borrowers. The Standard Bank Loan comprises two credit facilities:
  - 1) a US\$50,000 three year senior secured borrowing base revolving credit facility with an initial availability of US\$14,000; and
  - 2) a US\$11,600 mezzanine facility.

The security package and terms for the Standard Bank Loan comprises a lien on the shares of Rancho Hermoso S.A.; a guarantee from each of BrazAlta and Canacol; and a hedge of a percentage of Rancho Hermoso S.A. production. In addition, BrazAlta has issued to Standard Bank Plc., warrants to acquire 10,000,000 BrazAlta Common Shares at a price of C\$0.80 per BrazAlta Common Share for a period of five years, and has cancelled the 3,500,000 US\$2.00 warrants issued to Standard Bank Plc. last year as part of a Brazilian reserves based credit facility financing.

- Brazilian net production to the Corporation averaged 141 bbl/day down from 159 bbl/day from Q4-F2008 for a decrease of 18 bbl/day. Production during Q1-F2008 was a 132 bbl/day. The quarter-over-quarter decline is attributable a general decline in production volumes. The year-over-year increase of 9 bbl/day from average daily production of 132 bbl/day in Q1-F2008 is a result of production increases from the F2008 drilling program in Q2-F2008 offset by general declines in production volumes. Canadian net production averaged 7 boe/day which was down from average Q4-F2008 production of 11 boe/day and 22 boe/day during Q1-F2008 as a result of a continued decline in Canadian production.
- On October 1, 2008, BCH Ltd. was authorized to complete a non-brokered private placement of 4,474,999 BCH Common Shares at a price of US\$4.163 per BCH Common Share for aggregate gross proceeds of US\$18,629. On October 1, 2008, BrazAlta acquired 1,717,093 BCH Common Shares for consideration of US\$7,148 in conversion of loans receivable from BCH. In addition, BrazAlta has a share subscription payable to BCH of US\$2,353 relating to the purchase of an additional 565,156 shares. At the time of this document, these additional shares had not yet been purchased by or issued to BrazAlta. On October 1, 2008, Allis-Chalmers Energy Inc. acquired 2,192,750 BCH Common Shares in the financing for consideration of US\$3,500 in conversion of accrued interest payable on the Debenture and cash proceeds of US\$5,628. Following the completion of the first portion of the financing, BCH will have 13,909,843 BCH Common

Shares issued and outstanding of which BrazAlta will own 11,717,093 BCH Common Shares or 84.2%.

- On September 3, 2008, BrazAlta entered in a farm-in agreement with Benchmark Energy Corp. (“Benchmark”) whereby Benchmark can earn a 60% interest in BrazAlta’s Espirito Santo Blocks 318, 362, and 380 by funding 100% of an 83-km 2D seismic shoot. The estimated cost of the 2D seismic shoot is approximately US\$1,700.
- The Corporation completed its Round 7 drilling program. A total of 6 wells (net 1.4) were drilled of which 4 (0.95 net) were deemed un-commercial and were abandoned and 2 (0.48 net) were cased. The 2 (0.48 net) wells which were cased have yet to be completed as of the date of this document.

### *SUBSEQUENT EVENTS DURING Q2-F2009*

#### **Acquisition of Canacol Energy Inc.**

Subsequent to the end of the quarter, on October 30, 2008, the acquisition of Canacol Energy Inc. was successfully completed. A total of 40,000,000 shares of BrazAlta were issued for all of the outstanding shares and warrants of Canacol.

### **COMPANY OVERVIEW AND OVERALL PERFORMANCE**

BrazAlta Resources Corp. (“BrazAlta” or the “Corporation”)(TSX-Venture: BRX) is a Canadian-based independent onshore oil exploration company operating in Brazil. BrazAlta is engaged in the exploration, development, and production of oil and natural gas in Brazil’s Recôncavo, Sergipe, Espirito Santo and Tucano basins. The company also maintains exploration programs in Canada and Northern Ireland. Following its acquisition of Canacol after the end of the quarter, the Corporation now has oil exploration, development, and production operations in Colombia.

BCH Ltd. (“BCH”), BrazAlta’s drilling services subsidiary, has established itself as a leading onshore provider of both drilling and service rigs in Brazil by securing several long-term contracts with Petrobras, Brazil’s state-owned petroleum company, to provide rigs and services.

#### **Brazil E&P**

Effective January 5, 2006, BrazAlta entered into a Consortium and Joint Operating Agreement (the “Agreements”) with W. Washington Empreendimentos E. Participações Ltda, who subsequently has changed its name to W. Washington Petroleo S.A. (“W. Washington”) for the creation and operation of a Brazilian domiciled joint venture entity (“Brazil Joint Venture”) to hold, explore, develop, and produce hydrocarbons in Brazil. BrazAlta holds a 47.5% interest and W. Washington holds a 52.5% interest in the Brazil Joint Venture and W. Washington acts as the operator in Brazil.

BrazAlta’s E&P operations are primarily engaged in the exploration, development, and production of oil and gas in the Recôncavo, Sergipe, Espirito Santo, and Tucano basins of Brazil. BrazAlta has a platform of basic infrastructure to position the Corporation for growth.

BrazAlta holds a 47.5% working interest and W. Washington holds a 52.5% interest in the four main production concessions in Recôncavo, from which over 90% of BrazAlta’s current production is attributed to. The concession contracts were originally awarded to W. Washington by the Agência Nacional do Petróleo, Gás Natural e Biocombustível (“ANP”), Brazil’s national regulator, and BrazAlta subsequently registered its 47.5% interest on these contracts directly with the ANP. Rights to produce hydrocarbons on these four producing blocks run until 2025. As operator W. Washington sells all of the produced oil to Petrobras in Recôncavo at prices based on North Sea Brent less costs for transportation and processing. Payment for all oil revenues is made in Brazilian Real.

To date, the bulk of the E&P activity has been undertaken by BrazAlta in the Recôncavo and Sergipe basins and has been higher risk and exploratory in nature with minimal success achieved which has resulted in no appreciable increase in oil production or significant addition of reserves.

## Colombia E&P

Following its acquisition of Canacol, BrazAlta now has oil exploration, development, and production operations in countries of Colombia and Guyana. The assets in Colombia include the Rancho Hermoso and Entrerrios oil fields, and the La Sierra and Ombu exploration contracts. The two oil fields, which BrazAlta will operate, are located in the Llanos Basin and produce approximately 3,000 barrels of oil per day on a gross basis. The Corporation has plans to drill three development wells and workover three of the existing producing wells in 2009 of which 330 barrels oil per day are produced on a net basis, and approximately 1,500 barrels oil per day are produced on a tariff basis whereby the company receives a price of approximately US\$9 per barrel. The tariff rate increases through a series of steps to approximately US\$18 per barrel in 2012. The Corporation will also operate the La Sierra E&P contract located in the Middle Magdalena Basin, where it plans to drill two exploration wells in 2009. In addition, the Corporation has a non-operated working interest in the Ombu E&P contract, located in the Putumayo Basin, and recently participated in the drilling of the Capella heavy oil discovery. The company plans to participate in up to seven additional appraisal wells and a 3D seismic survey on the Capella discovery in 2009.

In addition to Colombia, in Guyana, the Corporation will have a 55% non-operated working interest in a large onshore exploration contract in which the Corporation plans to participate in the drilling of two exploration wells in 2009.

## Canada E&P

Operations in Canada are considered to be non-core, but provide cash flow to BrazAlta to offset a portion of G&A costs within Canada. Canadian properties are non-operated and at September 30, 2008 include: three natural gas wells (0.70 net) located in Sylvan Lake, Alberta, and royalty income from six oil wells in the Lochend area of Alberta.

## Ireland E&P

Exploration in Ireland is considered to be non-core and high risk and includes oil and natural gas exploration and the potential for development of salt cavern gas storage.

## Brazil Oilfield Services

In addition to the oil and gas exploration and development operations, the Corporation diversified its cash flow and strategic operations in fiscal 2007 through the incorporation BCH Ltd. and its wholly owned subsidiary, BCH Energy do Brasil Serviços de Petróleo Ltda (“BCH Ltda.”) a Brazil-based drilling services subsidiary. The principal undertaking of BCH is to engage in the oilfield services business in Brazil, which has ensured access to quality and timely oilfield services for the BrazAlta’s E&P activities while also providing revenue diversification through services provided to third party customers. In April 2007, BCH established itself as a leading onshore provider of both drilling and service rigs in Brazil by securing four multi-year contracts with Petrobras, Brazil’s state-owned petroleum company, to provide drilling rigs and services. The initial term on two of the contracts is for two years and the initial term on the other two contracts is for three years. The rigs that were designated to service these contracts were acquired, and exported to Brazil and put into use throughout 2008. During 2008 a fifth, three year contract with Petrobras was added and a sixth one-year contract was added bringing the total number of contracted drilling rigs with Petrobras to six. The term of each contract begins on its respective on-site rig commissioning date. In aggregate over their respective initial terms, the six Petrobras contracts, excluding renewal options, are expected to generate gross revenues of more than US\$105 million. To date, costs from BCH operations have exceeded revenues due in part to higher than expected costs and delays in the commissioning of rigs. The Corporation is currently focusing on reducing costs in BCH’s operations.

## FINANCIAL HIGHLIGHTS

Unless otherwise stated, amounts presented in this MD&A are in thousands of Canadian dollars (unaudited).

Quarterly Information (\$000s, except production data)	2009		2008			2007			2006			
	Q1	Q4	Q3	Q2	Q1	Q4 <sup>(2)</sup>	Q3 <sup>(2)</sup>	Q2 <sup>(2)</sup>	Q1 <sup>(2)</sup>	Q4	Q3	Q2 <sup>(3)</sup>
Petroleum and natural gas sales												
Brazil <sup>(2)</sup>	1,313	1,515	1,487	992	806	728	889	689	850	857	299	-
Canada	37	33	8	42	56	122	81	70	11	(17)	86	127
	1,350	1,549	1,495	1,034	862	850	970	759	861	840	385	127
Drilling services revenue	9,089	9,702	7,003	5,257	1,003	1,818	642	604	121	-	-	-
Total operating revenue	10,439	11,251	8,498	6,291	1,865	2,668	1,612	1,363	982	840	385	127
Total production (boe)	13,637	15,146	18,543	14,932	14,128	14,001	16,562	13,746	12,505	12,535	5,679	502
Drilling services activity days	529	464	287	284	109	120	36	70	16	-	-	-
Cash used in (from) operating activities	841	(48)	1,539	4,247	1,024	1,755	1,836	735	940	1,015	596	508
Per share <sup>(1)</sup>	0.01	(0.00)	0.02	0.05	0.01	0.03	0.03	0.01	0.02	0.00	0.01	0.03
Net loss	7,188	8,479	5,652	728	2,722	3,359	2,240	1,300	1,074	748	1,668	405
Per share <sup>(1)</sup>	0.08	0.09	0.06	0.01	0.03	0.05	0.04	0.02	0.02	0.02	0.04	0.03

<sup>(1)</sup> Per share amounts are basic and diluted.

<sup>(2)</sup> Certain of the prior year figures have been reclassified to conform with the current year's presentation. Transportation and processing charges were historically presented net of revenue.

<sup>(3)</sup> Brazil operations commenced March 1, 2006.

Total operating revenue for Q1-F2009 was \$10,439 (Q1-F2008 - \$1,865) for an increase of \$8,574 or 459% compared to Q1-F2008. Of this increase, \$8,086 relates to BCH while \$488 of the increase relates to the Corporation's E&P operations. The year-over-year increase in BCH's operating revenues is a result of the increased size and increase utilization of the Corporation's drilling fleet and a one time mobilization payment of US\$277 for BCH 06 which in Q1-F2009 commenced a one year contract. The year-over-year increase in operating revenues relating to the Corporation's E&P operations is a result of higher production volumes from its Brazilian properties and higher average prices achieved on those production volumes.

During Q1-F2009, total funds used in operations was \$841 (Q1-F2008 - \$1,024). The year-over-year increase primarily reflects the larger net loss during the period of \$7,188 (Q1-F2008 - \$2,722), net of non-cash items of \$3,999 (Q1-F2008 - \$17), and a net inflow of operating working capital of \$1,682 (Q1-F2008 - inflow \$1,862).

## SUMMARY OF RESULTS

### Petroleum and Natural Gas Sales (Net of Royalties)

Revenue for the three months ended September 30, 2008, totalled \$1,350 (Q1-F2008 - \$862), an increase of \$488 or 56.6% on a year-over-year basis. The increase is due to a combination of higher production volumes on a year-over-year basis and higher prices achieved on those volumes during the quarter. Production volumes during Q1-F2009 totalled 12,987 bbls (141 bbl/day) (Q1-F2008 - 12,163 bbls (132 bbl/day)), a 6.8% increase, of light oil from properties in Brazil and 650 boe (7 boe/day) (Q1-F2008 - 1,965 boe (21 boe/day)), a 67% decline, consisting of oil, natural gas, and natural gas liquids in Alberta. The year-over-year production increase was the result of the 3 (1.4 net) wells drilled during F2008 being on production. The average price achieved per bbl in Brazil in Q1-F2009 was \$120.90/bbl compared to \$125.73/bbl during Q4-F2008 and \$78.70/bbl Q1-F2008.

Production (boe)	Three Months Ended September 30,	
	2008	2007
Brazil	12,987	12,163
Canada	650	1,965
Total	13,637	14,128

Royalties as a percentage of gross petroleum and natural gas revenues by geographic region for the three month period ended September 30, 2008 and respective prior period comparable are shown in the table below. The current base royalty regime in Brazil is between 5% and 11% of gross production revenue. The actual rate the Corporation achieved in Q1-F2009 in Brazil was 8.1% compared to 6.5% in Q1-F2008. Royalty rates are based on a sliding scale down on incremental production over and above certain production thresholds on a block by block basis. Therefore, if aggregate production on any one block increases above the contracted thresholds the royalty on that block should decline over time.

Royalties		
	Three Months Ended September 30,	
	2008	2007
Brazil	8.1%	6.5%
Canada	10.7%	33.8%

Brazil oil sales are subject to non-refundable sales taxes which totalled \$130 during Q1-F2009 (Q1-F2008 - \$89). This has been recorded and netted against revenue for the three month period ended September 30, 2008.

#### Drilling Services Revenue

During Q1-F2009, total drilling services segment revenue, before inter-company consolidation eliminations, was \$9,869 (Q1-F2008 - \$2,337), a year-over-year increase of 322%. The drilling services unit generated net third party revenue of \$9,825 during Q1-F2009 (Q1-F2008 - \$1,343).

During Q1-F2009, one-time mobilization revenue of US\$277 (Q1-F2008 - \$Nil) was recorded relating to the mobilization of BCH-06 to begin a one year contract. The average active rig count for Q1-F2009 totalled 6.1 as compared to 5.7 in Q4-F2008 and only 2.0 in Q1-F2008 resulting in an increase in active rig days (defined as drilling and moving days) to 529 in Q4-F2008 up from 464 in Q4-F2008 (NB: active rig days are gross and have not been adjusted for inter-company transactions). The year-over-year increases are attributable to increased activity days as a result of the fleet and reduced intercompany activity. External third party revenue was significantly higher as percentage of overall drilling revenue as a result of greater amount of drilling and work-over services were being performed for third parties which are not subject to inter-company elimination.

BCH had an average of 6.1 rigs available for use during Q1-F2009 compared to 5.7 rigs during Q4-F2008 and 2.0 rigs during Q1-F2008. Gross activity days before consolidation adjustment in the current quarter totalled 529 compared to 464 days during Q4-F2008 and 109 days during Q1-F2008.

Drilling Services Revenue		
	Three Months Ended September 30,	
(\$000s)	2008	2007
Drilling services segment revenue	9,869	2,337
Less: Inter-segment sales <sup>(1)</sup>	(44)	(994)
Less: Sales taxes	(736)	(340)
Drilling services revenue	9,089	1,003

<sup>(1)</sup> Inter-segment revenue and profit have been netted against exploration and production capital expenditures on consolidation.

In July 2008, BCH 05 incurred an accident in which the rig's derrick collapsed as a result of structural failure. The accident caused damage to both the derrick and certain supporting buildings. It is expected the repair cost will be approximately US\$2,500 and that the repair cost will be fully funded by insurance proceeds. Total lost revenue days as a result of the accident are expected to total 175 days which represents gross receipts of approximately US\$4,600 being foregone during the period. It is expected that BCH-05 will resume operations late in Q2-F2009.

#### Interest and Other Income

During Q1-F2009 interest and other income of \$33 (Q1-F2008 - \$122) was recorded. The respective year-over-year decline is primarily attributable to lower average cash balances through the quarter and lower overall interest rates earned on those cash balances.

#### Operating Expenses and Netback - Petroleum and Natural Gas

During Q1-F2009 overall operating expense totalled \$677 (Q1-F2008 - \$659). For a year-over-year increase of \$18 or 3%. Details by operating segment are outlined in the table below. In Brazil, BrazAlta maintains a platform for growth and recognizes that its current production levels result in its operating costs not yet realizing the benefit of economies of scale. Approximately one-third of operating costs represents fixed costs that are expected to be scalable to approximately 2,000-3,000 gross boe/day. Therefore, if the company experiences future increases in production it is expected the operating expense per boe will be reduced from current levels.

Operating Expenses		
	Three Months Ended	
	September 30,	
(\$000s)	2008	2007
Operating expenses		
Brazil <sup>(1)</sup>	418	379
Canada	12	32
	<u>430</u>	<u>411</u>
Transportation & processing charges	169	158
Brazil well workover & repair	21	90
MEP work unit provision	57	-
	<u>676</u>	<u>659</u>
Operating expenses per boe		
Brazil <sup>(1)</sup>	32.19	31.16
Canada	18.08	16.28
Weighted Average	<u>31.51</u>	<u>29.09</u>

<sup>(1)</sup> Expenditures related to the planned non-routine enhancement workover program undertaken during the year are presented separately and excluded from the calculation of ongoing operating costs. Transportation and processing charges and MEP work unit provision are also shown separately.

#### Operating Expenses and Operating Margin - Drilling Services

The drilling services segment is approaching self sufficiency within its operational cash flows as rigs finalize commissioning onto long-term contracts. During Q1-F2009, operating rigs achieved a utilization rates (total operating and moving days) of 95% compared to 89% in Q4-F2008 and 59% in Q1-F2008.

Drilling services operating costs for the quarter totalled \$7,474 compared to \$7,370 in Q4-F2008 and were (Q1-F2008 - \$1,758). The increase over prior year is a result of the increased size of the drilling fleet and corresponding operations compared to prior year. Operating margin for Q1-F2009 was \$1,615 or 17.8% as compared to (Q1-F2008 - operating loss \$754) in the prior year.

Operating profit was negatively impacted as a result of BCH-05 being un-operational through much of the quarter and higher than expected operational costs. Management continues to seek cost reductions in BCH in order to improve overall profitability. As the BCH rig fleet begins full operations in Brazil during F2009, the Corporation expects on-going strong rig utilization rates, steady growth in rigs available for use, and improved economies of scale based on the current rig fleet and contracts.

#### **Depletion, Depreciation, and Accretion (DD&A)**

During Q1-F2009, overall corporate DD&A expense was \$2,022 (Q1-F2008 - \$491). During Q1-F2009, depreciation expense relating to the operations of BCH totalled \$1,014 (Q1-F2008 - \$154). The respective year-over-year and increases in depreciation expense relative to last year for BCH is primarily attributable to the increased size of the drilling fleet and overall increased utilization. DD&A relating to the Corporation's exploration and production activities totalled \$984 (Q1-F2008 - \$330) during the quarter. The respective increase on a quarter-over-quarter basis is a result of an increase in the amount of proven properties included in the depletion calculation and higher overall production volumes during the quarter compared to last year.

#### **General and Administrative**

During Q1-F2009, general and administrative (G&A) expenses were \$2,458 (Q1-F2008 - \$1,757). For the Q1-F2009, G&A costs related to BCH totalled \$1,078 (Q1-F2008 - \$945) while G&A costs related to the Corporation's exploration and production activities totalled \$657 (Q1-F2008 - \$268). Higher G&A costs in BCH are attributable to the year-over-year expansion of the Company's drilling fleet and the necessary administrative framework to support the expanded operations. Corporate general and administrative expense for the year totalled \$723 (Q1-F2008 - \$544). General and administrative expenses were incurred in both Canada and Brazil and primarily consist of management and advisory fees, professional fees, travel, and other administrative expenses needed to support operations. BrazAlta did not capitalize any indirect overhead costs.

#### **Interest and Financial Expenses**

During Q1-F2009, interest and financial expenses were \$3,075 (Q1-F2008 - \$402). This expense is comprised of interest on the Corporation's long-term debt facilities, convertible debenture, capital leases, and non-cash interest charges. Non-cash interest charges relate to the accretion of the deferred financing charges incurred on the Corporation's debt facilities as well as accretion of the convertible debenture. Non-cash interest charges for Q1-F2009 totalled \$817 (Q1-F2008 - \$85).

#### **Foreign Exchange**

The Corporation's activities in Brazil use the Brazilian Real (BRL) as its functional currency and therefore it is exposed to the risk of fluctuations in foreign exchange rates. The Corporation's sales purchase contract for the oil produced in Brazil is based on the US dollar but paid in Brazilian Real at the effective exchange rate on the day of the payment. The Corporation's drilling services contracts are based on a US dollar price with a portion paid in Brazilian Real and a portion of which is paid in US dollars. Both the Corporation's long-term debt facilities and its Convertible Debenture are denominated in the US dollar.

The Corporation incurred a foreign exchange loss of \$2,421 during Q1-F2009 (Q1-F2008 - gain \$983). The foreign exchange gain during the quarter is a result of the depreciation of the Canadian dollar relative to the US dollar and the corresponding impact on the Corporation's US denominated debt balances as well as the foreign exchange loss on translation as a result of the depreciation of the Brazilian Real relative to the Canadian dollar during the quarter. The Corporation entered into three currency derivatives to manage its exposure to the Brazilian Real. Refer to the Risk Factors Section below for additional details.

#### **Financial Derivatives**

During Q1-F2009, the Corporation had three financial derivatives in place. These included a Brent oil financial option collar, three foreign currency derivative contracts, and embedded derivatives associated with the Corporation's drilling contracts. The Corporation has embedded derivatives associated with several of its drilling rig contracts with its customers, whereby the revenues received from the lease portion of these

contracts is denominated in the US dollar which is neither the reporting currency of the Corporation nor the host currency of the customer. The Corporation has not designated any of these embedded derivatives as hedges and has therefore recorded the unrealized gain on these contracts on the balance sheet with changes in their fair value recorded in the net earnings for the period.

As September 30, 2008, the Corporation had a total net financial derivative liability of \$1,492 (June 30, 2008 - \$987). It was comprised of the following balances: A financial derivative liability of \$531 (June 30, 2008 - asset of \$480) relating to the Corporation's currency derivatives, a financial derivative asset of \$6 (June 30, 2008 - asset of \$21) relating to the Corporation's embedded derivative contracts, and a financial derivative liability of \$967 (June 30, 2008 - liability of \$1,488) relating to the Corporation's oil collars.

During Q1-F2009, the Corporation had a net realized financial derivative loss of \$228 (Q1-F2008 - \$6) which was comprised of the following balances: A realized financial derivative gain of \$55 (Q1-F2008 - \$Nil) relating to the Corporation's currency derivatives offset by a realized financial derivative loss of \$283 (Q1-F2008 - loss of \$6) relating to the outstanding oil collar.

### **Stock Based Compensation**

During Q1-F2009, a total of \$115 (Q1-F2008 - \$477) was expensed relating to the vesting of stock options. The year-over-year decline can be attributable to the timing of option grants during the year. Included in the above expenses in Q1-F2009 are options granted by BCH, a subsidiary of the Corporation. During Q1-F2009, a total of \$11 (Q1-F2008 - \$Nil) was recognized relating to options issued by BCH.

### **Income Taxes**

BrazAlta is subject to taxation in Canada and Brazil. The current income tax expense during Q1-F2009 was \$677 (Q1-F2008 - \$165) relating to Brazilian withholding taxes on the lease portion of BCH's drilling rig contracts paid which is paid to Canadian entity. The respective year-over-year increase is as a result of the increased revenues earned on the lease portion of BCH's drilling contracts. During Q1-F2009 future income tax recovery was \$2,003 (Q1-F2008 - recovery of \$165) resulting in net tax recovery of \$1,326 (Q1-F2008 - \$Nil). The Corporation's subsidiary, BCH recognizes a future income tax asset on the withholding tax amounts paid as the Corporation receives a business foreign tax credit in Canada related to these amounts. BCH has also recognized a future income tax asset for various timing differences arising between the book value and tax value of its capital assets. The large recovery during the quarter is primarily a result a foreign exchange losses on BCH's debt reducing BCH's taxable income. A future income tax asset is not recognized for the Corporation's remaining net-capital loss, non-capital loss, or other tax pool balances. A valuation allowance has conservatively been applied to the remainder of the future income tax assets in the entity due to the uncertainty of realization.

### **Assets Held For Sale**

As of September 30, 2008, the Corporation recorded assets held for sale of \$Nil (June 30, 2008 - \$975). The balance at June 30, 2008 relates to unused equipment that was sold by the Corporation during Q1-F2009 for net proceeds of US\$950.

## ***CASH FLOWS FROM OPERATING, FINANCING, AND INVESTING ACTIVITIES***

### **Operating**

During Q1-F2009, the cash flow deficiency from operating activities totalled \$839 (Q1-F2008 - \$1,024). BCH's operating cash flow was negatively impacted in part by BCH 05 being down during the quarter. BCH is continuing to take steps to seek cost reductions, improve efficiency, and maximize utilization of its drilling rigs.

### **Financing**

During Q1-F2009, the Corporation recorded net cash flow from financing activities of \$4,771 (Q1-F2008 - \$21,359). During Q1-F2009, the Corporation received cash proceeds of \$5,966 relating to the sale of equity in BCH to Allis Chalmers which was completed on October 1, 2008. During Q1-F2009, there was \$1,195 of debt and capital leases repayments.

## Investing

During the Q1-F2009, cash flows from investing activities totalled \$6,712 (Q1-F2008 - \$21,324). The year-over-year decline is primarily attributable to the rapid expansion of BCH undertaken during Q1-F2008.

During Q1-F2009, the Corporation incurred net \$2,117 in capital expenditures (Q1-F2008 - \$23,663). In addition, the Corporation advanced funds of \$6,598 (Q1-F2008 - \$Nil) to Canacol during the quarter. The majority of the capital spend during Q1-F2009 related to its Round 7 drilling program in Brazil in which a total of \$1,746 (Q1-F2008 - \$4,772) was incurred. In BCH, the oilfield services segment, capital expenditures during the quarter totalled \$1,015 (Q1-F2008 - \$18,800).

Other acquisition related costs of \$257, pursuant to the acquisition of Canacol were incurred during Q1-F2009 (Q1-F2008 - \$Nil). In addition, as previously disclosed, the Corporation completed its disposition of excess equipment during the quarter for proceeds of US\$950.

## *LIQUIDITY AND CAPITAL RESOURCES*

Funding for the Corporation's expenditures during the quarter was provided through a combination of operating revenue and surplus cash balances. At September 30, 2008 the Corporation had a working capital deficiency of \$21,707 (deficiency of \$3,636 excluding the reclassified portion of long-term debt) compared to (June 30, 2008 - deficiency of \$17,521 and surplus of \$1,265 respectively).

During Q1-F2009, W. Washington and BrazAlta repaid gross US\$1,900 (net US\$903) of the principal outstanding on its joint reserves based lending facility leaving an unpaid principal balance of US\$7,100 (US\$3,373 net).

During Q1-F2009, a debt facility was jointly put in place by BrazAlta and Canacol in order to finance the acquisition of Rancho Hermoso S.A. by Canacol. BrazAlta (through a subsidiary) and Canacol jointly borrowed from Standard Bank Plc., the sum of US\$25,600 as co-borrowers. The loan is comprised of two credit facilities:

- 1) a US\$50,000 three year senior secured borrowing base revolving credit facility with an initial availability of US\$14,000; and
- 2) a US\$11,600 mezzanine facility.

The security package and terms for the Standard Bank Loan comprises a lien on the shares of Rancho Hermoso S.A.; a guarantee from each of BrazAlta and Canacol; and a hedge of a percentage of Rancho Hermoso S.A. production. In addition, BrazAlta has issued to Standard Bank Plc., warrants to acquire 10,000,000 BrazAlta Common Shares at a price of C \$0.80 per BrazAlta Common Share for a period of five years ("New BRX Warrants"), and has cancelled the 3,500,000 warrants previously issued to Standard Bank Plc. At US\$2.00 last year as part of a Brazilian reserves based lending line.

As at September 30, 2008, BCH was in violation of its covenants relating to its long term debt facility pertaining to minimum working capital balances, debt coverage, and interest coverage. The Corporation has and continues to seek cost reductions in order to generate positive cash flow from operations. Also, the Corporation may need to either obtain a new debt facility or negotiate amendments and/or extensions of its existing debt facility as a result. The Corporation has not yet obtained the waivers from its lenders regarding the covenant violations. While the Corporation is focusing its best efforts on these matters and continues to negotiate with its lender, the outcome cannot be certain at this time. There is, therefore, a risk regarding the Corporation's ability to continue as a going concern with respect to this loan. The accompanying interim consolidated financial statements for the three month period ended September 30, 2008 do not include any adjustments to the amounts and classification of assets and liabilities, except for the term debt facility which has been reclassified as a current liability due to the fact that it is callable by the lender at any time, that might be necessary should the Corporation be unable to continue in business and therefore be unable to realize its assets and discharge its liabilities in the normal course of business. As a result any such adjustments could be material. Please see further discussion in the Risks section of this MD&A.

On October 1, 2008, BCH Ltd. was authorized to complete a non-brokered private placement of 4,474,999 BCH Common Shares at a price of US\$4.163 per BCH Common Share for aggregate gross proceeds of US\$18,629. On October 1, 2008, BrazAlta acquired 1,717,093 BCH Common Shares for consideration of US\$7,148 in conversion of loans receivable from BCH. In addition, BrazAlta has a share subscription payable

to BCH of US\$2,353 relating to the purchase of an additional 565,156 shares. At the time of this document, these additional shares had not yet been purchased by or issued to BrazAlta. On October 1, 2008, Allis-Chalmers Energy Inc. acquired 2,192,750 BCH Common Shares in the financing for consideration of US\$3,500 in conversion of accrued interest payable on the Debenture and cash proceeds of US\$5,628. Following the completion of the first portion of the financing, BCH will have 13,909,843 BCH Common Shares issued and outstanding of which BrazAlta will own 11,717,093 BCH Common Shares or 84.2%.

As disclosed in several press releases, it continues to remain the intention of BrazAlta to pursue a liquidity event for BCH. Any potential proceeds from a future sale, disposition or initial public offering of BCH will remain within the company to repay the US\$11,600 mezzanine facility of Canacol and, as available, to fund the future exploration and development activities of BrazAlta in Brazil and Colombia and will not be distributed to registered shareholders of BrazAlta.

The Corporation has one major lender, Standard Bank Plc. As such, the Corporation remains exposed to risks related to the health and viability of its lender in the current difficult financial markets and is exposed to the risk that the particular lender's appetite for the risks and exposures associated with financing junior international company operations. This is discussed further in the Risks section of this MD&A.

The Corporation continues to assess its requirements for capital on an on-going basis and the Corporation may be required to obtain additional capital to finance the execution of capital drilling programs and exploration commitments as well as to finance working capital deficiencies and expansion plans for BCH prior to any liquidity event being realized. The current state of the public capital markets in the near term severely restricts the options for the Corporation to raise additional equity or debt and there can be no guarantee the Corporation will be able to access all of the required capital it requires.

### ***COMMITMENTS, GUARANTEES, AND OFF-BALANCE SHEET ARRANGEMENTS***

As at September 30, 2008, BrazAlta has minimum exploration program ("MEP") work unit commitments to complete negotiated exploration work on its onshore blocks awarded by the Agência Nacional do Petróleo, Gás Natural e Biocombustível ("ANP"), Brazil's National Petroleum Agency. MEP work units are satisfied through completion of exploration wells, seismic programs, and other exploration survey methods all of which have prescribed work units for completion. Therefore, although actual dollars spent on projects do not directly correlate to reducing the MEP work units, the financial guarantees related to non-performance are shown in the table below. These properties are operated within the Brazilian Joint Venture and the commitments will be reduced as work is performed.

The Corporation and W. Washington have cross-guaranteed the working interest of the other partner for the non-performance guarantee placed with a Brazilian insurance company which has insured the performance of the MEP work units or the corresponding financial payment in lieu thereof to the ANP on certain of Round 7 exploration blocks. A large percentage of the Round 7 exploration commitments have been farmed-out and as such the Net Remaining MEP Work Units attributable to BrazAlta for Round 7 in the table above is only 266 units which at September 30, 2008 equated to approximately \$440 (June 30, 2008 - 1,867 units or \$3,576). Based on actual work performed, the Corporation has made an accrual as a contingent liability of \$440 (June 30, 2007 - \$1,119), relating to its net share of expected MEP work units yet to be fulfilled by means of financial settlement.

<b>Bid Round</b>	<b>Basin</b>	<b>Commitment Date</b>	<b>Gross Remaining MEP Work Units</b>	<b>Gross Financial Guarantee</b>	<b>Net Remaining MEP Work Units</b>	<b>Net Financial Guarantee<sup>1</sup></b>
7	Recôncavo & Sergipe	August 26, 2008	2,086	\$3,450 BRL \$6,258	266	\$440 BRL \$798
9	Recôncavo	March 12, 2010	1,600	\$2,646 BRL \$4,800	320	\$529 BRL \$960
9	Espirito Santo	March 12, 2011	1,020	\$1,687 BRL \$3,060	408	\$675 BRL \$1,224

<sup>1</sup>Net financial guarantee based on BrazAlta's net working interest.

In addition, the Corporation has commitments for office premises and other operating leases. As at September 30, 2008, the payments required in each of the next five years are as follows:

	\$
2009 - 9 Months	312
2010	416
2011	416
2012	Nil
2013	Nil

The Corporation has two arrangements with its main Brazilian partner W. Washington which could constitute off-balance sheet arrangements. In each case, these agreements are two way guarantees whereby BrazAlta has guaranteed W. Washinton's portion and W. Washington has guaranteed BrazAlta's portion.

As previously disclosed, on August 9, 2007, BrazAlta and W. Washington jointly closed a reserves-based US\$50,000 revolving line of credit facility with Standard Bank Plc. The draw on the facility currently totals gross US\$7,100 of which BrazAlta has recognized its respective 47.5% share or net US\$3,373 in the BrazAlta's consolidated financial statements for the period ended September 30, 2008. However, BrazAlta's ultimate exposure to the loan at September 30, 2008 could be the full US\$7,100 based on the guarantee signed with Standard Bank Plc.

As detailed above, BrazAlta has minimum exploration program MEP work unit commitments to complete negotiated exploration work on its onshore blocks awarded by the ANP. BrazAlta has cross-guaranteed the working interest of W. Washington for the non-performance guarantee placed with a Brazilian insurance company which has insured the performance of the MEP work units or the corresponding financial payment in lieu thereof to the ANP on certain of Round 7 exploration blocks. In addition, the ANP does not directly recognize the liability assumed by the farm-in partners under contract, so the potential maximum exposure to BrazAlta for unfulfilled MEP work unit commitments that it has cross guaranteed with W. Washington in Round 7 concession contracts as at September 30, 2008 could be the full 2,086 outstanding MEP work units which equates to BRL\$6,258 or approximately \$3,450.

### ***SUBSEQUENT EVENTS & PENDING TRANSACTIONS***

#### **Acquisition of Canacol Energy Inc.**

Subsequent to the end of the quarter, on October 30, 2008, the acquisition of Canacol Energy Inc. was successfully completed. The agreed aggregate consideration for all of the Canacol common shares and warrants is a total of 40,000,000 common shares in the capital of BrazAlta.

#### **Round 8 Land Auction**

The Corporation qualified for and bid for onshore land blocks offered by the ANP, Brazil's National Petroleum Agency in Brazil's Round 8 land auction held on November 28th and 29th, 2006 ("Round 8 Bid"). BrazAlta and its partners in the Round 8 Bid, W. Washington and Brownstone, were successful in winning and being awarded five separate blocks, each block totalling 180 square kilometres of exploration lands ("Round 8 Bid Lands") in the Tucano Basin which lies directly west of the Recôncavo Basin. However, the Round 8 Bid is the subject of a court injunction filed in Brasilia against the ANP. The premise for the injunction is that the restriction for any one E&P company to purchase more than four blocks of land in any one area, in any given bid round of land is not constitutional. As of this report date, the court injunction has been lifted in the superior court from one of two jurisdictions. BrazAlta and its partners in the Round 8 Bid have no information indicating that their successful Day 1 Round 8 Bid Lands will not be retained by them.

### ***TRANSACTIONS WITH RELATED PARTIES***

During Q1-F2009, companies controlled by directors or officers of the Corporation were paid a total \$47 (Q1-F2008 - \$106) in professional and consulting fees and office rent. All of the transactions were completed on normal industry terms. None of these amounts remained outstanding at each respective period end.

The Corporation has working interests in certain Canadian properties which are operated by a Corporation controlled by a director of the Corporation. The Corporation also has an operating agreement under

standard industry terms on the properties in Brazil and paid a total \$261 during the quarter (2008 - \$85) of management fees included in general and administrative expenses to a Brazilian Corporation related by virtue that it is controlled by a director of the Corporation as of September 30, 2008. These transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties. At September 30, 2008, \$1,092 (June 30, 2008 - \$2,009) was cash call receivable and \$88 (June 30, 2008 - \$91) was included in accounts payable and accrued liabilities.

The Corporation's oilfield services subsidiary, BCH, performed drilling services for W. Washington, the operator and 52.5% working interest holder in the Brazil Joint Venture. W. Washington is controlled by a director of the Corporation and is therefore a related party. These transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties. During Q1-F2009, the Corporation recorded \$280 (Q1-F2008 - \$1,098) for drilling services revenue from this related party for their share of drilling costs. At September 30, 2008, \$117 (June 30, 2008, \$Nil) was receivable by the Corporation.

## OUTLOOK

BrazAlta's goal and mandate has been to build a significant onshore oil producing company in the under-explored and prolific Recôncavo, Sergipe, Espirito Santo, and Tucano basins of Brazil through an active capital program of oil and gas exploration and development drilling in fiscal 2008 and to establish BCH as a successful, self-sufficient drilling and related services company onshore in Brazil.

On October 30, 2008, BrazAlta acquired all of the issued and outstanding common shares and warrants of a private oil and gas exploration company, Canacol Energy Inc. The intention of the transaction was to diversify BrazAlta E&P activity beyond Brazil, adding both assets, and additional management and oil finding expertise. With the acquisition of Canacol, BrazAlta now has oil exploration, development, and production operations in countries of Colombia and Guyana. The assets in Colombia include the Rancho Hermoso and Entrerrios oil fields, and the La Sierra and Ombu exploration contracts. The two oil fields, which BrazAlta will operate, are located in the Llanos Basin and produce approximately 3,000 barrels of oil per day on a gross basis. The Corporation has plans to drill three development wells and work over three of the existing producing wells in 2009 of which 330 barrels oil per day are produced on a net basis, and approximately 1,500 barrels oil per day are produced on a tariff basis whereby the company receives a price of approximately US\$9 per barrel. The tariff rate increases through a series of steps to approximately US\$18 per barrel in 2012. The Corporation will also operate the La Sierra E&P contract located in the Middle Magdalena Basin, where it plans to drill two exploration wells in 2009. In addition, the Corporation has a non-operated working interest in the Ombu E&P contract, located in the Putumayo Basin, and recently participated in the drilling of the Capella heavy oil discovery. The company plans to participate in up to seven additional appraisal wells and a 3D seismic survey on the Capella discovery in 2009.

In addition to Colombia, in Guyana, the Corporation will have a 55% non-operated working interest in a large onshore exploration contract in which the Corporation plans to participate in the drilling of two exploration wells in 2009.

On the service side, BCH has undergone significant growth and expansion in a very short period of time adding drilling rigs assets, contracts with Petrobras, and building infrastructure in the four main on-shore operating areas in Brazil. BrazAlta believes the future growth prospects in Brazil for BCH are bright but, as disclosed in several press releases, that it remains the intention of BrazAlta to pursue a liquidity event for BCH. Any potential proceeds from a future sale, disposition or initial public offering of BCH will remain within the company to repay the US\$11,600 mezzanine facility of Canacol and, as available, to fund the future exploration and development activities of BrazAlta in Brazil and Colombia and will not be distributed to registered shareholders of BrazAlta.

## DISCLOSURE OF OUTSTANDING SECURITIES (as at December 1, 2008)

There are an unlimited number of no par value common shares authorized for issuance. Details of the issued and outstanding shares are as follows:

## Issued & Outstanding Share Capital

Number of shares issued and outstanding, September 30, 2008	90,084,661
Issued upon acquisition of Canacol Energy Inc.	40,000,000
Number of shares issued, December 1, 2008	90,084,661

### *Options and Warrants Outstanding (as at December 1, 2008)*

The following are the outstanding stock options issued by the Corporation and their respective exercise price and expiry date. At September 30, 2008, total vested stock options totalled 6,786,000 at a weighted average price of \$0.92 per common share.

Stock Options Outstanding			
	Number	Exercise Price	Expiry Date Range
	10,000	\$0.35	March 2010
	515,000	\$0.40	March - June 2010
	1,950,000	\$0.75	January 2011
	125,000	\$1.00	February 2011
	100,000	\$1.30	April 2011
	865,000	\$1.20	November 2011
	1,565,000	\$1.20	February 2012
	658,333	\$1.20	June 2012
	160,000	\$1.20	October 2012
	150,000	\$1.20	March 2013
	1,267,000	\$0.65	March 1, 2013
Balance September 30, 2008	7,365,333	\$0.93	
Cancelled Options	(53,334)	\$1.20	October 2012
Cancelled Options	(34,000)	\$0.65	March 1, 2013
<b>Balance December 1, 2008</b>	<b>7,277,999</b>	<b>\$0.93</b>	

The Corporation's subsidiary, BCH, also has a stock option plan for directors and officers of BCH. As of September 30, 2008 there were a total of 800,000 options outstanding. All options were granted at an exercise price of US\$4.16 per BCH Common Share and expire on January 1, 2013.

### Warrants Outstanding

	Number	Exercise Price	Expiry Date
	1,505,000	\$1.20	January 8, 2009
	10,000,000	\$0.80	August 29, 2013
<b>Warrants Outstanding at December 1, 2008</b>	<b>11,505,000</b>	<b>\$0.85</b>	<b>4.31 years</b>

The 10,000,000 warrants which were issued to the lender pursuant to the Rancho Hermoso debt financing on August 29, 2008 at a price of C\$0.80 warrants have a mandatory exercise clause in which they must be exercised if the closing price of BrazAlta's shares exceeds C\$0.95 per share for 60 consecutive trading days.

The Corporation subsidiary, BCH has 250,000 warrants outstanding at an exercise price of US\$10.00 per BCH Common Share with an expiry date of July 2012. They were issued in conjunction with the closing of the term debt facility. All BCH warrants remain outstanding as of the date of this report.

## RISK FACTORS

The Corporation is subject to several risk factors including, but not limited to: the volatility of oil and natural gas prices; foreign exchange and currency risks; general risks related to foreign operations such as political, economic and other uncertainties as they relate to energy policies; Brazilian and Colombian governments exercising from time to time significant influence on the economy to control inflation; developing environmental regulations in foreign jurisdictions; discovery of new oil and natural gas reserves; concentration of oil sales receipts with one major customer; that the Corporation anticipates substantial capital expenditures for the acquisition, exploration, development and production of oil and natural gas reserves in the long-term for which it may require additional financings to implement its business plan; and a credit concentration risk of drilling services receivables generated by one major customer.

As the Corporation is not experiencing positive cash flow from operations it has been reliant on access to growth capital in the form of both debt and equity to fund on-going operations and to fund capital investments. The current state of the financial and capital markets severely limits the ability of the Corporation to access capital and there can be no guarantee the Corporation will be able to successfully attract the required investment capital as it has in the past.

The Corporation is also exposed to foreign exchange and currency risk as a result of fluctuations in exchange rates through its cash deposits and investments denominated in Brazil Real and United States dollar as well as its debt balances which are denominated in US dollars. At September 30, 2008, the Corporation held net -\$65 (BRL -118) on deposit in Brazilian currency (June 30, 2008 - \$2,064 (BRL 3,234)) and \$6,193 (US \$5,843) on deposit in US dollar (June 30, 2008 - \$6,957 (US \$6,830)). The Corporation has debt denominated in the US dollar. At September 30, 2008, the Corporation had \$72,466 (US\$ 68,373) in US dollar denominated debt outstanding (June 30, 2008 - \$70,563 (US\$ 69,275)).

Much of the Corporation's revenue and exploration and development costs are expected to be received/paid in or by reference to US dollar denominated prices while a significant portion of its operating and general and administrative costs are denominated in Canadian dollars or the Brazilian Real. Currently the Corporation has no hedging position with respect to the US dollar/Canadian dollar exposure.

The Corporation has entered into currency derivatives in order to hedge its exposure to fluctuations between the US dollar and the Brazilian Real. During Q4-F2008, BCH entered into three foreign currency derivative contracts on the Brazilian Real to hedge its currency exposure. These contracts extend through April 2009 and are detailed below:

Period	Notional Balance	Type	Settlement	Average BRL/US Exchange Rate
June 2008 - April 2009	US\$500,000 / month	Non-Deliverable Forward	Financial	1.7621
July 2008 - April 2009	US\$200,000 / month	Deliverable Forward	Physical Delivery	1.7306
July 2008 - April 2009	US\$100,000 / month	Deliverable Forward	Physical Delivery	1.7570

As a result of the current global financial crisis, the Brazilian Real has seen significant devaluation against the US\$ during the last five months and is currently experiencing significant daily fluctuations up and down making this particular currency risk more acute. The sudden swing in sentiment with respect to the Brazilian Real has also put each of the currency derivatives entered into by the Corporation "out of the money" and resulted in a significant unrealized hedge loss during the quarter.

Periodic fluctuations in energy prices will not only impact the revenues of the Corporation but may also affect lending policies of the Corporation's lenders for new borrowings. This in turn could limit growth prospects over the short run or may even require the Corporation to dedicate cash flow, dispose of properties, or raise new equity to reduce bank borrowings under circumstances of declining energy prices or disappointing drilling results.

In conjunction with the reserves based revolving line credit facility, the Corporation entered into oil price financial derivative collar in August 2007 with the following terms.

Period	Volume	Type	Price Range
Oct – Dec 2007	95 bbls/day	Financial Brent Crude Oil Collar	US\$60.00 - US\$74.72
Jan – Dec 2008	71 bbls/day	Financial Brent Crude Oil Collar	US\$60.00 - US\$74.72
Jan – Dec 2009	55 bbls/day	Financial Brent Crude Oil Collar	US\$60.00 - US\$74.72
Jan – Aug 2010	55 bbls/day	Financial Brent Crude Oil Collar	US\$60.00 - US\$74.72

While hedging activities may have opportunity costs when realized prices exceed hedged pricing, such transactions are not meant to be speculative and are considered with the broader framework of financial stability and flexibility. Management continuously reviews the need to utilize such financing techniques.

The Corporation has one major lender, Standard Bank Plc. As such the Corporation, remains exposed to risks related to the health and viability of its lender in the current difficult financial markets, and is exposed to the risk that the particular lender's appetite for the risks and exposures associated with financing junior international company operations. As at September 30, 2008, BCH was in violation of covenants relating to this term debt facility pertaining to minimum working capital balances, debt coverage, and interest coverage. The Corporation has and continues to seek cost reductions in order to generate positive cash flow from operations. Also, the Corporation may need to either obtain a new debt facility or negotiate amendments and/or extensions of its existing debt facility as a result. The Corporation has not yet obtained the waivers from its lenders regarding the covenant violations. While the Corporation is focusing its best efforts on these matters and continues to negotiate with its lender, the outcome cannot be certain at this time. There is, therefore, a risk regarding the Corporation's ability to continue as a going concern with respect to this loan. The accompanying interim consolidated financial statements for the three months ended September 30, 2008 do not include any adjustments to the amounts and classification of assets and liabilities, except for the term debt facility which has been reclassified as a current liability due to the fact that it is callable by the lender at any time, that might be necessary should the Corporation be unable to continue in business and therefore be unable to realize its assets and discharge its liabilities in the normal course of business. As a result any such adjustments could be material.

The Corporation attempts to mitigate its business and operational risk exposures by maintaining comprehensive insurance coverage on its assets and operations, by employing or contracting competent technicians and professionals, by instituting and maintaining operational health, safety and environmental standards and procedures and by maintaining a prudent approach to exploration and development activities. The company also addresses and regularly reports on the impact of risks to its shareholders, writing down the carrying values of assets that may not be recoverable.

### **CRITICAL ACCOUNTING ESTIMATES**

BrazAlta's significant accounting policies are contained in Note 2 to the Audited Consolidated Financial Statements for the year ended June 30, 2008. Certain policies are recognized as critical because in applying these policies management is required to make judgments, assumptions and estimates that have a significant impact on the financial results of the Corporation. The estimates used in applying these critical accounting policies are regularly reviewed and have been discussed with the Audit Committee. These policies include:

#### **Income taxes**

The Corporation uses the liability method of accounting for income taxes. Under this method, future income tax assets and liabilities are based on the differences between asset and liability balances reported for financial accounting purposes and those reported for income tax. Future income tax assets and liabilities are measured using the substantively enacted tax rates expected to apply in the years in which the temporary differences are expected to be recovered or settled. Future income tax assets are recognized to the extent that they are more likely than not to be realized.

#### **Property, plant, and equipment**

##### *Depletion and depreciation*

Petroleum and natural gas properties are recorded in accordance with the Canadian Institute of Chartered Accountants' guideline on full cost accounting for the oil and gas industry whereby all costs relating to the exploration and development of petroleum and natural gas reserves are capitalized on a country-by-country basis. Such costs include land acquisition costs, geological and geophysical costs, costs of drilling both productive and non-productive wells, production equipment, and overhead charges directly related to acquisition, exploration, and development activities. Gains or losses on disposal of properties are recognized

only when crediting the proceeds to the recorded costs would result in a change of 20% or more in the depletion and depreciation rate.

#### *Ceiling test and unproved properties*

An impairment loss is recognized in net earnings when the carrying amount of a cost centre of petroleum and natural gas assets and properties is not recoverable and the carrying amount of the cost centre exceeds its fair value. The carrying amount of the cost centre is tested for recoverability by determining if the carrying amount exceeds the sum of the undiscounted cash flows from proved reserves. If the sum of the cash flows is less than the carrying amount, the impairment loss is limited by the amount by which the carrying amount exceeds the sum of the fair value of the proved and probable reserves and the costs of unproved properties that are subject to a separate impairment test.

Certain costs related to unproved properties and major development projects are excluded from costs subject to depletion and depreciation until the earliest of a portion of the property becomes capable of production, development activity ceases, or impairment occurs. These properties are reviewed quarterly and are subject to a separate impairment test. Any impairment is transferred to the costs being depleted. If the properties are located in a cost centre where there is no reserve base, the impairment is charged directly to earnings.

#### *Depreciation - Drilling and service rig equipment*

Drilling rig and service rigs and equipment are depreciated on the basis of unit-of-production over a useful life of 5,000 utilization days and 3,500 utilization days respectively, both with a salvage value of 15%. Utilization days include both operating days and rig move days.

#### **Asset retirement obligations**

The fair value of the estimated asset retirement obligations is recognized in the consolidated balance sheet in the period which the liability is identified and incurred and a reasonable estimate of the fair value can be made. The obligations recognized are the legal obligations of the Corporation to retire and perform site restoration on tangible long-lived assets such as well sites. The obligations are discounted to their present value using the Corporation's credit adjusted risk-free interest rate. The corresponding amount increases the carrying amount of the related asset. The liability is accreted over time for changes in the fair value of the liability through charges to accretion expense. The amounts capitalized to the related assets are amortized to earnings over the expected remaining life of the underlying resources using the unit of production method. Actual costs incurred upon settlement of the asset retirement obligations are charged against the obligation to the extent of the liability recorded.

#### **Stock based compensation plan**

The Corporation records compensation expense in the consolidated financial statements for stock options granted to employees, directors, and consultants using the fair value method. Fair values are determined using the Black-Scholes option pricing model with compensation costs recognized over their vesting period. Any consideration paid to the Corporation on the exercise of stock options, along with amounts previously credited to contributed surplus, is credited to share capital.

#### **Financial instruments**

The Corporation's financial assets and liabilities consist of cash and cash equivalents, accounts receivable, accounts payable, accrued liabilities, convertible debentures, currency and commodity derivatives, and long-term debt. The fair value of these financial assets and liabilities approximates their carrying value, unless otherwise noted.

#### **Convertible Debenture**

The Corporation's Convertible Subordinated Secured Debenture has been classified as debt with a portion of the proceeds representing the value of the conversion option classified as equity. The debt balance accretes over time using the effective interest rate method such that upon maturity the liability balance recorded will equal the maturity value of the debenture. This increase in the debt balance is reflected as non-cash interest expense in the consolidated statement of loss. Where the Corporation's subsidiary has issued convertible debentures the fair value of the conversion right is presented within non-controlling interests in the consolidated balance sheet. Upon conversion of the debenture into common shares by the holder, the debt and equity components are transferred to common share capital.

## ***IMPACT OF NEW AND PROPOSED ACCOUNTING STANDARDS***

### ***Goodwill and intangible assets***

In February 2008, the CICA issued Section 3064, "Goodwill and Intangible Assets", replacing Section 3062, "Goodwill and Other Intangible Assets" and Section 3450, "Research and Development Costs". Various changes have been made to other sections of the CICA Handbook for consistency purposes. The new Section will be applicable to financial statements relating to fiscal years beginning on or after October 1, 2008. Accordingly, the Company will adopt the new standards for its fiscal year beginning July 1, 2009. It establishes standards for the recognition, measurement, presentation, and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. Standards concerning goodwill are unchanged from the standards included in the previous Section 3062. The Company does not expect that the adoption of these new Sections will have a material impact on its consolidated financial statements.

### ***Capital Disclosures***

The Accounting Standards Board ("AcSB") issued CICA Section 1535, "Capital Disclosures". The main features of this section are to establish requirements for an entity to disclose qualitative information about its objectives, policies, and processes for managing capital, quantitative data about what it regards as capital, and whether it has complied with any externally imposed capital requirements and, if not, the consequences of such non-compliance. The new requirements are effective for annual, and subsequent interim periods thereafter, beginning on or after October 1, 2007, and, upon adoption, are not expected to materially impact the consolidated financial statements.

### ***Other pronouncements***

On July 1, 2008, the Corporation will be required to adopt three additional CICA Handbook requirements, section 3862 "Financial Instruments - Disclosures", section 3863 "Financial Instruments - Presentations", section 3031 "Inventories". The effect of these standards will be incremental disclosures regarding the significance of financial instruments for the entity's financial position and performance, the nature, the extent, and management of risks to which the entity is exposed to arising from financial instruments.

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

On February 13, 2008, the AcSB confirmed that effective for interim and annual financial statements related to fiscal years beginning on or after January 1, 2011, International Financial Reporting Standards (IFRS) will replace Canada's current Generally Accepted Accounting Principles for all publicly accountable profit oriented enterprises. The Corporation is currently assessing the effect on its financial reporting practices and requirements and is preparing for this transition.

## ***MAINTENANCE OF DISCLOSURE CONTROLS AND PROCEDURES (DC&P) AND INTERNAL CONTROL OVER FINANCIAL REPORTING (ICFR)***

Management and the Board of Directors are committed to the promotion of investor confidence by ensuring that trading in the Corporation's securities takes place in an efficient, competitive, and informed market. In accordance with the continuous disclosure requirements under the securities commission rules and TSX Venture Exchange policies, the Corporation has adopted a Corporate Disclosure Policy and has procedures in place to ensure that any sensitive information is identified, reviewed by management, and disclosed in a timely manner to the regulatory authorities, shareholders, and the public.

However, in contrast to the requirements under Multilateral Instrument 52-109 Certification of Disclosure in Issuers' Annual and Interim Filings (MI 52-109), the Corporation has opted out under the rules afforded to TSX Venture issuers and Management and the Board do not make any representations relating to the establishment and maintenance of disclosure controls and procedures (DC&P) and internal control over financial reporting (ICFR), as defined in MI 52-109. In particular, Management and the Board are not making any representations relating to the establishment and maintenance of:

- i) Controls and other procedures designed to provide reasonable assurance that information required to be disclosed by the issuer in its annual filings, interim filings or other reports filed or submitted under securities legislation is recorded, processed, summarized and reported within the time periods specified in securities legislation; and
- ii) A process to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with the issuer's GAAP.

In addition, Management and the Board would also like to highlight that the Corporation has identified certain weaknesses in ICFR specific to the Corporation which are:

- i) Due to the limited number of staff, it is not possible to achieve segregation of all duties; and
- ii) Due to the limited number of staff, the Corporation has a risk of material misstatement related to non-routine complex accounting matters that may arise.

These weaknesses essentially arise because of the small size of the Corporation and its corresponding small accounting staff. Management and the board of directors have attempted to mitigate the risk of material misstatement in financial reporting related to segregation of duties through a combination of extensive and detailed review by the CFO of the financial reports, the integrity and reputation of senior financial and accounting personnel, and the candid discussion of this risk with our external advisors. The Corporation also employs outside consultants and accounting firms to assist with complex accounting and technical issues. In spite of management's best efforts, there can be no assurance that these risks can be reduced to less than a remote likelihood of a material misstatement.

### **ADDITIONAL INFORMATION**

Additional information relating to the Corporation can be found on its website at [www.brazalta.com](http://www.brazalta.com) or on SEDAR at [www.sedar.com](http://www.sedar.com).

# Corporate Information

## Management Team

Charle Gamba – President & Chief Executive Officer  
Mark Holliday - Chief Operating Officer  
Arthur Halleran – Vice President Exploration  
Luiz Azevedo, MBA – Brazil Country Manager

## Board of Directors

David R.P. Mears – Chairman, Director  
Charle Gamba President, CEO, Director  
Lyle F. Dunkley – Director  
Stuart Hensman – Director  
Louis (Lou) W. MacEachern – Director  
Jason Bednar – Director  
Alverra Barrera – Director  
Michael Hibberd – Director

## Corporate Information

### Head Office

Suite 300, 816 - 7th Avenue SW  
Calgary, Alberta,  
Canada T2P 1A1  
Tel: +1 (403) 561-1648  
Fax: +1 (403) 215-9254  
Email: info@brazalta.com

### Brazil Office

Av. Rio Branco, 01 - 8º andar - sala 804  
Rio de Janeiro - RJ  
20090-003  
Tel.: +55 21 - 3213-8350 / 3213-8353  
Fax: +55 21 - 3213-8351

### Colombia Office

CALLE 100 No. 8ª-55 Torre C Oficina 309 (W.T.C)  
Bogotá-Colombia  
Tel.: +(571) 6210067  
Fax: +(571) 6211779

### Auditors

Deloitte & Touche LLP Calgary, Alberta

### Bankers

HSBC Bank Canada and Brasil  
Calgary, Alberta and Rio de Janeiro - RJ, Brazil

### Independent Reserve Engineers

DeGolyer and MacNaughton Canada Limited  
Calgary, Alberta

### Legal Counsel

Davis & Company LLP  
Calgary, Alberta  
Schmidt, Valois, Miranda, Ferreira e Agel –  
Advogados Rio de Janeiro - RJ, Brazil

### Stock Exchange Listing

TSX Venture Exchange: BRX

### Transfer Agent & Registrar

Olympia Trust Company  
2300, 125 - 9th Avenue SE  
Calgary, Alberta T2G 0P6

[www.brazalta.com](http://www.brazalta.com)

