



# Annual Report 2010

**PRESIDENT'S MESSAGE**

This past year was a positive one for the broader global economy and a transformational one for Harvest. What started out as a period of great uncertainty, gradually gave way to the strengthening global economic outlook that we are faced with today. As the world's economic recovery continues to take hold, Harvest remains well situated to capitalize on these improving conditions. With oil prices rebounding to the US\$90/bbl mark, our predominantly oil-weighted asset base positions us well for increased revenues and returns.

The changes at Harvest over the past year were significant, as we positioned ourselves with a new strategy of growth. Following the purchase of our equity by Korea National Oil Corporation (KNOC) in late 2009, our balance sheet has been strengthened thereby enabling us to leverage our operating platform and highly capable workforce. This has facilitated a renewed focus on capturing the unexploited potential of our existing asset base, while simultaneously enabling us to explore growth opportunities via organic investment or acquisition. With the financial backing of KNOC and the strong technical capabilities of our employees, we continue to focus on assets that present attractive cash flow characteristics in the short and long-term.

**RESERVES**

At December 31, 2010, Harvest's proved plus probable reserves were 461.3 mmboc compared to 199.5 mmboc at December 31, 2009. Based on our average 2010 production, Harvest now has a reserve life of 25.6 years.

Reserves (mmboc)	December 31, 2010		December 31, 2009	
	Gross	Net	Gross	Net
<i>Oil &amp; Gas Excluding BlackGold</i>				
Proved Reserves	144.4	126.4	140.3	122.5
Probable Reserves	57.7	49.3	59.2	50.3
Total proved plus probable reserves excluding BlackGold	202.1	175.7	199.5	172.8
<i>BlackGold oil sands</i>				
Proved Reserves	93.6	77.1	-	-
Probable Reserves	165.6	130.7	-	-
Total proved plus probable reserves BlackGold	259.2	207.8	-	-
Total proved plus probable reserves	461.3	383.5	199.5	172.8

**UPSTREAM**

2010 was an eventful year from the perspective of our upstream business. Our liquids-weighted asset base has significant potential at current oil prices, but has been held back in recent years due to restricted capital investment. Our improved financial situation and renewed focus on economically attractive growth have allowed us to increase investment into this area of our business.

During 2010, we spent \$382 million on organic investment projects that not only supported our production in 2010, but more importantly, also positioned the business for future growth. In keeping with this, 2010's drilling activity totaled 171 gross wells with a 99% success rate. These operations were focused on initiating more extensive development of our substantial resource play assets, including the promising new Red Earth Slave Point resource play where we drilled 36 gross wells. Of these, 24 were horizontal wells with multi-stage fracture completions targeting our Slave Point light oil resource play. We were also busy drilling 29 wells in the Lloydminster heavy oil area, 10 wells in the West Central Alberta Cardium oil play, 13 wells in the Kindersley Viking play, and 5 wells in the liquids-rich natural gas plays in Western Alberta. All of these areas have allowed for attractive rates-of-return at current commodity prices.

While we have already ramped up drilling in our liquids-weighted asset base, substantial exploitable opportunity still remains. As such, we plan to increase our drilling in the above-mentioned resource plays by approximately 10% in 2011. By utilizing technologies such as horizontal drilling, aggressive stimulation, advanced pumping technology, and enhanced oil recovery (EOR), we see ourselves accelerating the capture of the potential these assets have to offer.

While pursuing the organic development of our asset base has remained a priority, we have also looked to expand our assets through acquisition. Net producing asset acquisitions during 2010 amounted to \$176 million, which provided 3,000 boe/d of production, as well as significant future potential in the 88,000 net acres of undeveloped land acquired with the assets. We were also actively bidding on land sales, purchasing 87,000 net acres of new, undeveloped property that provides opportunity for further investment in the years ahead.

While continuing to develop the conventional and unconventional potential of our upstream assets, we saw the opportunity to aggressively move into the oil sands resource base with the acquisition of the BlackGold oil sands project from KNOC. The acquisition of this project complements Harvest's current holding of approximately 57,000 acres of undeveloped oil sands mineral rights. The BlackGold project enhances Harvest's asset base with an additional 94 mmboe of proved reserves and 165 mmboe of probable reserves, bringing our total proved plus probable asset base to 461 mmboe.

As the development and construction of the BlackGold project had already been sanctioned at the time of acquisition, Harvest was able to play a complementary role by bolstering the team's experience with our own technological expertise, thereby improving timelines and execution of the project. Phase 1 of the project is anticipated to produce 10,000 bpd with the first oil expected in 2013. Phase 2 of the project, which is awaiting regulatory approval and project sanction, is targeted to increase production to 30,000 bpd.

Our focus on attractive acquisition opportunities also led to our recently announced acquisition of producing and undeveloped assets from Hunt Oil Company of Canada (Hunt) for a purchase price of \$525 million. The Hunt assets had production of approximately 11,720 boe/d in the third quarter of 2010 and proved plus probable reserves of 52.9 mmboe as at April 1, 2010 as determined by an independent Canadian evaluator. The acquisition received approval from Investment Canada on January 31, 2011. Although closing has been delayed from our original expectations, the acquisition is now expected to close February 28, 2011. The Hunt assets in West Central Alberta include interests in a third-party operated gas plant that is currently experiencing an outage, which has resulted in reduced production in certain oil and gas properties. Hunt has agreed to reimburse Harvest for costs associated with restoring production as well as any lost production between October 1, 2010 and the earlier of the date when production is resumed or October 31, 2011. It is our expectation that production will be restored within the first quarter of 2011. The acquisition of the Hunt assets will also provide Harvest an additional 377,000 net acres of undeveloped land, bringing our total undeveloped land holdings to approximately 900,000 acres. KNOC has provided \$505 million of equity to fund the acquisition subsequent to December 31, 2010. This acquisition is indicative of both our strong financial backing as well as our committed focus on opportunistic growth.

#### **DOWNSTREAM**

Harvest's downstream refining and marketing segment, North Atlantic Refining (North Atlantic), complements our upstream crude oil business and provides a natural hedge for our crude oil quality discounts. North Atlantic is located on Canada's east coast, which allows for easy access to the large refined product markets of the Canadian and U.S. eastern seaboard, Europe, and South America. North Atlantic sources its medium sour crude oil supplies from the Middle East, Russia, and South America.

Refined production mix for 2010 was weighted 37% towards distillates, 32% towards gasoline, and 31% towards heavy fuel oil, VGO and other products. While refining margins were poor in 2010, they have been improving as of late. 2010's fourth quarter margins improved from the previous quarter by US\$3.11/bbl, a trend that we expect to continue as global demand for transportation fuels continues to rebound.

North Atlantic's reported throughput for 2010 was 86,142 bbl/d. This total was impacted by low refinery margins which resulted in the decision to operate at somewhat lower throughput to maximize margins, as well as a small fire that occurred during the first quarter. The fourth quarter daily throughput increased by 43% to 111,317 bbl/d when compared to the average from the first three quarters of the year.

Also of note to our 2010 downstream operations, has been the continued progression of our debottlenecking suite of projects. These projects are intended to raise the refinery's capacity to 130,000 bbl/d, provide enhanced yields, and reduce expenses. During 2011, we expected to continue with certain high return projects and the full project is now schedule to be completed in 2013.

#### **ENVIRONMENT, HEALTH AND SAFETY**

Harvest is a recognized leader in business and operations activities. We have consistently maintained a disciplined approach in environment, health and safety issues and remain committed to operating in a socially responsible manner. Protecting our people, our partners, our stakeholders and the environment are key elements of our business. We are active throughout the organization and never forget that safe and environmentally friendly business practices are critical to our social license to operate.

In our upstream segment, we are participants in the Canadian Association of Petroleum Producers' Responsible Canadian Energy program. We are one of few companies to have shown the commitment to continuously report at the highest reporting level. In the downstream segment, we have set new internal safety records for time worked without lost time accidents, achieved industry leading recordable injury frequency rates, and have been recognized for this and other achievements by regulatory authorities.

Harvest continues efforts to reduce greenhouse gas and other emissions in all parts of our business. Our business units conduct emergency response training on a regular basis in all of our operating fields to ensure a high level of response capability when placed in challenging situations. We also perform safety and environmental audits of our operating facilities. We work diligently to manage our liabilities through the controlled abandonment and reclamation of facilities, wells and leases. Harvest has consistently supported the communities we operate in by sponsoring and donating to local initiatives. In all aspects of our business, we are committed to minimizing our environmental footprint, acting as a good and responsible corporate citizen, and conducting our affairs in an environmentally and socially responsible manner.

#### **CORPORATE**

Over the course of 2010, we made substantial improvement to our balance sheet position. A series of equity capital injections provided the opportunity to reduce debt while increasing the size of the company.

We also refinanced our long-term debt in late 2010. A newly issued US\$500 million 6<sup>7/8</sup>% senior notes due 2017 was met with significant interest and closed in October 2010. This issuance allowed us to redeem early the remaining principal amount of 7<sup>7/8</sup>% senior notes that were due in 2012 and position ourselves with access to the debt capital markets that we will use to fund growth in combination with appropriate equity injections.

Late in 2010 we expanded the capability of our Board of Directors by adding four new directors to replace two who resigned. Joining the Board were Brant Sangster, Kang-hyun Shin, Kyungluck Sohn, and Myunghuhn Yi. We are pleased to welcome them to the Board and look forward to their contribution in the years ahead. Meanwhile, Hong-Geun Im and Dennis Balderston resigned from the Board. Mr. Im will continue to support KNOC in other capacities. We thank both gentlemen for their contribution over the past year and wish them success in the future.

**MANAGEMENT'S DISCUSSION AND ANALYSIS**

This Management's Discussion and Analysis ("MD&A") should be read in conjunction with the audited consolidated financial statements of Harvest Operations Corp. for the year ended December 31, 2010. The financial information contained in this MD&A has been prepared under Canadian Generally Accepted Accounting Principles ("GAAP") unless otherwise noted. The information and opinions concerning our future outlook are based on information available at February 25, 2011.

In this MD&A, reference to "Harvest", "Company", "we", "us" or "our" refers to Harvest Operations Corp. and all of its controlled entities on a consolidated basis. All references are to Canadian dollars unless otherwise indicated. Tabular amounts are in thousands of dollars, except where noted. Natural gas volumes are converted to barrels of oil equivalent ("boe") using the ratio of six thousand cubic feet ("mcf") of natural gas to one barrel of oil ("bbl"). Boes may be misleading, particularly if used in isolation. A boe conversion ratio of 6 mcf to 1 bbl is based on an energy equivalent conversion method primarily applicable at the burner tip and does not represent a value equivalent at the wellhead. In accordance with Canadian practice, petroleum and natural gas revenues are reported on a gross basis before deduction of Crown and other royalties. In addition to disclosing reserves under the requirements of National Instrument (NI) 51-101, we also disclose our reserves on a company interest basis which is not a term defined under NI 51-101. This information may not be comparable to similar measures by other issuers.

On December 22, 2009, KNOC Canada Ltd. ("KNOC Canada"), a wholly owned subsidiary of Korea National Oil Corporation ("KNOC"), purchased all of the issued and outstanding trust units of Harvest Energy Trust (the "Trust"). The acquisition of all the issued and outstanding trust units of the Trust resulted in a change of control in which KNOC Canada became the sole unitholder of the Trust.

On May 1, 2010, an internal reorganization was completed pursuant to which the Trust was dissolved and the Trust's wholly owned subsidiary and manager of the Trust, Harvest Operations Corp., was amalgamated into KNOC Canada to continue as one corporation under the name Harvest Operations Corp. The carrying values of Harvest's assets and liabilities were determined from the existing carrying values of KNOC Canada's assets and liabilities and therefore reflect the fair values established through the purchase.

KNOC Canada was incorporated on October 9, 2009 and did not have any results from operations or cash flows in the period from October 9, 2009 to December 31, 2009 aside from capital injections from Korea National Oil Corporation to finance the purchase of the Trust. As such, the Company's financial statements for the year ended December 31, 2010 do not include prior year comparative information. Unaudited pro forma consolidated results of operations have been included in this MD&A to reflect the impact of the acquisition of the Trust, as if the acquisition occurred on January 1, 2009. This pro forma financial information is included for information purpose only and is not necessarily indicative of the results of future operations that would have been achieved had the KNOC's acquisition of the Trust taken place at the beginning of 2009.

**NON-GAAP MEASURES**

Throughout this MD&A we have referred to certain measures of financial performance that are not specifically defined under Canadian GAAP, such as "operating netbacks", "gross margin", "net revenue", "earnings from operations", "cash contributions from operations", "cash from operations", "total debt", "total capitalization" and "EBITDA". "Operating netbacks" are always reported on a per boe basis and used extensively in the Canadian energy sector for comparative purposes. "Operating netbacks" include "net revenue", operating expenses, and transportation and marketing expenses. "Net revenues" includes revenue and royalties. "Gross margin" is commonly used in the refining industry to reflect the net funds received from the sale of refined products after considering the cost to purchase the feedstock and is calculated by

deducting purchased products for resale and processing from total revenue. "Earnings from operations", "cash contributions from operations" and "cash from operations" are commonly used for comparative purposes in the petroleum and natural gas and refining industries to reflect operating results before items not directly related to operations. "Total debt", "total capitalization" and "EBITDA" are used to assist management in assessing liquidity and the Company's ability to meet financial obligations. The non-GAAP measures may not be comparable to similar measures by other issuers.

**FORWARD-LOOKING INFORMATION**

This MD&A highlights significant business results and statistics from our consolidated financial statements for the year ended December 31, 2010 and the accompanying notes thereto. In the interest of providing our lenders and potential lenders with information regarding Harvest, including our assessment of our future plans and operations, this MD&A contains forward-looking statements that involve risks and uncertainties. Such risks and uncertainties include, but are not limited to: risks associated with conventional petroleum and natural gas operations; risks associated with refining and marketing operations; risks associated with the construction of the oil sands project; the volatility in commodity prices, interest rates and currency exchange rates; risks associated with realizing the value of acquisitions; general economic, market and business conditions; changes in environmental legislation and regulations; the availability of sufficient capital from internal and external sources; and such other risks and uncertainties described from time to time in our regulatory reports and filings made with securities regulators.

Forward-looking statements in this MD&A include, but are not limited to, the forward looking statements made in the "Outlook" section as well as statements made throughout with reference to production volumes, refinery throughput volumes, royalty rates, operating costs, commodity prices, administrative costs, price risk management activities, acquisitions and dispositions, capital spending, reserve estimates, access to credit facilities, income taxes, cash from operating activities, and regulatory changes. For this purpose, any statements that are contained herein that are not statements of historical fact may be deemed to be forward-looking statements. Forward-looking statements often contain terms such as "may", "will", "should", "anticipate", "expects", and similar expressions.

Readers are cautioned not to place undue reliance on forward-looking statements as there can be no assurance that the plans, intentions or expectations upon which they are based will occur. Although we consider such information reasonable at the time of preparation, it may prove to be incorrect and actual results may differ materially from those anticipated. We assume no obligation to update forward-looking statements should circumstances, estimates or opinions change, except as required by law. Forward-looking statements contained in this MD&A are expressly qualified by this cautionary statement.

**SELECTED INFORMATION**

The table below provides a summary of our financial and operating results for the three months and year ended December 31, 2010.

	<b>December 31, 2010</b>	
	<b>Three Months Ended</b>	<b>Year Ended</b>
<b>FINANCIAL</b>		
Revenue, net <sup>(1)</sup>	1,255,785	3,802,178
Cash from operating activities	132,074	430,254
Net loss <sup>(2)</sup>	(1,446)	(44,561)
Bank debt	11,379	11,379
6 <sup>7</sup> / <sub>8</sub> % senior notes	482,389	482,389
Convertible debentures	745,257	745,257
Total financial debt	1,239,025	1,239,025
Total assets	5,367,227	5,367,227
 <b>UPSTREAM OPERATIONS</b>		
Daily sales volumes (boe/day)	50,054	49,397
Average realized price		
Oil and NGLs (\$/bbl)	\$68.67	\$67.34
Gas (\$/mcf)	\$3.81	\$4.21
Operating netback (\$/boe)	\$32.07	\$32.02
Capital asset additions (excluding acquisitions)	147,904	404,015
Property and business acquisitions (dispositions), net	(481)	176,261
Abandonment and reclamation expenditures	6,444	20,257
Net wells drilled	41.6	141.4
Net undeveloped land acquired (acres)	104,081	175,436
<b>DOWNSTREAM OPERATIONS</b>		
Average daily throughput (bbl/d)	111,317	86,142
Average refining margin (US\$/bbl)	6.13	5.13
Capital asset additions	32,591	71,234

<sup>(1)</sup> Revenues are net of royalties.

<sup>(2)</sup> Net loss includes a future income tax recovery of \$2.3 million and \$39.9 million for the three months and year ended December 31, 2010 respectively and net unrealized gains from risk management activities of \$1.1 million and \$2.4 million for the three months and year ended December 31, 2010.



**REVIEW OF OVERALL PERFORMANCE**

Harvest is an integrated energy company with our petroleum and natural gas business focused on the safe operation and development of assets in western Canada (our "upstream operations") and our refining and marketing business focused on the safe operation of a medium gravity sour crude oil hydrocracking refinery and a retail and wholesale petroleum marketing business both located in the Province of Newfoundland and Labrador (our "downstream operations"). Our earnings and cash flow from operating activities are largely determined by the realized prices for our crude oil and natural gas production as well as refined product crack spreads.

**Overview**

Consolidated cash flow from operating activities was \$430.3 million and net loss was \$44.6 million for the year ended December 31, 2010. The net loss was primarily due to lower market crack spreads and unit outages experienced in the first and third quarters of 2010 at the refinery.

**Upstream Operations**

The cash contribution from the upstream operations for the year ended December 31, 2010 was \$532.4 million. First quarter 2010 cash contribution of \$151.2 million was the highest quarterly contribution in 2010 due to relatively high commodity prices and strong volumes at an average of 50,178 bbl/d. Harvest's sales volumes averaged 49,397 bbl/d for the year ended December 31, 2010. The acquisition of the Red Earth assets allowed Harvest to offset natural declines from existing properties and increase sales volumes in the fourth quarter. Harvest's operating netback was strong in the first quarter of 2010 at \$36.20/boe due to a higher average realized price at \$60.17/boe. As a result of lower commodity prices during the second and third quarters, Harvest's operating netback fell to \$29.68/boe and \$30.05/boe respectively. However, in the fourth quarter, Harvest's operating netback increased to \$32.07/boe, reflecting the rebound in oil prices.

Capital expenditures (excluding acquisitions) for the year ended December 31, 2010 totaled \$404.0 million, which includes the drilling of 171 (141.4 net) wells with a 99% success rate. The largest component of our activity was in the Slave Point formation in the Red Earth area. Harvest had an active drilling program throughout 2010 due to strengthening oil prices and increased access to capital following the KNOC acquisition. During 2010, Harvest acquired \$176.3 million of upstream properties (net of dispositions), including a package of petroleum and natural gas assets purchased together with the remaining 40% interest in Red Earth Partnership for \$161.3 million. In August 2010, Harvest issued \$374.2 million of shares to KNOC in exchange for KNOC's BlackGold oil sands project assets. Subsequent to the acquisition, Harvest issued an additional \$85.7 million of shares to KNOC to fund BlackGold capital expenditures.

**Downstream Operations**

The negative cash contributions from the downstream operations of \$12.6 million for the year ended December 31, 2010 is a consequence of low global refinery margins as well as unplanned shutdowns of refinery process units. The unplanned shutdowns during the first and third quarters, reduced the year's average throughput to 86,142 bbl/day, which reflects an average gross margin of US\$5.13/bbl. Throughput levels climbed back to 111,317 bbl/day during the fourth quarter, reflecting a gross margin of US\$6.13/bbl. Operating expenses were \$220.8 million for the year ended December 31, 2010 comprising \$199.2 million of refinery operating expenses or \$6.34/bbl of throughput and \$21.6 million of marketing division costs.

Capital spending for year ended December 31, 2010 totaled \$71.2 million relating to various capital improvement projects including \$38.1 million of expenditures for the debottlenecking project.

**Corporate**

In 2010, Harvest successfully extended its credit facility. The credit facility maturity was extended to April 30, 2013 and reduced from \$600 million to \$500 million as Harvest intends to place less reliance on bank debt as a source of financing in the future. To provide flexibility to Harvest's borrowing base, the lending capacity of the credit facility may be increased up to the greater of 15% of total assets and \$1 billion. As at December 31, 2010, our bank borrowings totaled \$14.0 million with \$486 million of undrawn credit facility available.

In January 2010, Harvest received a capital injection from KNOC totaling \$465.7 million which was used to fund the repayment of \$240.2 million of bank debt, \$42.3 million of senior notes and \$156.4 million of convertible debentures. In October 2010, Harvest created a Global Technology and Research Centre ("GTRC"), which has been funded by a capital injection of \$7.1 million from KNOC.

On October 4, 2010, Harvest completed its offering of US\$500 million 6<sup>7/8</sup>% senior notes, maturing in 2017. Of the US\$484.6 million net proceeds, US\$210.2 million was used to redeem the outstanding 7<sup>7/8</sup>% senior notes and premium.

Harvest's corporate ratings have been upgraded to Ba2 by Moody's Investor Services and BB- by Standard and Poor's.

## UPSTREAM OPERATIONS

## Summary of Financial and Operating Results

	Three Months Ended December 31			Year Ended December 31		
	2010	2009 (pro forma) <sup>(2)</sup>	Change	2010	2009 (pro forma) <sup>(2)</sup>	Change
<b>FINANCIAL</b>						
Revenues	<b>258,013</b>	254,353	1%	<b>1,007,005</b>	886,308	14%
Royalties	<b>(38,102)</b>	(40,338)	(6%)	<b>(154,757)</b>	(128,860)	20%
Net revenues <sup>(1)</sup>	<b>219,911</b>	214,015	3%	<b>852,248</b>	757,448	13%
Operating	<b>69,649</b>	61,693	13%	<b>265,593</b>	258,675	3%
General and administrative	<b>11,111</b>	10,178	9%	<b>44,974</b>	36,452	23%
Transportation and marketing	<b>2,634</b>	3,142	(16%)	<b>9,394</b>	14,228	(34%)
Depreciation, depletion and accretion	<b>114,177</b>	110,653	3%	<b>448,091</b>	463,333	(3%)
Earnings from operations <sup>(1)</sup>	<b>22,340</b>	28,349	(21%)	<b>84,196</b>	(15,240)	(652%)
Capital asset additions (excluding acquisitions)	<b>147,904</b>	31,720	366%	<b>404,015</b>	186,276	117%
Property and business acquisitions (dispositions), net	<b>(481)</b>	(623)	(23%)	<b>176,261</b>	(62,116)	(384%)
Abandonment and reclamation expenditures	<b>6,444</b>	5,598	15%	<b>20,257</b>	14,270	42%
<b>OPERATING</b>						
Daily sales volumes						
Light / medium oil (bbl/d)	<b>24,079</b>	23,281	3%	<b>24,077</b>	23,651	2%
Heavy oil (bbl/d)	<b>9,433</b>	9,491	(1%)	<b>9,253</b>	10,261	(10%)
Natural gas liquids (bbl/d)	<b>2,736</b>	2,714	1%	<b>2,587</b>	2,718	(5%)
Natural gas (mcf/d)	<b>82,837</b>	83,610	(1%)	<b>80,881</b>	90,097	(10%)
Total (boe/d)	<b>50,054</b>	49,421	1%	<b>49,397</b>	51,646	(4%)

<sup>(1)</sup> These are non-GAAP measures; please refer to "Non-GAAP Measures" in this MD&A.

<sup>(2)</sup> The pro forma consolidated results of operations have been prepared as if the acquisition of the Trust and the subsequent reorganization occurred on January 1, 2009. For a summary of the pro forma adjustments, see note 1 to the December 31, 2010 consolidated financial statements.

Earnings from operations for the year ended December 31, 2010 were significantly higher than the December 31, 2009 pro forma results primarily due to the higher commodity prices in 2010, despite the higher average sales volumes in 2009. The rebounding oil prices in 2010 resulted in Harvest's realized prices for light/medium oil in 2010 increasing by 22%, heavy oil by 13% and NGL's by 31% from 2009. Earnings from operations for the three months ended December 31, 2010 were comparable to the pro forma results.

Capital asset additions in 2010 were more than double the asset additions in 2009. This is due to Harvest's shift to a growth focused strategy and our improved access to capital with the financial backing of KNOC. Additionally, the rebounding commodity price environment in 2010 provided attractive netbacks, resulting in more drilling activities during 2010.

Sales volumes for the fourth quarter increased marginally by 1% compared to the fourth quarter of 2009. This increase is due to the acquisition during the third quarter of 2010, which allowed Harvest to offset natural declines and increase sales volumes.

**Commodity Price Environment**

Benchmarks	December 31, 2010	
	Three Months Ended	Year Ended
West Texas Intermediate crude oil (WTI) (US\$/bbl)	85.17	79.53
Edmonton light crude oil (\$/bbl)	80.40	77.58
Bow River blend crude oil (\$/bbl)	68.90	68.25
AECO natural gas daily (\$/mcf)	3.62	4.00
Canadian / U.S. dollar exchange rate	0.987	0.971

Differential Benchmarks	2010			
	Q4	Q3	Q2	Q1
Bow River Blend differential to Edmonton Par (\$/bbl)	<b>11.50</b>	10.55	8.58	6.72
Bow River Blend differential as a % of Edmonton Par	<b>14.3%</b>	14.2%	11.0%	8.4%

While the Bow River price trend in 2010 was similar to the WTI trend, the heavy oil differential relative to Edmonton Par also increased. Heavy oil differentials fluctuate based on a combination of factors including the level of heavy oil inventories, pipeline capacity to deliver heavy crude to the U.S. markets and the seasonal demand for heavy oil.

**Realized Commodity Prices<sup>(1)</sup>**

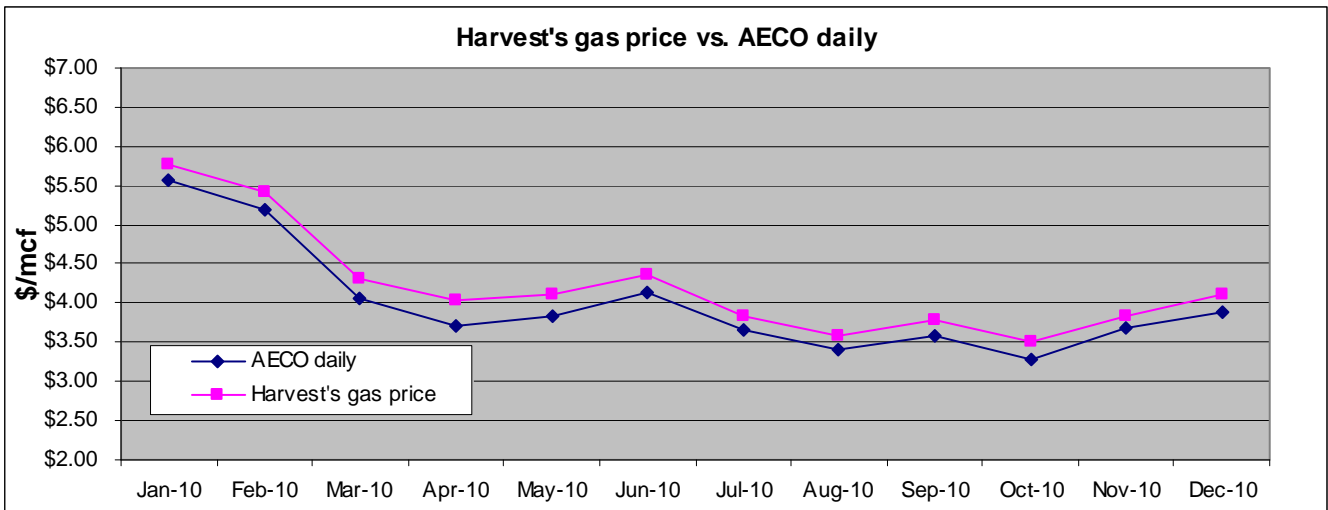
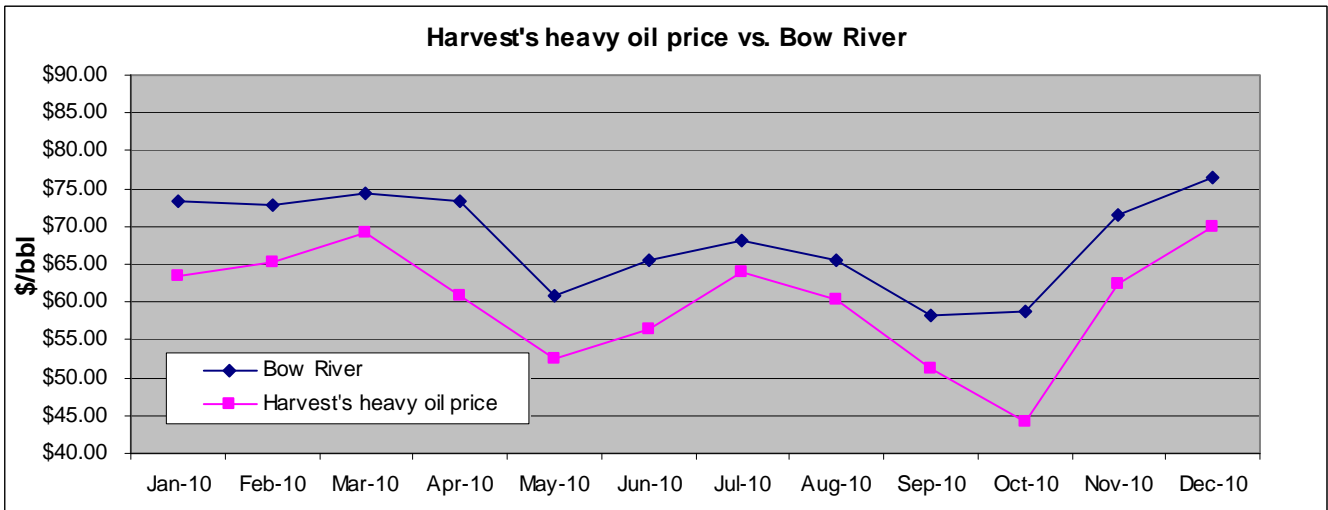
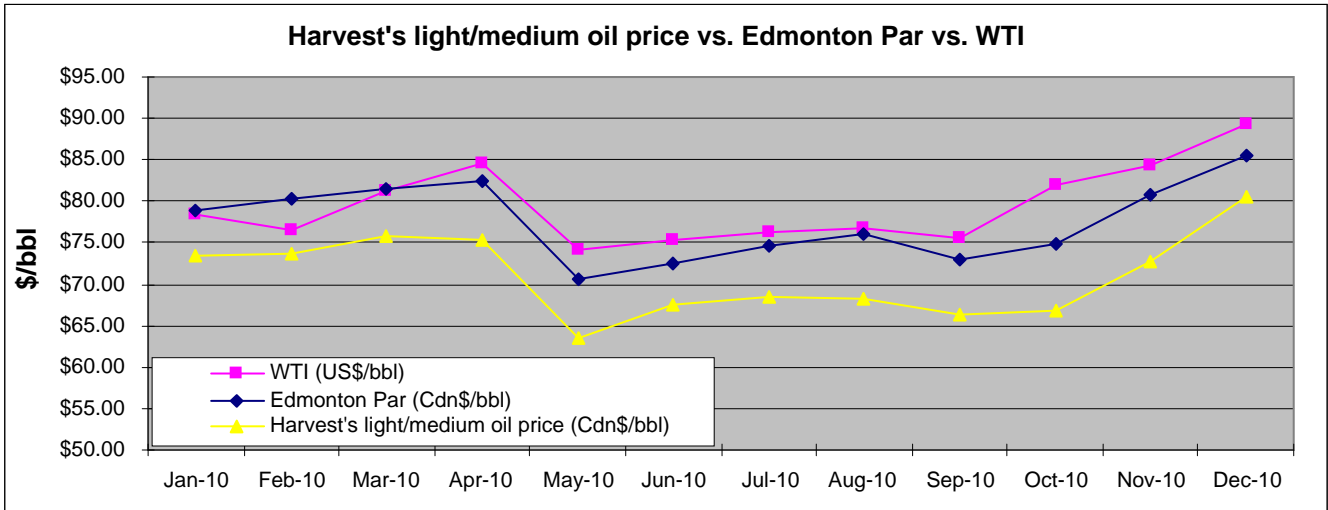
The following table summarizes our average realized price by product for the three months and year ended December 31, 2010:

	December 31, 2010	
	Three Months Ended	Year Ended
Light to medium oil (\$/bbl)	73.44	71.09
Heavy oil (\$/bbl)	58.82	59.94
Natural gas liquids (\$/bbl)	60.69	58.83
Natural gas (\$/mcf)	3.81	4.21
Average realized price (\$/boe)	56.03	55.85

<sup>(1)</sup> Realized commodity prices exclude the impact of price risk management activities.

Harvest's monthly average realized price fluctuated between \$49.11/boe and \$62.51/boe during 2010 with the higher prices realized during the first and fourth quarters. Harvest's realized oil prices peaked in December 2010, consistent with the global oil prices recovery. Harvest's realized gas prices were higher at the beginning of 2010 and dropped in March 2010 and remained between \$3.50/mcf and \$4.10/mcf for the rest of 2010.

The trend in Harvest's average realized price throughout the year is consistent with the trend in benchmark prices for 2010.



Harvest's realized price for light to medium oil increased by 8% to \$73.44/bbl in the fourth quarter of 2010 as compared to \$67.71/bbl in the third quarter, reflecting the 8% increase in Edmonton Par. Despite the 8% increase in the Bow River benchmark from the third to fourth quarter of 2010, Harvest's average realized price of heavy oil increased marginally by 1% from \$58.52/bbl in the prior quarter to \$58.82/bbl in the fourth quarter of 2010, partially due to a prior year price correction from one of our purchasers in the fourth quarter. The increase in the average realized price for gas of 2% for the fourth quarter of 2010 from \$3.74/mcf in the third quarter of 2010 is consistent with the 2% increase in the AECO benchmark price.

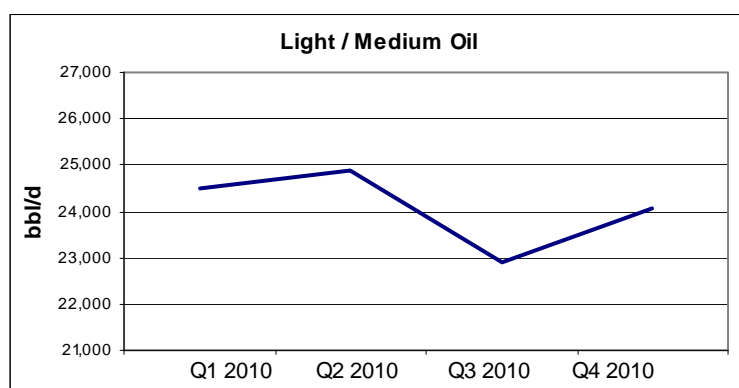
**Sales Volumes**

The average daily sales volumes by product were as follows:

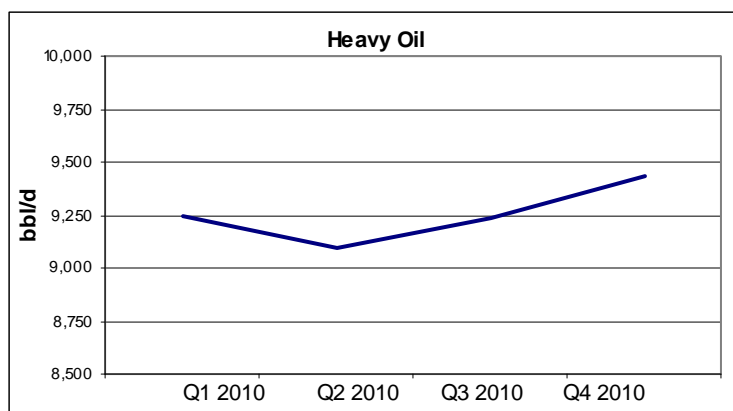
	December 31, 2010			
	Three Months Ended		Year Ended	
	Volume	Weighting	Volume	Weighting
Light / medium oil (bbl/d) <sup>(1)</sup>	24,079	48%	24,077	49%
Heavy oil (bbl/d)	9,433	19%	9,253	19%
Natural gas liquids (bbl/d)	2,736	5%	2,587	5%
Total liquids (bbl/d)	36,248	72%	35,917	73%
Natural gas (mcf/d)	82,837	28%	80,881	27%
Total oil equivalent (boe/d)	50,054	100%	49,397	100%

<sup>(1)</sup> Harvest classifies our oil production, except that produced from Hay River, as light, medium and heavy according to NI 51-101 guidance. The oil produced from Hay River has an average API of 24° (medium grade), however, it benefits from a heavy oil royalty regime and therefore would be classified as heavy oil according to NI 51-101.

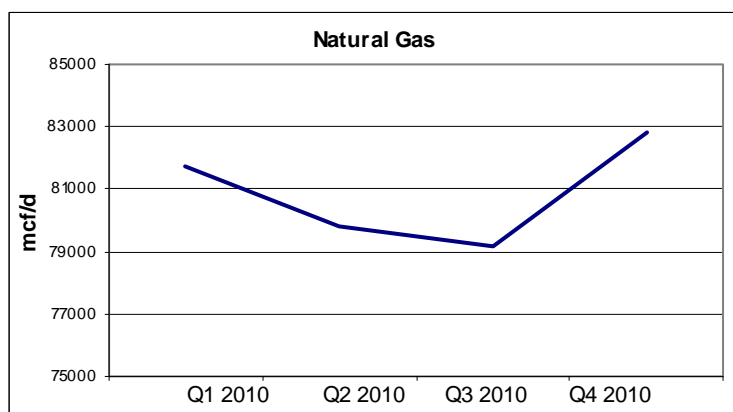
Harvest's sales volumes improved to 50,054 boe/d in the fourth quarter (5% increase from 47,777 boe/d in the third quarter) due to the acquisition at the end of the third quarter. Production was highest in the first quarter at 50,178 boe/d and lowest in the third quarter due to power outages and third party infrastructure constraints.



In the fourth quarter of 2010, Harvest's average daily sales of light/medium oil was 24,079 bbl/d compared to prior quarter of 22,886 bbl/d resulting in an increase of 1,193 bbl/d. This increase is mainly attributable to the third quarter acquisition.



Harvest's heavy oil sales increased to 9,433 bbl/d from 9,235 bbl/d in the prior quarter reflecting additional wells that were brought online between September and December 2010 in Metiskow, Murray Lake and Suffield.



Natural gas sales averaged 82,837 mcf/d in the fourth quarter of 2010 compared to prior quarter of 79,147 mcf/d as a result of an acquisition in the third quarter and the recovery from third party facility turnarounds in the prior quarter.

**Revenues**

	<b>December 31, 2010</b>	
	<b>Three Months Ended</b>	<b>Year Ended</b>
Light / medium oil sales	\$ 162,685	\$ 624,778
Heavy oil sales	51,048	202,445
Natural gas sales	29,003	124,226
Natural gas liquids sales and other	15,277	55,556
<b>Total sales revenue</b>	<b>258,013</b>	<b>1,007,005</b>
Royalties	(38,102)	(154,757)
<b>Net revenues</b>	<b>\$ 219,911</b>	<b>\$ 852,248</b>

Harvest's sales revenue in 2010 has decreased since the first quarter with a total of \$271.7 and climbed back to \$258.0 million in the fourth quarter. The decrease was mainly due to the decrease in sales volumes and the decrease in Harvest's realized price of light to medium, heavy oil and natural gas. Sales volumes decreased from an average of 50,178 bbl/d in the first quarter to 47,777 bbl/d in the third quarter and climbed back to 50,054 bbl/d in the fourth quarter of 2010. Harvest's average realized price fell from \$60.17/bbl in the first quarter of 2010 and rebounded back to \$56.03/bbl in the fourth quarter.

Harvest's revenue is impacted by changes to sales volumes, commodity prices and currency exchange rates. The upstream operation's total sales revenue for the three months ended December 31, 2010 was \$258.0 million, \$26.3 million higher than the prior quarter total sales revenue of \$231.7 million. The 11% increase is attributable to higher realized commodity prices and sales volumes, partially offset by the strengthening of the Canadian dollar against the US dollar.

**Royalties**

Harvest pays Crown, freehold and overriding royalties to the owners of mineral rights from which production is generated. These royalties vary for each property and product and our Crown royalties are based on a sliding scale dependent on production volumes and commodity prices.

Royalties for the fourth and third quarter of 2010 were \$38.1 million and \$33.7 million respectively. Royalties as a percentage of gross revenue were relatively consistent for the fourth quarter of 2010 at 14.8% as compared to 14.5% in the third quarter of 2010. The year-to-date royalties were \$154.8 million, or 15.4%.

**Operating Expenses**

	<b>December 31, 2010</b>			
	<b>Three Months Ended</b>		<b>Year Ended</b>	
	Total	Per boe	Total	Per boe
Operating expense				
Power and fuel	\$ 15,412	\$ 3.35	\$ 59,106	\$ 3.28
Well servicing	13,366	2.90	50,427	2.80
Repairs and maintenance	10,932	2.37	43,720	2.42
Lease rentals and property tax	7,233	1.57	30,637	1.70
Labour - internal	5,419	1.18	22,641	1.26
Labour - contract	4,146	0.90	15,966	0.89
Processing and other fees	2,902	0.63	13,538	0.75
Chemicals	2,636	0.57	12,981	0.72
Trucking	2,535	0.55	9,645	0.53
Other	5,068	1.10	6,932	0.38
<b>Total operating expenses</b>	<b>\$ 69,649</b>	<b>\$ 15.12</b>	<b>\$ 265,593</b>	<b>\$ 14.73</b>
Transportation and marketing expense	\$ 2,634	\$ 0.57	\$ 9,394	\$ 0.52

Operating expenses have been relatively consistent throughout 2010, at an average of \$66.4 million per quarter. Fourth quarter operating expenses were the highest during 2010 mainly due to the additional costs related to the acquisition in the third quarter. Second quarter operating expenses were higher than the first and third quarters due to the Alberta Power Pool electricity price peak of \$80.56/MWh for the second quarter of 2010, resulting in high power and fuel costs.

Fourth quarter 2010 operating costs totaled \$69.6 million, an increase of \$6.2 million as compared to the prior quarter operating costs of \$63.4 million. The increase in operating costs is due to higher power and fuel costs, increased well servicing costs and incrementally higher operating costs related to the acquisition at the end of the third quarter. On a per barrel basis, operating costs have increased to \$15.12/boe in the fourth quarter of 2010 as compared to \$14.42/boe in the third quarter of 2010. The 5% increase is substantially attributed to higher power and fuel costs due to the increase in the average Alberta Power Pool electricity price from \$35.69/MWh in the third quarter of 2010 to \$45.97/MWh for the fourth quarter of 2010.

<i>(\$ per boe)</i>	<b>December 31, 2010</b>			
	<b>Three Months Ended</b>		<b>Year Ended</b>	
Electric power and fuel costs	\$	3.35	\$	3.28
Realized losses on electricity risk management contracts		0.16		0.10
Net electric power and fuel costs	\$	3.51	\$	3.38
Alberta Power Pool electricity price (\$ per MWh)	\$	45.97	\$	50.78



Fourth quarter 2010 transportation and marketing expense was relatively consistent at \$2.6 million (\$0.57/boe) as compared to \$2.5 million (\$0.57/boe) in the third quarter of 2010. Throughout 2010, transportation and marketing expenses were relatively consistent at an average of \$2.3 million (\$0.52/boe) per quarter. These costs relate primarily to delivery of natural gas to Alberta's natural gas sales hub, the AECO Storage Hub, and Harvest's cost of trucking clean crude oil to pipeline receipt points. As a result, the total dollar amount of costs fluctuates in relation with Harvest's production volumes while the cost per boe typically remains relatively constant.

**Operating Netback**

(\$ per boe)	December 31, 2010	
	Three Months Ended	Year Ended
Revenues	\$ 56.03	\$ 55.85
Royalties	(8.27)	(8.58)
Operating expense	(15.12)	(14.73)
Transportation expense	(0.57)	(0.52)
Operating netback <sup>(1)</sup>	\$ 32.07	\$ 32.02

<sup>(1)</sup> This is a non-GAAP measure; please refer to "Non-GAAP Measures" in this MD&A.

Harvest's operating netback represents the net amount realized on a per boe basis after deducting directly related costs. The 2010 operating netback was strongest at \$36.20/bbl in the first quarter and weakest in the second quarter at \$29.68/bbl. The trend in the operating netback closely follows that in the average realized prices.

In the fourth quarter of 2010, our operating netback increased by \$2.02/boe from \$30.05/boe in the prior quarter. The increase is due to a higher average realized price in the fourth quarter, partially offset by higher royalties and operating costs.

**General and Administrative ("G&A") Expense**

	December 31, 2010	
	Three Months Ended	Year Ended
Total G&A	\$ 11,111	\$ 44,974
G&A per boe (\$/boe)	2.41	2.49

For the three months ended December 31, 2010, G&A expense increased nominally by \$1.4 million from \$9.7 million in the third quarter of 2010. The increase in G&A is primarily due to increased consulting expenses and payroll taxes related to KNOC employees seconded to Harvest. Approximately 80% of the G&A expenses are related to salaries and other employee related costs.

**Depletion, Depreciation, Amortization and Accretion Expense ("DDA&A")**

	December 31, 2010	
	Three Months Ended	Year Ended
Depletion and depreciation	\$ 99,251	\$ 387,462
Depletion of capitalized asset retirement costs	8,469	35,388
Accretion on asset retirement obligation	6,457	25,241
Total depletion, depreciation and accretion	\$ 114,177	\$ 448,091
Per boe (\$/boe)	\$ 24.79	\$ 24.85

Harvest's DDA&A is closely aligned with the sales volume and is impacted by our asset base which has slightly increased during the fourth quarter of 2010 due to acquisitions and higher drilling activities throughout the period.

Harvest's DDA&A expense for the three months ended December 31, 2010 was marginally higher by \$1.9 million than the prior quarter expense of \$112.3 million.

**Capital Expenditures**

	<b>December 31, 2010</b>	
	<b>Three Months Ended</b>	<b>Year Ended</b>
Drilling and completion	\$ 82,428	\$ 223,543
Well equipment, pipelines and facilities	35,756	107,933
Land and undeveloped lease rentals	6,954	23,803
Capitalized G&A expenses	2,944	13,027
Geological and geophysical	874	12,719
Furniture, leaseholds and office equipment	1,508	1,934
<b>Total conventional oil and gas capital expenditures</b>	<b>130,464</b>	<b>382,959</b>
Oil sands		
BlackGold oil sands	17,440	21,056
<b>Total development capital expenditures excluding acquisitions</b>	<b>\$ 147,904</b>	<b>\$ 404,015</b>

*Conventional Oil and Gas*

In 2010, approximately 58% of our conventional development capital expenditures were incurred to drill 171 gross wells with a success rate of 99%. Harvest had an active drilling program in 2010 due to strengthening oil prices and increased access to capital following the KNOC acquisition in 2009. Our 2010 drilling activity focused primarily on our oil properties where attractive netbacks generated positive economic returns. At Red Earth we drilled 36 gross (30.5 net) wells and completed infrastructure upgrades for a total cost of \$85.4 million. The majority of our activity was in the Slave Point formation where we are drilling horizontal wells and applying multi-staged fracturing technology. At Hay River BC, we drilled 10 gross (10 net) including 5 water injection wells to continue our Enhanced Oil Recovery efforts in the Bluesky formation, for a total expenditure of \$36.2 million. In SE Saskatchewan we drilled 20 gross (19.5 net) wells for a total expenditure of \$27.0 million. At SE Saskatchewan, Harvest produces light oil from the Tilston, Souris Valley and Bakken formations. Heavy oil prices in 2010 were very attractive and Harvest drilled 6 gross (6 net) wells at Suffield and 29 gross (26.8 net) wells in our Lloydminster area for a total expenditure of \$43.6 million. In our Markerville/Rimbey area, Harvest drilled 26 gross (15.4 net) wells and invested in infrastructure upgrades for a total expenditure of \$52.2 million. Targeted formations include the Cardium and Eilerslie (light oil) as well as the Ostracod (liquids rich natural gas). At Kindersley, Saskatchewan, we drilled 13 gross (10.2 net) horizontal wells with multi-staged fracture completions targeting light oil in the Viking formation.

During the three months and the year ended December 31, 2010 the Harvest invested \$107.9 million and \$35.8 million, respectively in well equipment, pipelines and facilities relating to drilling and production optimization projects.

In 2010, Harvest invested \$23.8 million to acquire additional mineral rights on approximately 175,436 net acres of undeveloped land that will provide additional drilling opportunities in the future.

Capital expenditures for the fourth quarter increased as Harvest was able to accelerate the winter drilling programs at Red Earth. At Red Earth, Harvest further delineated and continued the development of our Slave Point light oil resources play by drilling 18 gross (15.8 net) wells in the fourth quarter, the majority of which were multi-stage fractured horizontal wells, for a total expenditure of \$30.3 million. Similarly at Kindersley, Saskatchewan, Harvest drilled 7 gross (5.5 net) multi-stage fractured horizontal wells in our Viking light oil resource play for a total expenditure of \$6.4 million. At Rimbey/Markerville we drilled 11 gross (6.9 net) wells for a total expenditure of \$36.2 million with 7 gross horizontal wells targeting the

Cardium light oil formation. Additional drilling focused on attractive heavy oil netbacks in Lloydminster (4 gross; 3.8 net wells) and light oil netbacks in SE Saskatchewan (4 gross; 4 net wells) for a total expenditure of \$12.2 million.

During the fourth quarter of 2010 Harvest continued to add to our undeveloped land base and invested \$7.0 million in undeveloped land opportunities in various areas to be used for future exploration and development.

The following summarizes Harvest's participation in gross and net wells drilled during the three and year ending December 31, 2010:

Area	December 31, 2010			
	Three Months Ended		Year Ended	
	Gross	Net	Gross	Net
Hay River	2.0	2.0	10.0	10.0
SE Alberta	2.0	2.0	20.0	15.4
Rimbey/Markerville	11.0	6.9	26.0	15.4
SE Saskatchewan	4.0	4.0	20.0	19.5
Red Earth	18.0	15.8	36.0	30.5
Suffield	0.0	0.0	6.0	6.0
Lloydminster Heavy Oil	4.0	3.8	29.0	26.8
Crossfield	1.0	0.6	4.0	3.5
Kindersley	7.0	5.5	13.0	10.2
Other Areas	2.0	1.0	7.0	4.0
<b>Total</b>	<b>51.0</b>	<b>41.6</b>	<b>171.0</b>	<b>141.4</b>

#### *Oil sands*

On August 6, 2010, Harvest acquired the BlackGold oil sands project assets ("BlackGold") from KNOC for \$374 million of Harvest's shares. As KNOC is the sole shareholder of Harvest, these assets were recorded at the existing carrying values as previously recorded by KNOC.

BlackGold is located in northeastern Alberta and has existing Energy Resources Conservation Board ("ERCB") approval for phase 1 project of 10,000 bbl/d and an application has been made for a phase 2 project that is targeted to increase production to 30,000 bbl/d. Approval for phase 2 of the project is expected from the ERCB in 2012. The project will utilize steam assisted gravity drainage; a proven technology that uses innovation in horizontal drilling, with the first oil expected in early 2013 at an estimated production of 10,000 bbl/d.

During 2010, Harvest signed an engineering, procurement and construction ("EPC") lump sum contract with a third party to build a central processing facility for BlackGold for an aggregate of \$311 million. A 10% deposit of \$31.1 million was paid in 2010. Year-to-date capital expenditures were \$21.1 million, relating to engineering and site preparation work for the main facility and production pad sites. The remaining \$289.9 million of the EPC contracted cost is expected to be incurred in 2011 and 2012.

#### **Asset Retirement Obligations ("ARO")**

Harvest's upstream asset retirement obligations result from its net ownership interest in petroleum and natural gas assets including well sites, gathering systems and processing facilities and the estimated costs and timing to reclaim and abandon them. In connection with property acquisitions and development expenditures, Harvest records the fair value of the ARO as a liability in the same year the expenditures occur. The associated asset retirement costs are capitalized as part of the carrying amount of the assets and are depleted and depreciated over our estimated net proved reserves. Once the initial ARO is measured, it is adjusted at the end of each period to reflect the passage of time as well as changes in the estimated

future cash flows of the underlying obligation. At December 31, 2010, Harvest estimates the total undiscounted amount of cash flows required to settle its upstream asset retirement obligations to be approximately \$1,227 million which will be incurred between 2011 and 2070. A credit-adjusted risk-free discount rate of 8% - 10% and inflation rate of approximately 2% were used to calculate the fair value of the asset retirement obligations. Our asset retirement obligation increased by \$18.0 million during 2010 as a result of accretion expense of \$25.2 million, new liabilities recorded at \$11.4 million and revision of estimates of \$1.7 million, offset by \$20.3 million of asset retirement liabilities settled.

**Goodwill**

Goodwill is recorded when the purchase price of an acquired business exceeds the fair value of the net identifiable assets and liabilities of that acquired business. At December 31, 2010, Harvest had \$404.9 million of goodwill on the balance sheet related to the upstream segment. The goodwill balance is assessed annually for impairment or more frequently if events or changes in circumstances occur that would reasonably be expected to reduce the fair value of the acquired business to a level below its carrying amount.

**DOWNSTREAM OPERATIONS**
**Summary of Financial and Operational Results**

	Three Months Ended December 31			Year Ended December 31		
	2010	2009 (pro forma) <sup>(5)</sup>	Change	2010	2009 (pro forma) <sup>(5)</sup>	Change
<b>FINANCIAL</b>						
Revenues	<b>1,035,874</b>	639,123	62%	<b>2,949,930</b>	2,381,637	24%
Purchased feedstock for processing and products purchased for resale <sup>(4)</sup>	<b>958,845</b>	579,108	66%	<b>2,733,019</b>	2,015,671	36%
Gross margin <sup>(1)</sup>	<b>77,029</b>	60,015	28%	<b>216,911</b>	365,966	(41%)
Costs and expenses						
Operating expense	<b>28,980</b>	28,265	3%	<b>114,697</b>	102,556	12%
Purchased energy expense	<b>40,504</b>	33,715	20%	<b>106,126</b>	91,868	16%
Marketing expense	<b>1,544</b>	2,291	(33%)	<b>6,366</b>	12,009	(47%)
General and administrative expense	<b>441</b>	228	93%	<b>1,764</b>	1,593	11%
Depreciation and amortization expense	<b>20,553</b>	20,708	(1%)	<b>83,091</b>	89,238	(7%)
Earnings (Loss) from operations <sup>(1)</sup>	<b>(14,993)</b>	(25,192)	40%	<b>(95,133)</b>	68,702	(238%)
Capital expenditures	<b>32,591</b>	9,964	227%	<b>71,234</b>	91,362	(22%)
<b>OPERATING</b>						
Feedstock volume (bbl/day) <sup>(2)</sup>	<b>111,317</b>	75,814	47%	<b>86,142</b>	83,939	3%
Yield (000's barrels)						
Gasoline and related products	<b>3,575</b>	2,488	44%	<b>9,877</b>	10,499	(6%)
Ultra low sulphur diesel and jet fuel	<b>3,988</b>	2,930	36%	<b>11,339</b>	12,196	(7%)
High sulphur fuel oil	<b>2,674</b>	1,598	67%	<b>9,657</b>	7,538	28%
Total	<b>10,237</b>	7,016	46%	<b>30,873</b>	30,233	2%
Average refining gross margin (US\$/bbl) <sup>(3)</sup>	<b>6.13</b>	6.55	(6%)	<b>5.13</b>	9.12	(44%)

<sup>(1)</sup> These are non-GAAP measures; please refer to "Non-GAAP Measures" in this MD&A.

<sup>(2)</sup> Barrels per day are calculated using total barrels of crude oil feedstock and vacuum gas oil.

<sup>(3)</sup> Average refining gross margin is calculated based on per barrel of feedstock throughput.

<sup>(4)</sup> Purchased feedstock for processing and products purchased for resale includes inventory write-downs, net of reversals, of (\$0.1) million and \$2.4 million for the three months and year ended December 31, 2010, respectively.

<sup>(5)</sup> The pro forma consolidated results of operations have been prepared as if the acquisition of the Trust and the subsequent reorganization occurred on January 1, 2009. For a summary of the pro forma adjustments, see note 1 to the December 31, 2010 consolidate financial statements.

Despite the increase in revenues in 2010, the year to date gross margin is 41% lower than the 2009 pro forma results and a loss has resulted from operations compared to earnings from operations in 2009. This is largely due to the shutdowns that occurred during the first and third quarters of 2010. The low throughput volumes during those quarters had a negative impact on earnings from operations. Costs relating to the repairs and maintenance during the shutdowns in the first and third quarters were included in operating expenses, therefore increasing the loss from operations for the year ended December 31, 2010. The gross margin for the year ended December 31, 2010 of US\$5.13/bbl was significantly lower than the 2009 pro forma gross margin of US\$9.12/bbl as a result of lower crack spreads during 2010.

Capital expenditures in 2010 were 22% lower than the 2009 pro form capital expenditures primarily due to the turnaround and catalyst works performed during 2009.

Our downstream operations, North Atlantic Refining ("North Atlantic") consists of a 115,000 bbl/d medium gravity sour crude oil hydrocracking refinery and a retail and wholesale petroleum marketing business both located in the Province of Newfoundland and Labrador. Our petroleum marketing business is composed of branded and unbranded retail and wholesale distribution and sales of gasoline, diesel, jet and other transportation fuels, as well as home heating fuels and the revenues from our marine services businesses.

Our refining gross margin is a function of the sales value of the refined products produced and the cost of crude oil and other feedstocks purchased as well as the yield of refined products from various feedstocks. We continuously evaluate the market and relative refinery values of several different crude oils and vacuum gas oils ("VGO") to determine the optimal feedstock mix. We analyze the refining gross margin for our sales revenue relative to refined product benchmark prices and the WTI benchmark prices. With respect to feedstock costs, we analyze our price discounts relative to the WTI benchmark prices and segregate crude oil sources by country of origin for reporting.

In 2010, we purchased substantially all of our refinery feedstock and sold our distillates, gasoline products and our high sulphur fuel oil ("HSFO") to Vitol Refining S.A. ("Vitol") pursuant to the supply and offtake agreement ("SOA"), with the exception of products sold in Newfoundland through our petroleum marketing division and spot sales of HSFO products sold to various credit approved customers.

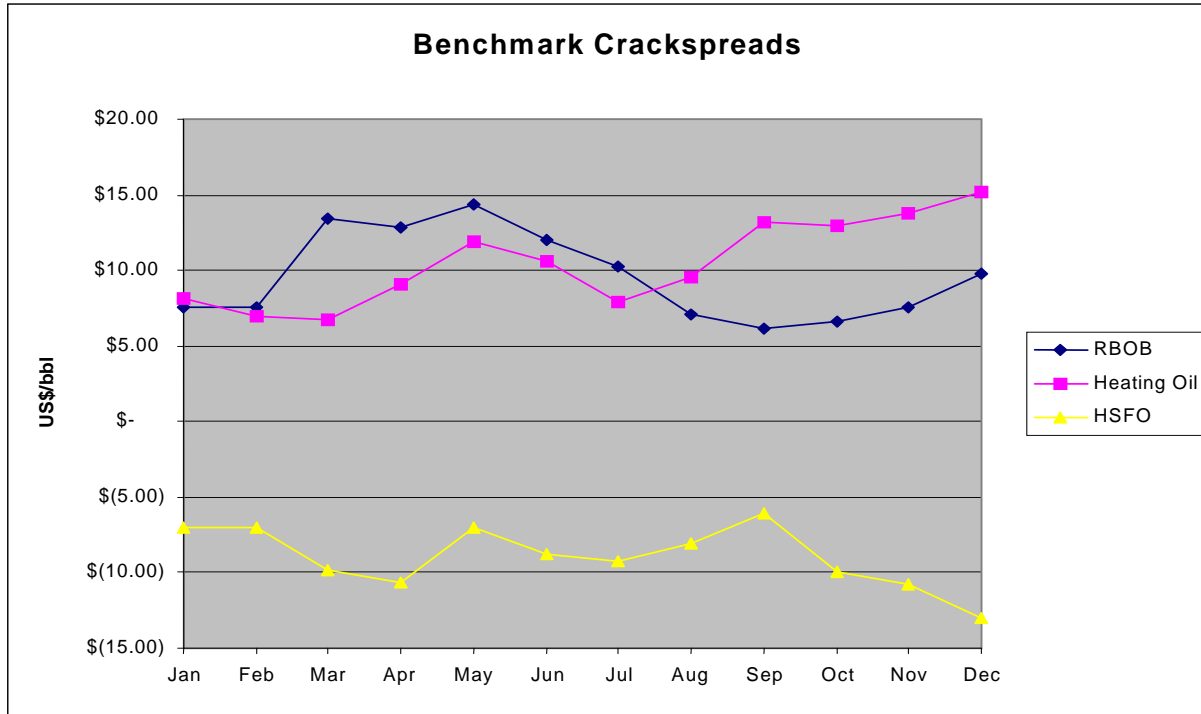
The SOA with Vitol contains pricing terms that reflect market prices based on an average ten-day delay which results in our purchases from, and sales to, Vitol being priced on future prices as compared to pricing at the time of the delivery. Refined product sales to customers other than Vitol are sold at prices that reflect market prices at the time that the product is delivered to the purchaser.

#### Refining Benchmark Prices

The following average benchmark prices and currency exchange rates are the reference points from which we discuss our refinery's financial performance:

	<b>December 31, 2010</b>	
	<b>Three Months Ended</b>	<b>Year Ended</b>
WTI crude oil (US\$/bbl)	85.17	79.53
Brent crude oil (US\$/bbl)	87.32	80.29
RBOB gasoline (US\$/bbl)	93.17	89.11
RBOB gasoline crack spread (US\$/bbl)	8.00	9.58
Heating oil (US\$/bbl)	99.15	90.03
Heating oil crack spread (US\$/bbl)	13.98	10.50
High Sulphur Fuel Oil (US\$/bbl)	73.92	70.57
High Sulphur Fuel Oil discount	(11.25)	(8.96)
Canadian / U.S. dollar exchange rate	0.987	0.971

The following graph summarizes the WTI crack spreads for the respective benchmark product prices for the year ended December 31, 2010:

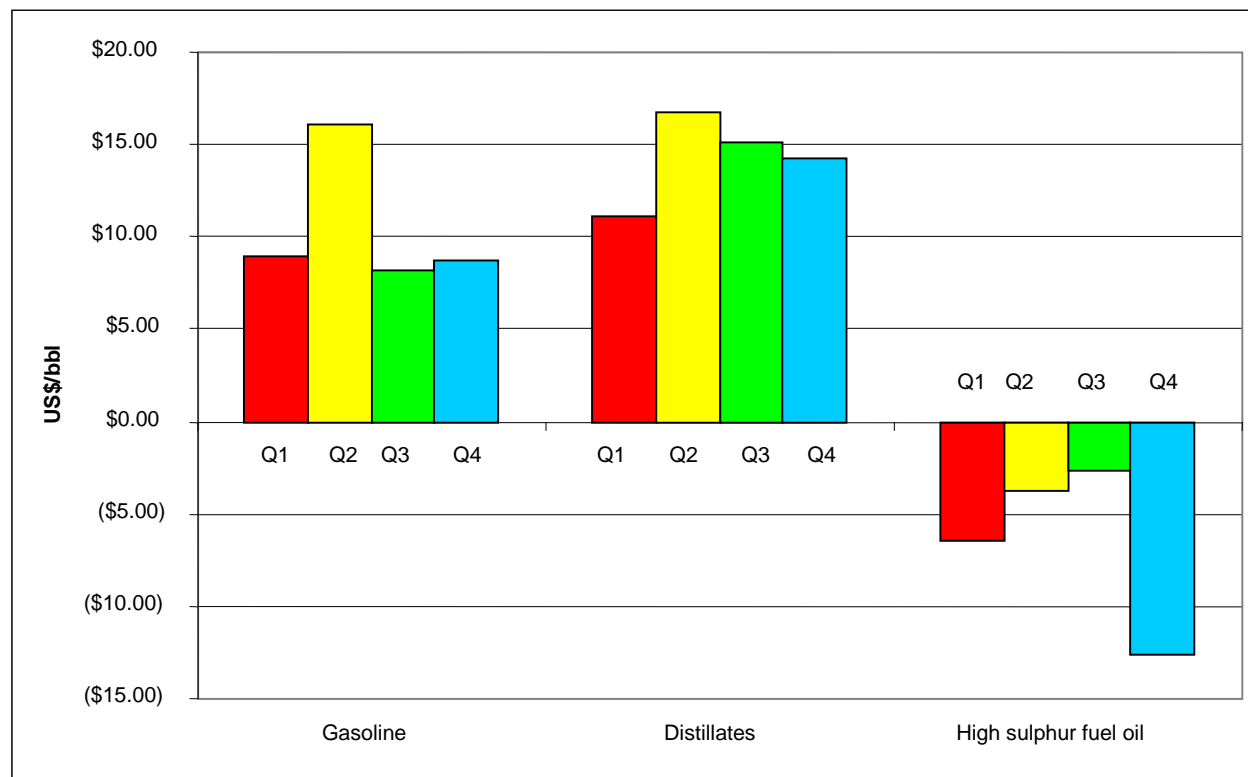


The following table details the refinery's products average crack spread over WTI as compared to the benchmark crack spreads:

(US \$ per bbl)	December 31, 2010			
	Three Months Ended		Twelve Months Ended	
	Refinery	Benchmark	Refinery	Benchmark
Gasoline and related products	8.78	8.00	8.78	9.58
Distillates	14.32	13.98	12.69	10.50
High sulphur fuel oil	(12.57)	(11.25)	(8.59)	(8.96)

The average crack spread of our refinery products differs from the benchmark crack spreads as a result of timing of sales under the SOA, transportation costs, location differentials, quality differentials and variability in our throughput volume over a given period of time.

The following chart summarizes our refined products average crack spread by quarter in 2010:



**Summary of Gross Margin**

The following table summarizes our downstream gross margin for the three months and year ended December 31, 2010 segregated between refining activities and petroleum marketing and other related businesses.

	December 31, 2010					
	Three Months Ended			Year Ended		
	Refining	Marketing	Total	Refining	Marketing	Total
Sales revenue <sup>(1)</sup>	1,001,948	152,577	1,035,874	2,824,154	569,345	2,949,930
Cost of feedstock for processing and products for resale <sup>(1)</sup>	938,365	139,131	958,845	2,658,059	518,529	2,733,019
Gross margin <sup>(2)</sup>	63,583	13,446	77,029	166,095	50,816	216,911

(1) Downstream sales revenue and cost of products for processing and resale are net of intra-segment sales of \$118.7 million and \$443.6 million for the three months and year ended December 31, 2010, respectively, reflecting the refined products produced by the refinery and sold by the Marketing Division.

(2) This is a non-GAAP measure; please refer to "Non-GAAP Measures" in this MD&A.

As a consequence of a fire in early January of 2010, the refinery units were shut down for part of the first quarter, which resulted in a negative impact on revenues and operations for the year ended December 31, 2010. An insurance claim has been submitted relating to the cost of the business interruption loss. The net proceeds will be recorded as income in the period in which there is agreement on the amount to be received under the insurance coverage. The average daily throughput was 86,142 bbl/d for the year ended December 31, 2010. Fourth quarter daily average throughput increased by 15% compared to the average daily throughput of 96,514 bbl/d in the prior quarter. The 14,803 bbl/d increase reflects the



normal operations of the units following an unplanned maintenance and catalyst change-out in the hydrogen unit in the third quarter.

For the three months ended December 31, 2010, our refining gross margin increased 128% to \$63.6 million from the prior quarter of \$27.9 million. The increase reflects the return to normal operations in the fourth quarter. The gross margins from the marketing operations in the fourth quarter are only slightly lower than the prior quarter gross margin of \$14.0 million. The strengthening of the Canadian dollar in the fourth quarter of 2010 has slightly offset the contribution from our downstream operations as substantially all of its gross margin, cost of purchased energy and marketing expense are denominated in U.S. dollars.

### Refinery Sales Revenue

A comparison of our refinery yield, product pricing and revenue for the three months and year ended December 31, 2010 is presented below:

	<b>December 31, 2010</b>					
	<b>Three Months Ended</b>			<b>Year Ended</b>		
	<b>Refinery Revenues</b>	<b>Volume</b> <i>(000s of bbls)</i>	<b>Sales Price</b> <i>(US\$ per bbl)</i>	<b>Refinery Revenues</b>	<b>Volume</b> <i>(000s of bbls)</i>	<b>Sales Price</b> <i>(US\$ per bbl)</i>
Gasoline products	384,268	4,037	93.95	985,737	10,838	88.31
Distillates	397,447	3,943	99.49	1,114,963	11,740	92.22
High sulphur fuel oil	220,233	2,994	72.60	723,454	9,902	70.94
	1,001,948	10,974	90.12	2,824,154	32,480	84.43
Inventory adjustment		(737)			(1,607)	
Total production		10,237			30,873	
Yield (as a % of Feedstock) <sup>(1)</sup>		100%			98%	

<sup>(1)</sup> Based on production volumes after adjusting for changes in inventory held for resale.

The table below details the refinery's product yields for the three months and year ended December 31, 2010:

	<b>December 31, 2010</b>	
	<b>Three Months Ended</b>	<b>Twelve Months Ended</b>
Gasoline and related products	35%	32%
Distillates	39%	37%
High sulphur fuel oil <sup>(1)</sup>	26%	31%

<sup>(1)</sup> Includes 1.2 million bbls of produced VGO for the year ended December 31, 2010

The refinery yields for the year ended December 31, 2010 are impacted by the unplanned shutdowns in the first and third quarters of the year. Fourth quarter yields are reflective of normal operations with an increase in yields of gasoline products and distillates and a decrease in the yield of HSFO as compared to the prior quarter yields of 28% gasoline products, 32% distillates and 40% HSFO. The third quarter yields are a consequence of the unplanned maintenance and catalyst change-out in the hydrogen unit that resulted in a decrease in the production of gasoline and distillates and an increase in the production of HSFO and VGO.

**Refinery Feedstock**

A comparison of crude oil and VGO feedstock processed for the three months and year ended December 31, 2010 is presented below:

	<b>December 31, 2010</b>					
	<b>Three Months Ended</b>			<b>Twelve Months Ended</b>		
	<b>Cost of Feedstock</b>	<b>Volume</b> <i>(000s of bbls)</i>	<b>Cost per Barrel</b> <sup>(1)</sup> <i>(US\$/bbl)</i>	<b>Cost of Feedstock</b>	<b>Volume</b> <i>(000s of bbls)</i>	<b>Cost per Barrel</b> <sup>(1)</sup> <i>(US\$/bbl)</i>
Middle Eastern	607,721	7,019	85.46	1,713,780	21,456	77.56
Russian	211,780	2,453	85.21	485,884	5,884	80.18
South American	33,867	423	79.02	211,318	2,978	68.90
Crude Oil Feedstock	853,368	9,895	85.12	2,410,982	30,318	77.22
Vacuum Gas Oil	31,367	347	89.22	95,519	1,124	82.52
	884,735	10,242	85.26	2,506,501	31,442	77.41
Net inventory adjustment <sup>(2)</sup>	20,505			9,427		
Additives and blendstocks	33,224			139,742		
Inventory write-down (recovery) <sup>(3)</sup>	(99)			2,389		
	938,365			2,658,059		

<sup>(1)</sup> Cost of feedstock includes all costs of transporting the crude oil to the refinery in Newfoundland.

<sup>(2)</sup> Inventories are determined using the weighted average cost method.

<sup>(3)</sup> Inventory write-downs are calculated on a product by product basis using the lower of cost or net realizable value.

The volatility of WTI prices from month to month makes it difficult to compare the financial impact of specific crude types when our consumption of crude types varies over the period. Further, our refinery competes for international waterborne crude oil and VGO's and the WTI benchmark price reflects a land-locked North American price with limited access to the international markets.

The cost of our feedstock reflects numerous factors beyond WTI prices, including the quality of the crude oil processed, the mix of crude oil types, the costs of transporting the crude oil to our refinery, the operational hedging of the WTI component of our feedstock costs through the SOA, the ten day delay in pricing pursuant to the SOA and for Middle Eastern crude oil purchased, the OSP and the carrying costs of inventories due to shutdowns.

As is normal business practice, the WTI component of our feedstock cost is operationally hedged under the SOA with Vitol. When we commit to crude oil purchases, Vitol sells a forward WTI price contract for the next contract month, which results in price fluctuations subsequent to our purchase commitment being offset by the price volatility of the forward price curve. If the timing between processing the crude oil and the expiration of the forward contract are not aligned, the volume of the forward contract relating to unprocessed crude oil is rolled to the next contract month. This practice results in better matching of our refined product sales prices with our cost of feedstock. The persistent contango shape of the NYMEX WTI futures results in operational hedging gains from the rolling forward of these price contracts, which reduce our feedstock costs in the month the feedstock is processed.

The following table details the differential of our feedstock pricing to the benchmark WTI for the three months and year ended December 31, 2010:

<i>(US \$ per bbl)</i>	<b>December 31, 2010</b>			
	<b>Three Months Ended</b>		<b>Year Ended</b>	
	<b>Crude</b>	<b>VGO</b>	<b>Crude</b>	<b>VGO</b>
Quality discount	(0.50)	5.83	(1.78)	5.56
Operational hedging gain	(0.43)	(1.81)	(0.96)	(2.02)
Timing under the SOA	0.88	0.03	0.43	(0.55)
<b>Total</b>	<b>(0.05)</b>	<b>4.05</b>	<b>(2.31)</b>	<b>2.99</b>

Included in the additives and blendstocks for the three months and year ended December 31, 2010 is the cost of a gasoline blendstock which is blended with summer RBOB gasoline and the cost of products purchased for resale to the local market.

### Operating Expenses

The following summarizes the operating expenses of the refinery and marketing divisions for the three months and year ended December 31, 2010:

	<b>December 31, 2010</b>					
	<b>Three Months Ended</b>			<b>Year Ended</b>		
	<b>Refining</b>	<b>Marketing</b>	<b>Total</b>	<b>Refining</b>	<b>Marketing</b>	<b>Total</b>
Operating cost	23,387	5,593	28,980	93,078	21,619	114,697
Purchased energy	40,504	-	40,504	106,126	-	106,126
	63,891	5,593	69,484	199,204	21,619	220,823
<i>(Per barrel of feedstock throughput)</i>						
Operating cost	2.28	-	-	2.96	-	-
Purchased energy	3.96	-	-	3.38	-	-
	6.24	-	-	6.34	-	-

During the three months ended December 31, 2010, refining operating costs per barrel of feedstock throughput was comparable to the operating cost of \$2.26/bbl of feedstock throughput in the prior quarter and is lower than the \$2.96/bbl for the year ended December 31, 2010. The higher cost per barrel for the year reflects higher maintenance costs and lower average daily throughput as a result of the shutdowns in the first and third quarters of 2010.

Purchased energy, consisting of low sulphur fuel oil ("LSFO") and electricity, is required to provide heat and power to refinery operations. The 52% increase in purchase energy costs from \$2.61/bbl in the third quarter is due to a volume variance of \$15.0 million combined with a price variance of \$2.0 million.

Operating costs for the domestic marketing division are fairly consistent quarter over quarter with the fourth quarter operating costs comparable to the third quarter operating cost of \$5.6 million.

### Marketing Expense and Other

During the three months and year ended December 31, 2010, marketing expense was \$0.2 million and \$0.8 million respectively and a time value of money (TVM) charge of \$1.3 million and \$5.6 million respectively both pursuant to the terms of the SOA. The marketing fees and TVM charges are comparable to the \$0.2 million and \$1.3 million costs respectively in the third quarter.

**Capital Expenditures**

Capital spending for the three months and year ended December 31, 2010 totaled \$32.6 million and \$71.2 million, respectively, relating to various capital improvement projects including \$16.2 million and \$38.1 million of expenditures, respectively related to the debottlenecking projects which are intended to raise the refinery's capacity to 130,000 bbl/d, provide enhanced yields and reduce expenses.

**Depreciation and Amortization Expense**

The following summarizes the depreciation and amortization expense for the three months and year ended December 31, 2010:

	December 31, 2010					
	Three Months Ended			Twelve Months Ended		
	Refining	Marketing	Total	Refining	Marketing	Total
Tangible assets	19,674	879	20,553	79,615	3,476	83,091

The process units are amortized over an average useful life of 20 to 30 years.

**Environmental Contingencies**

North Atlantic has been named a defendant in one of more than 100 methyl tertiary butyl ether U.S. product liability litigation cases that have been consolidated for pre-trial purposes in this matter. The plaintiffs seek relief for alleged contamination of ground water from the various defendants' use of the gasoline additives. Although the plaintiffs have not made a particular monetary demand, they are asserting collective and joint liability against all defendants. The evaluation of the risk of liability to the Company is not determinable at this time and no amounts are accrued in the consolidated financial statements in respect of this matter. Harvest is indemnified by Vitol Group B.V. in respect of this contingent liability.

**Asset Retirement Obligations**

Harvest's downstream asset retirement obligations result from its ownership of the refinery and marketing assets. Harvest has a legal obligation to reclaim and abandon these assets. At December 31, 2010, Harvest estimates the total undiscounted amount of cash flows required to settle its downstream asset retirement obligations to be approximately \$14.9 million which will be incurred beyond 2070. This obligation was not recorded in Harvest's total ARO as the fair value can not be determined because the timing of the assets retirement is uncertain.

**CORPORATE**
**Cash Flow Risk Management**

Harvest periodically enters into derivatives contracts such as forwards, futures, swaps, options and costless collars to hedge against the potential adverse impact of changes in market prices due to changes in the underlying indices. The following is a summary of Harvest's risk management contracts outstanding at December 31, 2010:

**Contracts not Designated as Hedges**

<b>Contract Quantity</b>	<b>Type of Contract</b>	<b>Term</b>	<b>Contract Price</b>	<b>Fair value</b>
30 MWh	Electricity price swap contracts	Jan - Dec 2011	Cdn \$46.87	\$1,007

**Contracts Designated as Hedges**

<b>Contract quantity</b>	<b>Type of Contract</b>	<b>Term</b>	<b>Contract Price</b>	<b>Fair value</b>
8200 bbl/day	Crude oil price swap contract	Jan - Dec 2011	US \$91.23/bbl	\$(7,553)

Harvest uses electricity price swap contracts to manage some of its electricity price risk exposures relating to its electricity consumption. For the year ended December 31, 2010, the total realized loss and unrealized gain recognized in the consolidated statement of income relating to the electricity price swap contracts was \$1.8 million and \$3.1 million respectively (\$0.7 million and \$1.9 million respectively for the three months ended December 31, 2010).

Harvest's strategic crude oil hedging program is subject to periodic management reviews to determine appropriate hedge requirements in light of the Company's tolerance for exposure to market volatility, as well as the need for stable cash flow to finance future growth. The Company may be exposed to certain losses in the event that the counterparties to derivative financial instruments are unable to meet their obligations to Harvest. This risk is minimized by entering into agreements with investment grade counterparties and counterparties that are lenders in Harvest's syndicated credit facilities. During the fourth quarter, Harvest entered into crude oil swap contracts to reduce the volatility of cash flows from a portion of its forecasted sales. The swaps were designated as cash flow hedges and are entered into for the periods consistent with forecasted petroleum sales. The effective portion of the unrealized loss of \$5.0 million (net of deferred tax asset of \$1.8 million) was included in other comprehensive income for the three months and year ended December 31, 2010. The ineffective portion of the unrealized loss of \$0.7 million was recorded to net income for the three months and year ended December 31, 2010.

**Interest Expense**

	<b>December 31, 2010</b>	
	<b>Three Months Ended</b>	<b>Year Ended</b>
Interest on short term debt		
Bank loan	\$ -	\$ 1,370
Convertible debentures	302	703
Senior notes	-	30
<b>Total interest on short term debt</b>	<b>302</b>	<b>2,103</b>
Interest on long term debt		
Bank loan	984	4,326
Convertible debentures	12,102	50,827
Senior notes	8,520	20,867
<b>Total interest expense on long term debt</b>	<b>\$ 21,606</b>	<b>\$ 76,020</b>
<b>Total interest expense<sup>(1)</sup></b>	<b>\$ 21,908</b>	<b>\$ 78,123</b>

<sup>(1)</sup> Net of capitalized borrowing cost of \$0.4 million relating to BlackGold oil sands project

The bank loan, convertible debentures and 7<sup>7/8</sup>% senior notes are recorded at amortized cost and as such interest is calculated using the effective interest method. Therefore, total interest includes non-cash interest income of \$1.4 million and \$7.0 million for the three months and year ended December 31, 2010 relating to the amortization of the premium on the convertible debentures and 7<sup>7/8</sup>% senior notes and the fees incurred on the credit facility.

Total interest expense for the fourth and third quarter of 2010, including the amortization of related financing costs, was \$21.9 million and \$18.7 million, respectively. This increase is mainly attributed to a \$4.5 million increase in senior note interest expense due to the higher borrowing balance relating to Harvest's 6<sup>7/8</sup>% senior notes and premium paid on the existing 7<sup>7/8</sup>% senior notes for early redemption.

Interest expense on our bank loan was \$1.0 million for the fourth quarter of 2010 compared to \$1.8 million in the prior quarter. The decrease is attributed to the decrease in bank debt from \$288.7 million at September 30, 2010 to \$14.0 million at December 31, 2010. Interest expense for the fourth quarter of 2010 on our convertible debentures remained consistent with prior quarter.

**Currency Exchange**

Currency exchange gains and losses are attributed to the changes in the value of the Canadian dollar relative to the U.S. dollar on our U.S. dollar denominated debt as well as any other U.S. dollar working capital balances. At December 31, 2010 the Canadian dollar has strengthened compared to September 30, 2010 and December 31, 2009 resulting in an unrealized foreign exchange gain of \$3.7 million and \$2.3 million for the three months and year ended December 31, 2010, respectively. Realized foreign exchange gains were \$6.8 million and \$1.5 million for the three months and year ended December 31, 2010 respectively, resulting from the redemption of the 7<sup>7/8</sup>% senior notes and settlement of U.S. dollar denominated transactions.

Our downstream operations use U.S. dollar as their functional currency. The foreign exchange gains and losses incurred by our downstream operations relate to Canadian dollar transactions converted to U.S. dollars as their functional currency is U.S. dollars. The cumulative translation adjustment recognized in other comprehensive income represents the translation of our downstream operation's U.S. dollar functional currency financial statements to Canadian dollars using the current rate method. During the three months and year ended December 31, 2010, net cumulative translation losses were \$32.4

million and \$46.4 million respectively. Losses resulted due to the strengthening of the Canadian dollar against the U.S. dollar at December 31, 2010 compared to September 30, 2010 and December 31, 2009, reflecting a decrease in the relative value of the net assets in our downstream operations.

#### **Future Income Tax**

As a result of the reorganization in the second quarter of 2010, Harvest now is a taxable corporate structure, with the effective corporate rate applicable to all entities. At December 31, 2010, Harvest recognized \$42.5 million of investment tax credits relating to downstream operations. As a result of the restructuring of intercompany debt, downstream operations are expected to be taxable in the future and will be able to utilize these credits.

At December 31, 2010, Harvest had a net future income tax (FIT) liability of \$177.2 million (2009 – \$211.2 million), comprised of \$80 million (2009 – \$112.5 million) for the downstream corporate entities and \$97.2 million (2009 – \$98.7 million) for the upstream corporate entities.

As a result of KNOC Canada's acquisition of the Trust, the opening FIT liability of \$211.2 million was reflected as part of the purchase price allocation recorded at that date. The change in the FIT liability between December 31, 2010 and December 31, 2009 was \$34 million and resulted from a FIT recovery of \$39.9 million recognized in net loss for the year, a FIT recovery of \$1.8 million recognized in other comprehensive income relating to the effective portion of hedge contracts, and offset by the FIT liability associated with the Red Earth Partnership acquisition of \$7.7 million.

At December 31, 2010, we estimated our unclaimed capital expenditures to be:

Tax classification	Upstream	Downstream	Total
Canadian development & exploration expenditures	\$ 593,124	\$ -	\$ 593,124
Canadian oil & gas property expenditures	852,862	-	852,862
Unclaimed capital cost	400,223	307,314	707,537
Non-capital losses and other	1,033,918	343,431	1,377,349
	\$ 2,880,127	\$ 650,745	\$ 3,530,872

#### **Income Tax Assessment**

In January 2009 Canada Revenue Agency issued a Notice of Reassessment to Harvest Energy Trust in respect of its 2002 through 2004 taxation years claiming past taxes, interest and penalties totaling \$6.2 million. The CRA adjusted Harvest Energy Trust's taxable income to include their net profits interest royalty income on an accrual basis whereas the tax returns had reported this revenue on a cash basis. A Notice of Objection was filed with CRA requesting the adjustments to an accrual basis be reversed. On January 25, 2011, CRA indicated that they will not pursue the matter.

#### **Contractual Obligations and Commitments**

We have contractual obligations and commitments entered into in the normal course of operations including the purchase of assets and services, operating agreements, transportation commitments, sales commitments, royalty obligations, and land lease obligations. These obligations are of a recurring and consistent nature and impact cash flow in an ongoing manner.

As at December 31, 2010, we also have contractual obligations and commitments that are of a less routine nature as disclosed in the following table:

	<b>Maturity</b>				
	<b>Total</b>	<b>Less than 1 year</b>	<b>1-3 years</b>	<b>4-5 years</b>	<b>After 5 years</b>
Long-term debt <sup>(1)</sup>	\$ 1,245,273	\$ -	\$ 451,344	\$ 296,629	\$ 497,300
Interest on long-term debt <sup>(1)</sup>	401,952	87,200	160,754	94,167	59,831
Operating and premise leases	28,751	7,514	13,355	7,602	280
Purchase commitments <sup>(2)</sup>	806,193	694,651	111,542	-	-
Asset retirement obligations <sup>(3)</sup>	1,242,033	16,148	30,756	34,185	1,160,944
Transportation <sup>(4)</sup>	4,259	3,253	1,006	-	-
Pension contributions <sup>(5)</sup>	24,783	5,318	7,590	7,850	4,025
Feedstock commitments <sup>(6)</sup>	900,131	900,131	-	-	-
<b>Total</b>	<b>\$ 4,653,375</b>	<b>\$ 1,714,215</b>	<b>\$ 776,347</b>	<b>\$ 440,433</b>	<b>\$ 1,722,380</b>

<sup>(1)</sup> Assumes constant foreign exchange rate.

<sup>(2)</sup> Relates to drilling commitments, AFE commitments, BlackGold oil sands project commitment, Hunt's assets purchase agreement and downstream purchase commitments.

<sup>(3)</sup> Represents the undiscounted obligation by period.

<sup>(4)</sup> Relates to firm transportation commitment on the Nova pipeline.

<sup>(5)</sup> Relates to the expected contributions for employee benefit plans.

<sup>(6)</sup> Relates to feedstock commitments under the supply and offtake agreement and others

#### **Off Balance Sheet Arrangement**

As of December 31, 2010, we have no off balance sheet arrangements in place.



**LIQUIDITY**

Harvest manages its cash requirements by optimizing the capital structure of the Company and maintaining sufficient liquid financial resources to fund obligations as they come due in the most cost effective manner. The Company's liquidity needs are met through the following sources: cash generated from operations, borrowings under our long-term credit facility, long-term debt issuances and equity injections by KNOC. Harvest's primary uses of funds are operating expenses, capital expenditures, and interest and principal payments on debt instruments.

For the year ended December 31, 2010, cash flow from operating activities was \$430.3 million including \$22.6 million provided by a reduction in non-cash working capital and \$20.3 million used in the settlement of asset retirement obligations. At December 31, 2010, Harvest's financing activities provided \$212.5 million of cash, including \$558.5 million capital injections from KNOC and the issue of \$495.9 million 6<sup>7/8</sup>% senior notes, which was used to fund the repayment of \$406.7 million of bank debt, the redemption of \$256.9 million of 7<sup>7/8</sup>% senior notes and the redemption of \$180.2 million of convertible debentures. Harvest funded \$651.5 million of capital expenditures and net asset acquisition activity during 2010 with cash generated from operating activities and financing activities.

Harvest had working capital of \$2.0 million at December 31, 2010, as compared to a deficiency of \$589.2 million at December 31, 2009. The negative working capital in 2009 was primarily related to the \$428 million of bank loan and the classification of \$182.8 million and \$42.9 million of convertible debentures and senior notes, respectively as current liabilities. A portion of the bank loan and convertible debentures were repaid during 2010 with capital injections from KNOC. The Company's working capital is expected to fluctuate from time to time, and will be funded from cash flows from operations and borrowings from Harvest's credit facility, as required.

As well as future petroleum and natural gas prices, our upstream operations rely on the successful exploitation of our existing reserves, future development activities and strategic acquisitions to replace existing production and add additional reserves. With a prudent maintenance program, our downstream assets are expected to have a long life with additional growth in profitability available by upgrading the HSFO currently produced and/or expanding our refining throughput capacity. Future development activities and acquisitions in our upstream business as well as the maintenance program in our downstream business will likely be funded from cash flow from operating activities, while we will generally rely on funding more significant acquisitions and growth initiatives from some combination of cash flow from operating activities, issuances of incremental debt and capital injections from KNOC. Should incremental debt not be available to us through debt capital markets, our ability to make the necessary expenditures to enhance or expand our assets may be impaired. Harvest's liquidity is closely related to its ability to generate cash from operating activities, which is affected by changes in commodity prices, market demands for petroleum and natural gas products and the operating performances of both our upstream and downstream assets. Harvest enters into risk management contracts (refer to the "Financial Instrument" section of this MD&A) to protect the Company from cash flow fluctuations due to commodity price changes.

Through a combination of cash available at December 31, 2010, cash from operating activities, available undrawn credit capacity and the working capital provided by the supply and offtake agreement with Vitol, as further discussed below, it is anticipated that Harvest will have adequate liquidity to fund future operations, debt repayments and forecasted capital expenditures (excluding major acquisitions). Refer to the "Contractual Obligations and Commitments" section above for Harvest's future commitments and the discussion below on certain significant items.

**Hunt Acquisition**

On December 14, 2010 Harvest signed an agreement to purchase the assets of Hunt Oil Company of Canada, Inc. and Hunt Oil Alberta, Inc. (collectively "Hunt") for an initial purchase price of \$525 million. The transaction is expected to close on February 28, 2011. Upon signing the agreement Harvest provided a \$40 million deposit which is held in trust. The

agreement contains a mechanism that allows for a subsequent \$25 million payment to Hunt in the event that Canadian natural gas prices exceed certain pre-determined levels over the next 2 years. The Hunt assets include working interests in a third-party operated gas plant that is currently experiencing an outage, which results in reduced production in certain oil and gas properties. Hunt has agreed to reimburse Harvest for costs associated with restoring production as well as the lost production between October 1, 2010 and the earlier of (i) the date when production is resumed, and (ii) October 31, 2011. Subsequent to December 31, 2010, KNOG has provided \$505 million of equity to fund the acquisition.

#### **BlackGold Oil Sands Project**

In August 2010, Harvest issued \$374 million of shares to KNOG in exchange for the BlackGold assets. Subsequently, Harvest issued \$85.7 million of shares to KNOG for funding the BlackGold's initial capital expenditures. In August 2010, Harvest entered into two EPC contracts relating to the BlackGold production and processing facilities. The contracted cost is \$311 million of which \$43.5 million, including the \$31.1 million deposit, was paid in 2010 and the remaining balance will be paid in 2011 and 2012. The development of the BlackGold assets is expected to be completed by the fourth quarter of 2012. Harvest expects to fund the future capital expenditures with the \$85.7 million capital injection already funded by KNOG, future cash flow from operating activities and the undrawn credit facility.

#### **Global Technology and Research Centre ("GTRC")**

On October 4, 2010, 0.7 million shares were issued to KNOG for total consideration of \$7.1 million to provide funding for the initial set up and operation of the KNOG GTRC that will be owned and operated by Harvest. During 2010, \$1.2 million capital spending was incurred relating to the GTRC.

#### **Supply and Offtake Agreement**

Concurrent with the acquisition of North Atlantic by Harvest in 2006, North Atlantic entered into a supply and offtake agreement (the "SOA") with Vitol Refining S.A. ("Vitol"), and this agreement was amended and extended on November 1, 2009. The SOA is effective until November 1, 2011 and may be terminated by either party at any time thereafter by providing notice of termination no later than six months prior to the desired termination date or if the refinery is sold in an arm's length transaction, upon 30 days notice prior to the desired termination date. Further, the SOA may be terminated upon the continuation for more than 180 days of a delay in performance due to force majeure but prior to the recommencing of performance.

The SOA provides that the ownership of substantially all crude oil and other feed stocks and refined product inventories at the refinery be retained by Vitol and that Vitol be granted the exclusive right and obligation to provide crude oil feedstock and other feed stocks for delivery to the refinery as well as the exclusive right and obligation to purchase virtually all refined products produced by the refinery for export. The SOA requires that Vitol purchase and lift all refined products, within specified quality, produced by the refinery, except for certain excluded refined products to be marketed by North Atlantic in the local Newfoundland market, and provides a product purchase pricing formula. North Atlantic is required to purchase the related feed stocks and refined product inventories at the prevailing market prices.

This arrangement provides working capital financing for its inventories of crude oil and substantially all refined products held for sale. The amendments made in 2009 to the SOA increased the amount of working capital financing available, reduced the cost of financing inventory and other working capital, and increased the prices realized for product sales. Pursuant to the SOA, we estimate that Vitol held inventories of VGO and crude oil feedstock (both delivered and in-transit) valued at approximately \$774.7 million at December 31, 2010 (as compared to \$582.1 million at December 31, 2009), which would have otherwise been assets of Harvest.

**CAPITAL RESOURCES**

The following table summarizes the Company's capital structure as at December 31, 2010 and 2009 and provides the key financial ratios contained in the Company's revolving credit facility. For a complete description of the revolving credit facility, 7<sup>7/8</sup>% senior notes, 6<sup>7/8</sup>% senior note and convertible debentures, see notes 9, 10 and 11, respectively, to Harvest's consolidated financial statements for the year ended December 31, 2010.

	December 31, 2010	December 31, 2009
<b>Debts</b>		
Revolving credit facility <sup>(1)</sup>	<b>\$14,000</b>	\$428,017
7 <sup>7/8</sup> % senior notes, at principal amount (US\$209.6 million) <sup>(2)</sup>	-	262,750
6 <sup>7/8</sup> % senior notes, at principal amount (US\$500 million) <sup>(2)</sup>	<b>497,300</b>	-
Convertible debentures, at principal amount	<b>733,973</b>	914,166
<b>Total Debt</b>	<b>1,245,273</b>	1,604,933
<b>Shareholder's Equity</b>		
330,953,567 issued at December 31, 2010	<b>3,250,942</b>	-
242,268,802 issued at December 31, 2009	-	2,422,688
<b>Total Capitalization</b>	<b>\$4,496,215</b>	\$4,027,621
<b>Financial Ratios<sup>(3)</sup></b>		
Secured Debt to Annualized EBITDA <sup>(4) (5)</sup>	<b>0.1</b>	0.7
Total Debt to Annualized EBITDA <sup>(4) (6)</sup>	<b>2.4</b>	2.7
Senior Debt to Total Capitalization <sup>(5) (7)</sup>	<b>1%</b>	11%
Total Debt to Total Capitalization <sup>(6) (7)</sup>	<b>31%</b>	40%

<sup>(1)</sup> Net of transaction costs – \$11.4 million

<sup>(2)</sup> Principal amount converted at the period end exchange rate.

<sup>(3)</sup> Calculated based on Harvest's credit facility covenant requirements (see note 9 of the December 31, 2010 financial statements)

<sup>(4)</sup> Annualized Earnings Before Interest, Taxes, Depreciation and Amortization based on twelve month rolling average.

<sup>(5)</sup> "Senior Debt" includes letter of credit, bank debt and guarantees

<sup>(6)</sup> "Total Debt" includes the secured debt, convertible debentures and notes

<sup>(7)</sup> "Total Capitalization" includes total debt and shareholder's equity

During 2010, the improvement in global economic condition resulted in an increase in oil prices by the end of the year. During the second quarter of 2010, Harvest's balance sheet improvement together with the improvement in global economic recovery, supported the renewal of Harvest's revolving credit facility. The improvement of Harvest's financial and business risks backstopped by the support from KNOC resulting in a stronger balance sheet that led to Standard and Poor's Ratings Services ("S&P") and Moody's Investors Service upgrading Harvest's corporate ratings to "BB-" and "Ba2", respectively and the 6<sup>7/8</sup>% senior notes rating to "BB-" and "Ba1" in 2010.

**Credit Facility**

On April 30, 2010, Harvest entered into a syndicated credit agreement establishing a \$500 million three year extendible revolving credit facility ("the Facility"), maturing on April 30, 2013 unless extended. Harvest has the option to increase the capacity limit from \$500 million to \$1.0 billion, without lender consents, by utilizing the accordion feature and securing additional capacity from an existing or new lender(s). In addition, the capacity under the Facility (as long as it is fully secured) is limited to the greater of \$1 billion or 15% of total assets as outlined in the limitations on liens covenant of the 6<sup>7/8</sup>% senior notes described in the "Senior Note" section below. At December 31, 2010, Harvest had \$486 million of unutilized borrowing capacity under the Facility. The unused borrowing capacity and the option to increase the capacity limit provide Harvest the flexibility to manage fluctuations in its liquidity needs.

The Facility is fully secured by a first floating charge over all of the assets of Harvest's operating subsidiaries (except the BlackGold assets) plus a first mortgage security interest on the downstream operation's refinery assets. The most restrictive covenants of the Facility include an aggregate limitation of \$25 million on financial assistance and/or capital contributions to parties other than those included in the first floating charge, a limitation to carrying on business in countries that are not members of the Organization of Economic Co-operation and Development and a limitation on the payment of distributions to shareholders of an amount greater than EBITDA minus capital expenditures by Harvest and its subsidiaries. Harvest did not pay any dividend to its shareholder during 2010. The Facility is subject to the following covenant ratios:

Senior debt to EBITDA	3.0 to 1.0 or less
Total debt to EBITDA	3.5 to 1.0 or less
Senior debt to Capitalization	50% or less
Total debt to Capitalization	55% or less

#### **Convertible Debentures**

At December 31, 2010, Harvest had \$734 million of principal amount of convertible debentures issued in four series with the earliest maturity date of October 31, 2012. As a result of the Trust's acquisition, the debentures are no longer convertible into units but debenture holders would receive \$10.00 for each unit notionally received based on each series' conversion rate. Because every series of debentures carry a conversion price that exceeds \$10.00 per unit, it is assumed that no investor would exercise their conversion option.

The debentures may be redeemed by Harvest at its option in whole or in part prior to their respective redemption dates. The redemption price for the first redemption period is at a price equal to \$1,050 per debenture and at \$1,025 per debenture during the second redemption period. Harvest may redeem the debentures at par after the second redemption period. Any redemption will include accrued and unpaid interest at such time.

#### **Senior Notes**

On October 4, 2010, Harvest completed an offering of US\$500 million principal amount of unsecured 6<sup>7/8</sup>% senior notes for net cash proceeds of US\$484.6 million of which US\$210.2 million was used to redeem the outstanding principal amount of the existing 7<sup>7/8</sup>% senior notes and premium. These notes are guaranteed by all of Harvest's existing and future restricted subsidiaries that guarantee the Facility and future restricted subsidiary that guarantees certain debt. Prior to maturity, redemptions are permitted in whole or in part, at any time at a redemption price equal to the greater of 100% of the principal amount redeemed and the make-whole redemption premium plus any unpaid interest to the redemption date. Harvest may also redeem all of the notes at any time in the event that certain changes affecting Canadian withholding taxes occur.

The covenants of the senior notes will, among other things, restrict the sale of assets, restrict Harvest's ability to enter into certain types of transactions with affiliates and restrict Harvest's ability to pay dividends or make other restricted payments should the consolidated leverage ratio be greater than 2.50 to 1. It also restricts the incurrence of additional indebtedness if such issuance would result in an interest coverage ratio as defined of less than 2.0 to 1. Notwithstanding the interest coverage ratio limitation, the incurrence of additional secured indebtedness under the Facilities may be limited to the greater of \$1.0 billion and 15% of total assets.

**SUMMARY OF QUARTERLY RESULTS**

The following table and discussion highlights our quarterly results for 2010:

	<b>2010</b>			
	<b>Q4</b>	<b>Q3</b>	<b>Q2</b>	<b>Q1</b>
Revenue, net of royalties <sup>(1)</sup>	\$ <b>1,255,785</b>	\$ 951,735	\$ 1,024,896	\$ 569,762
Net income (loss)	<b>(1,446)</b>	(22,079)	18,203	(39,239)
Cash from operating activities	<b>132,074</b>	97,711	122,335	78,134
Total long term debt	<b>1,239,025</b>	1,275,551	1,177,945	1,174,375
Total assets	\$ <b>5,367,227</b>	\$ 5,262,694	\$ 4,758,472	\$ 4,765,580
Upstream daily sales volume (boe/d)	<b>50,054</b>	47,777	49,597	50,178
Upstream realized price (\$/boe)	\$ <b>56.03</b>	\$ 52.71	\$ 54.41	\$ 60.17
Downstream daily throughput volume	<b>111,317</b>	96,514	94,833	41,016
Downstream gross margin (US\$/bbl)	\$ <b>6.13</b>	\$ 3.02	\$ 8.56	\$ 0.54

<sup>(1)</sup> Revenues are comprised of revenues net of royalties from upstream operations as well as sales of refined products from downstream operations.

The quarterly revenues and cash from operating activities are impacted by the upstream sales volume and realized prices and downstream throughput volume and gross margin. Significant items that impacted Harvest's quarterly revenues include:

- Revenues were the lowest in the first quarter of 2010. This was primarily due to the shutdown of the refinery units and scheduled maintenance in the first quarter in the downstream operations.
- Revenues recovered in the second quarter and were the highest in the fourth quarter of 2010 due to increased throughput volumes from the downstream operations and increased sales volumes and commodity prices in the upstream operations.
- The higher upstream sales volumes in the fourth quarter are attributable to the acquisition of certain oil and gas assets on September 30, 2010.

Net income (loss) reflects both cash and non-cash items. Changes in non-cash items including future income tax, DDA&A expense, unrealized foreign exchange gains and losses and unrealized gains on risk management contracts impact net income from period to period. For these reasons, our net income (loss) may not necessarily reflect the same trends as net revenues or cash from operating activities, nor is it expected to.

Total assets have significantly increased from the second quarter to the third quarter due to the acquisition of the BlackGold assets in August and certain oil and gas assets in September. The increase in total assets from the third quarter to the fourth quarter was due to the acceleration of Harvest's winter drilling programs at Red Earth and increased capital expenditures in the fourth quarter relating to site engineering and preparation work for the main facility and production pad sites for the BlackGold project.

**OUTLOOK**

As we start 2011, we are optimistic about the ongoing global economic recovery and the continuing increase in global demand for crude oil and refined products. While natural gas prices are relatively weak and may be for some months until supply/demand imbalances are corrected, we are well-positioned at Harvest with our oil-weighted asset base. We continue to focus on exploiting oil or liquids-rich natural gas opportunities, as we have little dry gas assets in our portfolio. The improving economic climate bodes well for Harvest and our planned 2011 capital expenditures reflect this growing sense of optimism, as well as our sound financial backing from KNOC.

The majority of 2011's \$1.4 billion capital budget will be spent on our upstream operations. Our approved upstream spending plan will allot \$525 million to acquire Hunt Oil Company of Canada's producing and undeveloped assets in Western Canada. The transaction is expected to close on February 28, 2011.

An additional \$450 million of upstream capital spending is intended to facilitate our active drilling program and continue our investment in longer term Enhanced Oil Recovery (EOR) projects. The majority of this capital will be spent during the first quarter, when we target our Hay River and Red Earth areas. We plan to drill 34 horizontal wells in the Hay River area and approximately 37 wells in Red Earth's promising Slave Point light oil resource play. In addition to this, we plan to be active in the Viking, Cardium, and Ellerslie light oil plays, bringing our total forecasted wells drilled to over 200. With the strength in oil prices, we remain fully confident in pushing ahead with this active start to the year.

Rounding out our upstream capital spending is the \$240 million we plan to invest in our BlackGold oil sands project. Of this cost, \$190 million will be allocated to the construction and design of the BlackGold facility and \$50 million will be spent drilling 10 production well pairs, 12 observation wells, as well as developing other capital growth opportunities. 2011 is slated to be an important year for this project, as a substantial portion of the detailed engineering, procurement and construction will take place in the coming months. We anticipate first oil in 2013.

With the delay in closing the Hunt transaction, our expectation for 2011 upstream production is approximately 59,000 boe/d, consisting of 41,300 bbls/d of liquids and 106 mmscf/d of natural gas (55% of this production will consist of light and medium gravity oil (including natural gas liquids), 15% will consist of heavy oil, and 30% will consist of natural gas). The acquisition will increase Harvest's upstream asset base by \$525 million and is expected to increase cash contribution from upstream operations in 2011. We will continue to focus on cost-effective methods of operating and expect our operating costs to average approximately \$14.00/boe in 2011.

In our downstream operations, we plan to spend approximately \$190 million on capital projects in 2011. This includes \$69 million intended for a planned refinery turnaround, \$62 million allotted to refinery debottleneck projects, \$50 million intended for ongoing capital expenditures, and \$9 million assigned to our retail marketing assets. 2011 full-year refinery throughput is forecasted to average 98,500 bbl/d of feedstock, with operating and purchased energy costs aggregating to approximately \$6.64/bbl.

From a financial standpoint, we will continue to leverage on our convertible debentures, 6<sup>7/8</sup>% senior notes, and extendible revolving credit facility, balanced with KNOC-held equity. Our exposure to interest rate fluctuations will continue to be managed by maintaining a mix of short and long term financing that carries both floating and fixed interest rates. Our long term debt, which is comprised of our senior notes and convertible debentures, will continue to pay fixed and stable interest rates on a semi-annual basis. Conversely, our short-term revolving credit facility, which had \$14 million drawn against its \$500 million facility at December 31, 2010, requires payments that are subject to floating rates. We are anticipating the average amount drawn on the Facility to climb to approximately \$250 million in 2011, which subjects approximately 16% of our interest rate exposure to floating rates.

While we do not forecast commodity prices or refining margins, we do enter into price risk management contracts to mitigate price volatility and stabilize cash flow from operating activities. In the first quarter of 2011, we held hedging contracts on 16,400 bbl/d of crude oil for the remainder of 2011. The following table reflects the sensitivity of our 2011 operations to changes in the following key areas of our business:

	<b>Assumption</b>	<b>Change</b>	<b>Annual Impact on Cash Flow (\$ millions)</b>
WTI oil price (US\$/bbl)	\$ 83.00	\$ 5.00	\$ 49
CAD/USD exchange rate	\$ 0.96	\$ 0.05	\$ 51
AECO daily natural gas price	\$ 4.19	\$ 1.00	\$ 36
Refinery crack spread (US\$/bbl)	\$ 8.93	\$ 1.00	\$ 36
Upstream Operating Expenses (per boe)	\$ 13.54	\$ 1.00	\$ 22



**CRITICAL ACCOUNTING ESTIMATES**

There are a number of critical estimates underlying the accounting policies applied when preparing the consolidated financial statements due to timing differences between when certain activities are settled and when these activities are recognized for accounting purposes. Changes in these estimates could have a material impact on our reported results.

*Reserves*

The process of estimating reserves impacts the upstream operations and is complex. It requires significant judgments and decisions based on available geological, geophysical, engineering and economic data. In the process of estimating the economically recoverable oil and natural gas reserves and related future net cash flows, we incorporate many factors and assumptions, such as:

- Expected reservoir characteristics based on geological, geophysical and engineering assessments;
- Future production rates based on historical performance and expected future operating and investment activities;
- Future oil and gas prices and quality differentials; and
- Future development costs.

We follow the full cost method of accounting for our oil and natural gas activities. All costs of acquiring oil and natural gas properties and related exploration and development costs, including overhead charges directly related to these activities, are capitalized and accumulated in one cost centre. Maintenance and repairs are charged against income, and renewals and enhancements that extend the economic life of the capital assets are capitalized. The provision for depletion and depreciation of petroleum and natural gas assets is calculated on the unit-of-production method based on proved reserves as estimated by independent petroleum engineers. Reserve estimates impact net income through depletion, the determination of asset retirement obligations and the application of an impairment test. Revisions or changes in the reserve estimates can have either a positive or a negative impact on net income, property, plant and equipment and asset retirement obligations.

*Asset Retirement Obligations*

Harvest recognizes ARO on its upstream operations. In the determination of our ARO, management is required to make a significant number of estimates and assumptions with respect to activities that will occur in many years to come including the ultimate settlement amounts, inflation factors, credit adjusted risk free discount rates, timing of settlement and expected changes in legal, regulatory, environmental and political environments. The ARO also results in an increase to the carrying cost of capital assets. The obligation accretes to a higher amount with the passage of time as it is determined using discounted present values. A change in any one of the assumptions could impact the estimated future obligation and in return, net income. It is difficult to determine the impact of a change in any one of our assumptions. As a result, a reasonable sensitivity analysis cannot be performed.

*Impairment of Property, Plant and Equipment ("PP&E")*

Numerous estimates and judgments are involved in determining any potential impairment of PP&E. The most significant assumptions in determining future cash flows are future prices and reserves for our upstream operations and expected future refining margins and capital spending plans for our downstream operations.

The estimates of future prices and refining margins require significant judgments about highly uncertain future events. Historically, oil, natural gas and refined product prices have exhibited significant volatility from time to time. The prices used in carrying out our impairment tests for each operating segment are based on prices derived from a consensus of future price forecasts among industry analysts. Given the number of significant assumptions required and the possibility that actual conditions will differ, we consider the assessment of impairment to be a critical accounting estimate.



If forecast WTI crude oil prices were to fall by 40%, the initial assessment of impairment of our upstream assets would not change; however, below that level, we would likely experience an impairment. Although oil and natural gas prices fluctuate a great deal in the short-term, they are typically stable over a longer time horizon. This mitigates potential for impairment. Similarly, for our downstream operations, if forecast refining margins were to fall by more than 15%, it is likely that our downstream assets would experience an impairment.

Reductions in estimated future prices may also have an impact on estimates of economically recoverable proved reserves. It is difficult to determine and assess the impact of a decrease in our proved reserves on our impairment tests. The relationship between the reserve estimate and the estimated undiscounted cash flows is complex. As a result, we are unable to provide a reasonable sensitivity analysis of the impact that a reserve estimate decrease would have on our assessment of impairment.

#### *Carrying Value of Goodwill*

Goodwill is tested for impairment, at least annually, using the fair value of the upstream reporting unit. Impairment is assessed based on the difference between the fair value of the reporting unit and its carrying value, including goodwill. Any excess of the carrying value of the reporting unit over the fair value is charged to earnings. The process of assessing goodwill for impairment requires estimates of fair values including various assumptions and judgments such as reserve estimates, future commodity prices, future cash flows of the reporting unit and discount rates.

#### *Employee Future Benefits*

We maintain a defined benefit pension plan for the employees of North Atlantic. Obligations under employee future benefit plans are recorded net of plan assets where applicable. An independent actuary determines the costs of our employee future benefit programs using the projected benefit method. The determination of these costs requires management to estimate or make assumptions regarding the expected plan investment performance, salary escalation, retirement ages of employees, expected health care costs, employee turnover, discount rates and return on plan assets. The obligation and expense recorded related to our employee future benefit plans could increase or decrease if there were to be a change in these estimates. Pension expense represented less than 0.5% of our total expenses for the year ended December 31, 2010.

#### *Purchase Price Allocations*

Business acquisitions are accounted for by the purchase method of accounting. Under this method, the purchase price is allocated to the assets acquired and the liabilities assumed based on the fair values at the time of the acquisition. The excess of the purchase price over the assigned fair values of the identifiable assets and liabilities is allocated to goodwill. In determining the fair value of the assets and liabilities we are often required to make assumptions and estimates about future events, such as future oil and gas prices, refining margins and discount rates. Changes in any of these assumptions would impact amounts assigned to assets and liabilities and goodwill in the purchase price allocation and as a result, future net earnings.

#### *Risk Management Contracts*

Derivative risk management contracts are valued using valuation techniques with market observable inputs. The most frequently applied valuation techniques include forward pricing and swap models, using present value calculations. The models incorporate various inputs including the credit quality of counterparties, foreign exchange spot and forward rates, interest rate curves and forward rate curves of the underlying commodity. Changes in any of these assumptions would impact fair value of the risk management contracts and as a result, future net earnings and other comprehensive income. For risk management contracts designated as hedges, changes in the abovementioned assumptions may impact hedge effectiveness assessment and Harvest's ability to continue applying hedge accounting.

**RECENT CANADIAN ACCOUNTING AND RELATED PRONOUNCEMENTS**

The CICA Handbook Section 1582 "Business Combinations" is effective for business combinations with an acquisition date after January 1, 2011. This standard was amended to require additional use of fair value measurements, recognition of additional assets and liabilities, and increased disclosure. Adopting the standard is expected to have a material effect on the way the Company accounts for future business combinations. Entities adopting Section 1582 will also be required to adopt CICA Handbook Sections 1601 "Consolidated Financial Statements" and 1602 "Non-Controlling Interests". These standards require non-controlling interests to be presented as part of Shareholder's Equity on the balance sheet. In addition, the income statement of the controlling parent will include 100 per cent of the subsidiary's results and present the allocation between the controlling and non-controlling interests. These standards will be effective January 1, 2011, with early adoption permitted. The changes resulting from adopting Section 1582 will be applied prospectively and the changes from adopting Sections 1601 and 1602 will be applied retrospectively. Harvest has not elected to early adopt these standards.

**International Financial Reporting Standards**

In February 2008, the CICA Accounting Standards Board ("AcSB") announced that Canadian public reporting issuers will be required to report under International Financial Reporting Standards ("IFRS") commencing January 1, 2011, including comparatives for 2010 and an opening balance sheet at January 1, 2010 showing the changes from Canadian GAAP to IFRS.

Harvest has an IFRS conversion plan and staffed a project team with regular reporting to our senior management team and to the Audit Committee of the Board of Directors to ensure Harvest will meet the IFRS transition requirements for 2011.

**IFRS Project Status**

Harvest is carrying out the final phase of the IFRS conversion project and has substantially completed the IFRS opening balance sheet and has identified adjustments to PP&E, exploration and evaluation ("E&E") expenditures, asset retirement obligations and an offsetting adjustment to retained earnings. The KNOC acquisition of Harvest has minimized the IFRS transitional adjustments due to the fair values assigned to the Company's assets and liabilities from the KNOC purchase price allocation. The Company is in the process of finalizing accounting policy changes and implementing and testing data, process, system and control changes.

**Potential Impacts of IFRS Adoption**

Significant differences that have been identified between Canadian GAAP and IFRS that will impact Harvest are: accounting for capital assets including exploration costs, depletion and depreciation, impairment testing, asset retirement obligations, employee benefits and an increased level of disclosure requirements. These differences have been identified based on the current IFRS standards issued and expected to be in effect on the date of transition. Current IFRS standards may be modified, and as a result, the impact may be different than Harvest's current expectations; as such, Harvest cannot guarantee that the following information will not change as the date of transition approaches. Harvest will continue to communicate information in relation to its conversion process as it becomes available.

*First Time Adoption of IFRS*

IFRS 1, "First Time Adoption of International Financial Reporting Standards" ("IFRS 1") prescribes requirements for preparing IFRS-compliant financial statements in the first reporting period after the changeover date. IFRS 1 requires retrospective application of IFRS as if they were always in effect. IFRS 1 also provides entities adopting IFRS for the first time with a number of mandatory exceptions and optional exemptions from retrospective application of IFRS to ease the transition to IFRS in the transition year. Harvest will apply the IFRS 1 exemptions associated with business combinations and arrangements containing a lease which will not have any impact to the opening balance on transition date. Harvest will also apply the IFRS 1 exemptions associated with ARO (refer to the ARO section below for detail).

*Property, Plant and Equipment*

IFRS requires costs recognized as PP&E to be allocated to the significant parts of the asset and to depreciate each significant component separately which is different from Harvest upstream's current depreciation and depletion calculations under Canadian GAAP. The adoption of IFRS will increase the number of components to be amortized separately for the upstream segment and will have an impact on the amount of depreciation/depletion expense recognized. The amortization for downstream segment will not change as it has already been componentized and amortized separately under Canadian GAAP.

For the upstream assets, the net book value of PP&E excluding E&E expenditures as at December 31, 2009 will be the opening cost of the upstream PP&E balance at January 1, 2010. This amount will be allocated, based on reserve value, to depletable units which consolidate into cash generating units for impairment purposes. IFRS provides the option to calculate depletion using a reserve base of proved reserves or both proved plus probable reserves, as compared to the Canadian GAAP method of calculating depletion using proved reserves only. In aligning with KNOC's IFRS accounting policies, Harvest plans to determine its depletion expense using proved developed reserves as its depletion base. This change in the depletion base will result in a higher depletion expenses and lower net income under IFRS.

*Exploration and Evaluation Expenditures*

Oil and gas companies are required to account for E&E expenditures in accordance with IFRS 6 "Exploration for and Evaluation of Mineral Resources". This standard addresses the recognition, measurement, presentation and disclosure requirements for costs incurred in the exploration phase. IFRS requires the identification and presentation of E&E expenditures to be separated from those expenditures incurred on developed and producing properties. E&E expenditures are transferred to PP&E when technical feasibility and commercial viability has been proved. An impairment test is required to be performed on E&E expenditures when they are transferred to PP&E. Harvest will re-classify all E&E expenditures that are currently included in the PP&E balance and will consist of the book value of E&E land costs, and related drilling costs and seismic costs. E&E assets will not be depleted and will be assessed for impairment when indicators suggest the possibility of impairment. The reclassification of E&E expenditures will not have any impact to Harvest's opening balance on transition; however, it will result in lower depletion, depreciation and amortization ("DD&A") expense and higher net income as E&E assets are excluded from the DD&A calculation.

*Impairment of Assets*

Under IFRS, impairment of PP&E will be calculated at a more granular level than what is currently required under Canadian GAAP as impairment will be calculated at the cash generating unit ("CGU") level. In addition, IAS 36 "Impairment of Assets" uses a one-step approach for testing and measuring asset impairments, with asset carrying values being compared to the higher of value in use and fair value less costs to sell. Under IAS 36 impairment losses previously recognized may be reversed where circumstances change. Due to the one-step approach for impairment testing, the likelihood of recognizing an impairment loss is higher under IFRS.

*Asset Retirement Obligations*

Under IFRS, the decommissioning liability is required to be remeasured at each reporting date using the current liability specific discount rate, which requires retroactive adjustment to the estimated liability, whereas under Canadian GAAP, ARO adjustments are made on a prospective basis. Under Canadian GAAP, Harvest uses a credit-adjusted interest rate. Harvest has made a preliminary decision to apply the risk free interest rate to measure the obligation. The lower discount rate will increase the ARO liability by approximately \$264 million on transition date with the offset recorded in retained earnings as allowed under the IFRS 1. This will result in lower future accretion expenses on opening ARO liability. In addition, the recognition criteria under IFRS are more stringent which will result in an additional recognition of \$9.4 million ARO liability relating to downstream assets on transition date with the offset recorded in retained earnings. Going forward, the lower

discount rate will cause new ARO assets and liabilities to be recorded at higher amounts. This in turn will result in higher future DD&A expenses and lower accretion expenses.

#### *Employee Benefits*

Under IFRS and Canadian GAAP, actuarial gains and losses arising from defined benefit plans can be recognized into earnings through various appropriate methods. Canadian GAAP does not permit actuarial gains and losses to be recognized directly in equity whereas IAS 19 "Employee Benefits" provides an additional accounting policy option to recognize actuarial gains and losses directly in other comprehensive income ("OCI") in the period in which they occur. Harvest has decided to recognize the full amount of gains or losses in OCI at the time it incurred. There will not be any impact on the opening balance at transition date as the full benefit obligation has already been recognized in KNOC's purchase price allocation at acquisition date. However, going forward, this accounting policy will impact the OCI and net income as the full amount of gains or losses will be recognized in OCI instead of an amortized amount being recognized in net income.

#### *Deferred Income Taxes*

IAS 12 requires recognizing of the FIT that arises on the difference between historical and current exchange rates on the translation of non-monetary assets, whereas Canadian GAAP does not. This difference, however, does not impact the FIT balance on transition date as the cumulative translation adjustments balance at transition date was zero as a result of the KNOC acquisition. Any future fluctuation in the US dollar over the Canadian dollar will impact the FIT liability and the Company future net income. In addition, the FIT liability will decrease by approximately \$70 million on the transition date as a result of the ARO opening balance adjustment.

#### *Internal Controls over Financial Reporting ("ICFR") and Disclosure*

As the IFRS accounting policies are finalized, an assessment will be made to determine changes required for ICFR. This will be an ongoing process throughout 2011 to ensure that all changes in accounting policies include the appropriate additional controls and procedures for future IFRS reporting requirements. Harvest has established internal controls associated with the IFRS transition which include approvals at various stages of the project and the involvement of its auditors and other external advisors. Throughout the transition process, Harvest will be assessing stakeholders' information requirements and will ensure that adequate and timely information is provided so all stakeholders are informed of the transition progress.

#### *IT Systems*

The conversion to IFRS will have an impact on the company's IT system requirements. Harvest has modified its IT system to accommodate the requirement to track PP&E costs and E&E costs separately as well as the tracking of costs at a more granular level of detail for IFRS reporting.

**OPERATIONAL AND OTHER BUSINESS RISKS**

Both Harvest's upstream operations and its downstream operations are conducted in the same business environment as most other operators in the respective businesses and the business risks are very similar. Harvest has a risk management committee that meets on a regular basis to assess and manage operational and business risks and has a corporate Environment, Health and Safety ("EH&S") policy. We intend to continue executing our business plan to create value. The following summarizes the more significant risks:

**Upstream Operations**

- Prices received for petroleum and natural gas have fluctuated widely in recent years and are also impacted by the volatility in the Canadian/US currency exchange rate. The differential between light oil and heavy oil compounds the fluctuations in the benchmark oil prices.
- The operation of petroleum and natural gas properties involves a number of operating and natural hazards which may result in blowouts, environmental damage and other unexpected and/or dangerous conditions. Harvest's corporate EH&S manual has a number of specific policies to minimize the risk of environmental contamination, including emergency response should an incident occur. If areas of higher risk are identified, Harvest will undertake to analyze and recommend changes to reduce the risk including replacement of specific infrastructure.
- The production of petroleum and natural gas may involve a significant use of electrical power and since de-regulation of the electric system in Alberta, electrical power prices in Alberta have been volatile.
- The markets for petroleum and natural gas produced in western Canada depend upon available capacity to refine crude oil and process natural gas as well as pipeline capacity to transport the products to consumers.
- The reservoir and recovery information in reserve reports are estimates and actual production and recovery rates may vary from the estimates and the variations may be significant.
- Absent capital reinvestment, production levels from petroleum and natural gas properties will decline over time and absent commodity price increases, cash generated from operating these assets will also decline.
- Prices paid for acquisitions are based in part on reserve report estimates and the assumptions made preparing the reserve reports are subject to change as well as geological and engineering uncertainty.
- The operation of petroleum and natural gas properties is subject to environmental regulation pursuant to local, provincial and federal legislation and a breach of such legislation may result in the imposition of fines as well as higher operating standards that may increase costs.
- The BlackGold oil sands project is exposed to the risks associated with major construction projects. These risks include the possibility that the project will not be completed on budget, on time and/or will not achieve the design objectives. This would have a significant impact on the financial results of the project.
- The oil sands project is subject to government regulations. Phase 2 of the BlackGold oil sands project is subject to approval by the ERCB and the delay of approval could impact Harvest's ability and/or timing of reaching the targeted production of 30,000 bbl/d.

**Downstream Operations**

- The market prices for crude oil and refined products have fluctuated significantly, the direction of the fluctuations may be inversely related and the relative magnitude may be different resulting in volatile refining margins.
- The prices for crude oil and refined products are generally based in US dollars while our operating costs are denominated in Canadian dollars which introduces currency exchange rate exposure.
- Crude oil feedstock is delivered to our refinery via waterborne vessels which could experience delays in transporting supplies due to weather, accidents, government regulations or third party actions.

- We are relying on the creditworthiness of Vitol for our purchase of feedstock and should their creditworthiness deteriorate, crude oil suppliers may restrict the sale of crude oil to Vitol.
- Our refinery is a single train integrated interdependent facility which could experience a major accident, be damaged by severe weather or otherwise be forced to shutdown which may reduce or eliminate our cash flow.
- Our refining operations which include the transportation and storage of a significant amount of crude oil and refined products are adjacent to environmentally sensitive coastal waters, and are subject to hazards and similar risks such as fires, explosions, spills and mechanical failures, any of which may result in personal injury, damage to our property and/or the property of others along with significant other liabilities in connection with a discharge of materials. We regularly perform stack sampling, soil, vegetation, and fresh and ocean water tests, and we have monitoring stations to record the air quality in three adjacent communities, as well as at the refinery perimeter.
- The production of aviation fuels subjects us to liability should contaminants in the fuel result in aircraft engines being damaged and/or aircraft crashes.
- Collective agreements with our employees and the United Steel Workers of America may not prevent a strike or work stoppage and future agreements may result in an increase in operating costs.
- Refinery operations are subject to environmental regulation pursuant to local, provincial and federal legislation and a breach of such legislation may result in the imposition of fines as well as higher operating standards that may increase costs.
- The refinery operates under permits issued by the federal and provincial governments and these permits must be renewed periodically. The federal and provincial governments may make operating requirements more stringent which may require additional spending.

#### **General Business Risks**

- The loss of a member of our senior management team and/or key technical operations employee could result in a disruption to either our upstream or downstream operations.
- Variations in interest rates on our current and/or future financing arrangements may result in significant increases in our borrowing costs.
- Our crude oil sales and refining margins are denominated in US dollars while we incur costs in Canadian dollars which results in a currency exchange exposure.
- Changes in tax and other laws may affect shareholders. Income tax laws, other laws or government incentive programs relating to the oil and gas industry, may in the future be changed or interpreted in a manner that affects Harvest or its stakeholders.
- Although the Company monitors the credit worthiness of third parties it contracts with through a formal risk management policy, there can be no assurance that the Company will not experience a loss for non-performance by any counterparty with whom it has a commercial relationship. Such events may result in material adverse consequences on the business of the Company.
- Harvest is required to comply with covenants under the Facility and the senior notes. In the event that the Company does not comply with the covenants, its access to capital may be restricted or repayment may be required.

**CHANGES IN REGULATORY ENVIRONMENT****Alberta**

On October 25, 2007, the Government of Alberta released its New Royalty Framework (the "NRF") outlining changes that increase the royalty rates on conventional oil and gas, oil sands and coal bed methane using a price-sensitive and volume-sensitive sliding rate formula for both conventional oil and natural gas. These proposals were given Royal Assent on December 2, 2008 and became effective January 1, 2009. Prior to the NRF, the amount of royalties payable was influenced by the oil price, oil production, density of oil and the vintage of the oil with the rate ranging from 10% to 35% and with respect to natural gas production, the royalty reserved was between 15% to 35% depending on the a prescribed or corporate average reference price and subject to various incentive programs.

The NRF sets royalty rates for conventional oil by a single sliding rate formula which is applied monthly and increases the range of royalty rates to up to 50% and with rate caps once the price of conventional oil reaches \$120 per barrel. With respect to natural gas production, the royalties outlined in the NRF are set by a single sliding rate formula ranging from 5% to 50% with a rate cap once the price of natural gas reaches \$16.59 per GJ.

The NRF also includes a policy of "shallow rights reversion." The shallow rights reversion policy affects all petroleum and natural gas agreements, however, the timing of the reversion will differ depending on whether the leases and licenses were acquired prior to or subsequent to January 1, 2009. Leases granted after January 1, 2009 will be subject to shallow rights reversion at the expiry of the primary term, and in the event of a license, the policy will apply after the expiry of the intermediate term. Holders of leases and licenses that have been continued indefinitely prior to January 1, 2009 will receive a notice regarding the reversion of the shallow rights which will be implemented three years from the date of the notice. The lease or license holder can make a request to extend this period. The Government intends this policy to maximize the development of currently undeveloped resources by having the mineral rights to shallow gas geological formations that are not being developed revert back to the Government and be made available for resale.

On April 10, 2008, the Government of Alberta introduced two new royalty programs for the development of deep oil and natural gas reserves. A five-year oil program for exploratory wells over 2,000 meters will provide royalty adjustments up to \$1 million or 12 months of royalty offsets whichever comes first while a natural gas deep drilling program for wells deeper than 2,500 meters will create a sliding scale of royalty credit according to depth of up to \$3,750/meter.

On November 19, 2008, the Government of Alberta announced the introduction of a five year program of Transitional Royalty Plan (the "TRP") which effective January 1, 2009, offers companies drilling new natural gas or conventional deep oil wells (between 1,000 and 3,500 meters) a one-time option, on a well-by-well basis, to reduced royalty rates for new wells for a maximum period of five years to December 31, 2013 after which all wells convert to the NRF. To qualify for this program, wells must be drilled between November 19, 2008 and December 31, 2013.

On March 3, 2009, the Government of Alberta announced a new three-point stimulus plan, and extended the plan to two years on June 25, 2009. The drilling royalty credit for new conventional oil and natural gas wells is a two-year program effective for wells spud on or after April 1, 2009, and will provide a \$200 per-metre-drilled royalty credit, with the maximum credit determined on a sliding scale based on the individual company's total Alberta-based 2008 Crown oil and gas production. The royalty rate cap is also effective April 1, 2009 for new conventional oil and natural gas wells and will provide a maximum 5% royalty rate for the first 12 months of production, to a maximum of 50,000 barrels of oil or 500 million cubic feet of natural gas per well, to all new wells that begin producing conventional oil or natural gas between April 1, 2009 and March 31, 2011. The third point is an abandonment and reclamation fund which will provide \$30 million to be invested by the Orphan Well Association to abandon and reclaim old well sites where there is no legally responsible or financially able party available.



On May 27, 2010, in connection with its competitiveness review, the province amended the maximum royalty rates and royalty curves applicable to the NRF and amended the new well incentive program that applied to wells commencing production of conventional oil or natural gas on or after April 1, 2009 that was scheduled to expire on March 31, 2011 so that the program was permanent. The incentive provides for a maximum 5% royalty rate for the first 18 to 48 months of production, to a maximum of 50,000 to 100,000 barrels of oil equivalent depending on the depth of the well. The Province will review this program in 2014 and committed to provide three years notice prior to eliminating it.

On January 28, 2011, the Minister of Energy, Ron Liepert, announced that the Alberta Government had accepted the recommendations of the Regulatory Enhancement Task Force, including the proposal to consolidate a variety of upstream oil and gas regulatory functions into the authority of a single regulator. These changes are intended to streamline the approval process for projects, resulting in more consistency, less duplication and greater certainty to the regulatory regime in Alberta.

### **Saskatchewan**

In Saskatchewan, the amount payable as a Crown royalty or freehold production tax in respect of crude oil depends on the type, value, quantity produced in a month and vintage. Crude oil type classifications are "heavy oil", "southwest designated oil" or "non-heavy oil other than southwest designated oil". Vintage categories applicable to each of the three crude oil types are old, new, third tier and fourth tier. Crude oil rates are also price sensitive and vary between the base royalty rates of 5% for all fourth tier oil to 20% for old oil. Marginal royalty rates, applied to the portion of the price that is above the base price, are 30% for all fourth tier oil to 45% for old oil.

The royalty payable on natural gas is determined by a sliding scale based on a reference price, which is the greater of the amount obtained by the producer and a prescribed minimum price. As an incentive for the marketing of natural gas produced in association with oil, a lower royalty rate is assessed than the royalty payable on non-associated natural gas. The rates and vintage categories of natural gas are similar to oil.

Saskatchewan has introduced a new orphan oil and gas well and facility program, solely funded by oil and gas companies to cover the cost of cleaning up abandoned wells and facilities where the owner cannot be located or has gone out of business. The program is composed of a security deposit, based upon a formula considering assets of the well and the facility licensee against the estimated cost of decommissioning the well and facility once it is no longer producing, and an annual levy assessed to each licensee.

On May 27, 2010, the Government of Saskatchewan announced an incentive to encourage increased natural gas exploration and production in the province. The volume-based incentive establishes a maximum Crown royalty rate of 2.5 per cent and a freehold production tax rate of zero per cent on the first 25 million cubic metres of natural gas produced from every horizontal gas well drilled between June 1, 2010 and March 31, 2013.

### **British Columbia**

The British Columbia royalty regime for oil is dependent on age and production. Oil is classified as "old", "new" or "third tier" and a separate formula is used to determine the royalty rate depending on the classification. The rates are further varied depending on production. Lower royalty rates apply to low productivity wells and third tier oil to reflect the increased cost of exploration and extraction. There is no minimum royalty rate for oil.

The British Columbia natural gas royalty regime is price-sensitive, using a "select price" as a parameter in the royalty rate formula. When the reference price, being the greater of the producer price or the Crown set posted minimum price ("PMP"), is below the select price, the royalty rate is fixed. The rate increases as prices increase above the select price. The



Government of British Columbia determines the producer prices by averaging the actual selling prices for gas sales with shared characteristics for each company minus applicable costs. If this price is below the PMP, the PMP will be the price of the gas for royalty purposes.

Natural gas is classified as either "conservation gas" or "non-conservation gas". There are three royalty categories applicable to non-conservation gas, which are dependent on the date on which title was acquired from the Crown and on the date on which the well was drilled. The base royalty rate for non-conservation gas ranges from 9% to 15%. A lower base royalty rate of 8% is applied to conservation gas. However, the royalty rate may be reduced for low productivity wells.

In May 2008, the Government of British Columbia introduced the Net Profit Royalty Program to stimulate development of high risk and high cost natural gas and oil resources in British Columbia that are not economic under other royalty programs. The program allows for the calculation of royalties based on the net profits of a particular project and is governed under the Net Profit Royalty Regulation, which came into effect in May 2008.

On August 6, 2009, the Province of British Columbia announced an Oil and Gas Stimulus package providing for:

- A one-year, two per cent royalty rate for all natural gas wells drilled in a 10 month window (September 2009 - June 2010).
- An increase of 15 per cent in the existing royalty deductions for natural gas deep drilling.
- Qualification of horizontal wells drilled between 1,900 and 2,300 metres into the Deep Royalty Credit Program.

An additional \$50 million was allocated in the fall of 2009 for the Infrastructure Royalty Credit Program to stimulate investment in oil and gas roads and pipelines.

### ***Environmental Regulation***

In 2007, the Government of Alberta introduced the Climate Change and Emissions Management Amendment Act which intends to reduce greenhouse gas emissions intensity from large emitting facilities. On January 24, 2008, the Government of Alberta announced their plan to reduce projected emissions in the province by 50% under the new climate change plan by 2050. This will result in real reductions of 14% below 2005 levels. The Government of Alberta stated they will form a government-industry council to determine a go-forward plan for implementing technologies, which will significantly reduce greenhouse gas emissions by capturing air emissions from industrial sources and locking them permanently underground in deep rock formations.

The Canadian Government has indicated its commitment to reduce greenhouse gas emissions and will be making changes to environmental legislation for criteria air contaminants and renewable fuels but has provided no specific target guidelines or policies that relate to the oil and gas industry. Such legislation could have potentially adverse effects on both Harvest's upstream and downstream financial results. Harvest will participate in the discussion of any initiatives whether at a Federal or Provincial government level, and will be able to determine if there is any financial impact once guidelines are established. On an ongoing basis, Harvest continues to undertake projects that reduce emission of greenhouse gases, such as evaluating the injection of carbon dioxide into oil reservoirs and the further capture of fugitive emissions in our field operations as part of our annual capital program.

In 2002, the Government of Canada ratified the Kyoto Protocol which calls for Canada to reduce its greenhouse gas emissions to specified levels. On April 26, 2007, the Government of Canada released its Action Plan to Reduce Greenhouse Gases and Air Pollution (the "Action Plan") which includes a regulatory framework for air emissions. This Action Plan is to regulate the fuel efficiency of vehicles and the strengthening of energy standards for a number of energy-using products. On March 10, 2008, the Government of Canada released "Turning the Corner" outlining additional details to implement

their April 2007 commitment to cut greenhouse gas emissions by an absolute 20% by 2020. "Turning the Corner" sets out a framework to establish a market price for carbon emissions and sets up a carbon emission trading market to provide incentives for Canadians to reduce their greenhouse gas emissions. In addition, the regulations include new measures for oil sands developers that require an 18% reduction from 2006 levels by 2010 for existing operations and for oil sands operations commencing in 2012, a carbon capture and storage capability. There is no mention of targeting reductions for unintentional fugitive emissions for conventional producers. Companies will be able to choose the most cost effective way to meet their emissions reduction targets from in-house reductions, contributions to time-limited technology funds, domestic emissions trading and the United Nations' Clean Development Mechanism. Companies that have already reduced their greenhouse gas emissions prior to 2006 will have access to a limited one-time credit for early adoption. Giving the evolving nature of the debate related to climate change and the control of greenhouse gases and resulting requirements, and the lack of detail in the Government of Canada's announcement, it is not possible to assess the impact of the requirements on our operations and financial performance.

#### **DISCLOSURE CONTROLS AND PROCEDURES**

As part of the corporate reorganization and dissolution of the Trust on May 1, 2010, the newly reorganized company, Harvest will continue to assume the disclosure controls and procedures. Under the supervision of the Chief Executive Officer and Chief Financial Officer, the Company has evaluated the effectiveness of its disclosure controls and procedures as of December 31, 2010 as defined under the rules adopted by the Canadian securities regulatory authorities and the U.S. Securities and Exchange Commission. Based on this evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that as of December 31, 2010, the disclosure controls and procedures were effective to ensure that information required to be disclosed by Harvest in reports it files or submits to Canadian and U.S. securities authorities was recorded, processed, summarized and reported within the time period specified in Canadian and U.S. securities laws and was accumulated and communicated to management, including its Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosures.

#### **INTERNAL CONTROL OVER FINANCIAL REPORTING**

Management is responsible for establishing and maintaining internal control over our financial reporting. Our internal control is designed to provide reasonable assurance regarding the reliability of financial reporting and preparation of financial statements for external purposes in accordance with Canadian Generally Accepted Accounting Principles. Management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our internal control over financial reporting as of December 31, 2010. The evaluation was based on the Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on that evaluation, management has concluded that as of December 31, 2010, the design and operation of internal controls were effective.

During the year ended December 31, 2010, there were no changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Based on their inherent limitations, disclosure controls and procedures and internal control over financial reporting may not prevent or detect misstatements, errors or fraud. Control systems, no matter how well conceived or operated, can provide only reasonable, but not absolute, assurance that the objectives of the control systems are met.

**ADDITIONAL INFORMATION**

Further information about us can be accessed under our public filings found on SEDAR at [www.sedar.com](http://www.sedar.com) or at [www.harvestenergy.ca](http://www.harvestenergy.ca). Information can also be found by contacting our Investor Relations department at (403) 265-1178 or at 1-866-666-1178.

## MANAGEMENT'S REPORT

In management's opinion, the accompanying consolidated financial statements of Harvest Operations Corp. (the "Company") have been prepared within reasonable limits of materiality and in accordance with Canadian generally accepted accounting principles. Since a precise determination of many assets and liabilities is dependent on future events, the preparation of financial statements necessarily involves the use of estimates and approximations. These have been made using careful judgment and with all information available up to February 25, 2011. Management is responsible for the consistency, therewith, of all other financial and operating data presented in Management's Discussion and Analysis for the year ended December 31, 2010.

To meet its responsibility for reliable and accurate financial statements, management has established and monitors systems of internal control which are designed to provide reasonable assurance that financial information is relevant, reliable and accurate, and that assets are safeguarded and transactions are executed in accordance with management's authorization.

Under the supervision of our Chief Executive Officer and our Chief Financial Officer, we have conducted an evaluation of the effectiveness of our internal control over financial reporting based on the *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). We have concluded that as of December 31, 2010 our internal controls over financial reporting were effective.

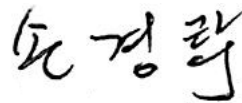
Because of inherent limitations, internal control over financial reporting may not prevent or detect misstatements and even those systems determined to be effective can provide only reasonable assurance with respect to the financial statement preparation and presentation.

The consolidated financial statements have been examined by our auditors, KPMG LLP. Their responsibility is to express a professional opinion on the fair presentation of the consolidated financial statements prepared in accordance with Canadian generally accepted accounting principles. The Auditors' Report outlines the scope of their examination and sets forth their opinion on our financial statements.

The Board of Directors is responsible for approving the consolidated financial statements. The Board fulfills its responsibilities related to financial reporting mainly through the Audit Committee. The Audit Committee consists exclusively of independent directors and includes at least one director with financial expertise. The Audit Committee meets regularly with management and the external auditors to discuss reporting and governance issues and ensures each party is discharging its responsibilities. The Audit Committee has reviewed these financial statements with management and the Independent Registered Public Accountants and has recommended their approval to the Board of Directors. The Board of Directors has approved the consolidated financial statements of the Company.



John E. Zahary  
President and Chief Executive Officer



Kyungluck Sohn  
Chief Financial Officer

Calgary, Alberta  
February 25, 2011

**INDEPENDENT AUDITORS' REPORT**

To the Directors and the Shareholder

We have audited the accompanying consolidated financial statements of Harvest Operations Corp. and subsidiaries which comprise the consolidated balance sheets as at December 31, 2010 and 2009, the consolidated statements of income (loss) and comprehensive income (loss), shareholder's equity and cash flows for the year ended December 31, 2010 and for the period from incorporation on October 9, 2009 to December 31, 2009, and notes, comprising a summary of significant accounting policies and other explanatory information.

*Management's Responsibility for the Consolidated Financial Statements*

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

*Auditors' Responsibility*

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

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

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

*Opinion*

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Harvest Operations Corp. and subsidiaries as at December 31, 2010 and 2009, and the results of their operations and their cash flows for the year ended December 31, 2010 and for the period from incorporation on October 9, 2009 to December 31, 2009 in accordance with Canadian generally accepted accounting principles.

*KPMG LLP*

Chartered Accountants

Calgary, Canada  
February 25, 2011

**CONSOLIDATED BALANCE SHEETS**

<i>(thousands of Canadian dollars)</i>	<b>December 31, 2010</b>	December 31, 2009
<b>Assets</b>		
Current assets		
Cash and cash equivalents	\$ 18,906	\$ -
Accounts receivable and other	215,795	180,839
Prepaid expenses and deposits	73,280	15,551
Inventories [Note 5]	75,517	86,819
Fair value of risk management contracts [Note 16]	1,007	-
Future income tax [Note 14]	1,633	-
	<b>386,138</b>	283,209
Long term deposit	12,394	-
Investment tax credits receivable	42,475	-
Property, plant and equipment [Note 6]	4,521,277	4,090,653
Goodwill [Note 1]	404,943	404,943
	<b>\$ 5,367,227</b>	<b>\$ 4,778,805</b>
<b>Liabilities and Shareholder's Equity</b>		
Current liabilities		
Bank loan [Note 9]	\$ -	\$ 428,017
Accounts payable and accrued liabilities [Note 7]	376,635	216,563
Current portion of convertible debentures [Note 11]	-	182,806
Current portion of 7 <sup>7/8</sup> % senior notes [Note 10]	-	42,921
Fair value deficiency of risk management contracts [Note 16]	7,553	2,052
	<b>384,188</b>	872,359
Bank loan [Note 9]	\$ 11,379	\$ -
Senior notes [Note 10]	482,389	222,456
Convertible debentures [Note 11]	745,257	748,261
Asset retirement obligations [Notes 7 & 8]	297,105	284,042
Employee future benefits [Note 15]	16,872	17,453
Deferred credit	294	358
Future income tax [Note 14]	178,801	211,188
	<b>2,116,285</b>	2,356,117
Shareholder's equity		
Shareholder's capital [Note 12]	3,355,350	2,422,688
Deficit	(53,028)	-
Accumulated other comprehensive loss	(51,380)	-
	<b>3,250,942</b>	2,422,688
	<b>\$ 5,367,227</b>	<b>\$ 4,778,805</b>

Commitments and contingencies [Note 18]

See accompanying notes to these consolidated financial statements.

On behalf of the Board of Directors:



William D. Robertson, Director



J. Richard Harris, Director

CONSOLIDATED STATEMENTS OF INCOME (LOSS) AND COMPREHENSIVE INCOME (LOSS)

<i>(thousands of Canadian dollars)</i>	For the Year Ended December 31, 2010	For the Period from Incorporation on October 9, 2009 to December 31, 2009 <i>[Note 1(b)]</i>
<b>Revenue</b>		
Petroleum, natural gas, and refined product sales	\$ 3,956,935	\$ -
Royalty expense	(154,757)	-
	<b>3,802,178</b>	-
<b>Expenses</b>		
Purchased products for processing and resale	2,733,019	-
Operating	486,416	-
Transportation and marketing	15,760	-
General and administrative	46,738	-
Realized losses on risk management contracts <i>[Note 16]</i>	1,808	-
Unrealized gains on risk management contracts <i>[Note 16]</i>	(2,358)	-
Interest and other financing charges on short term debt, net	2,103	-
Interest and other financing charges on long term debt	76,020	-
Depletion, depreciation, amortization and accretion	531,182	-
Currency exchange gain	(3,840)	-
Large corporations tax recovery and other taxes	(212)	-
Future income tax recovery	(39,897)	-
	<b>3,846,739</b>	-
<b>Net loss</b>	<b>(44,561)</b>	-
<b>Other comprehensive loss</b>		
Losses on designated hedges, net of tax <i>[Note 16]</i>	(5,020)	-
Change to cumulative translation adjustment	(46,360)	-
<b>Comprehensive loss</b>	<b>\$ (95,941)</b>	<b>\$ -</b>

See accompanying notes to these consolidated financial statements.

CONSOLIDATED STATEMENT OF SHAREHOLDER'S EQUITY

<i>(thousands of Canadian dollars)</i>	Shareholder's Capital	Deficit	Accumulated Other Comprehensive Income
<b>At October 9, 2009</b>	\$ -	\$ -	\$ -
Issued for cash			
December 22, 2009	2,422,688	-	-
<b>At December 31, 2009</b>	2,422,688	-	-
Issued for cash			
January 29, 2010	465,679	-	-
August 20, 2010	47,000	-	-
October 4, 2010	7,128	-	-
October 25, 2010	38,686	-	-
BlackGold acquisition <i>[Note 4]</i>	374,169	(8,467)	-
Losses on designated hedges, net of tax <i>[Note 16]</i>	-	-	(5,020)
Change to cumulative translation adjustment	-	-	(46,360)
Net loss	-	(44,561)	-
<b>At December 31, 2010</b>	<b>\$ 3,355,350</b>	<b>\$ (53,028)</b>	<b>\$ (51,380)</b>

See accompanying notes to these consolidated financial statements.



**CONSOLIDATED STATEMENTS OF CASH FLOWS**

<i>(thousands of Canadian dollars)</i>	<b>For the Year Ended December 31, 2010</b>	For the Period from Incorporation on October 9, 2009 to December 31, 2009 <i>[Note 1(b)]</i>
<b>Cash provided by (used in)</b>		
<b>Operating Activities</b>		
Net loss	\$ (44,561)	\$ -
Items not requiring cash		
Depletion, depreciation, amortization and accretion	531,182	-
Unrealized currency exchange gain	(2,315)	-
Non-cash interest expense and amortization of finance charges	(7,029)	-
Unrealized gains on risk management contracts <i>[Note 16]</i>	(2,358)	-
Future income tax reduction	(39,897)	-
Employee benefit obligation <i>[Note 15]</i>	(581)	-
Other non-cash items	(89)	-
Realized foreign exchange gain on senior note redemptions	(6,438)	-
Settlement of asset retirement obligations <i>[Note 8]</i>	(20,257)	-
Change in non-cash working capital	22,597	-
	<b>430,254</b>	<b>-</b>
<b>Financing Activities</b>		
Issue of common shares, net of issue costs	558,493	2,422,688
Bank repayments, net	(406,729)	-
Issue of 6 <sup>7/8</sup> % senior notes, net of issue costs	495,935	-
Redemptions of 7 <sup>7/8</sup> % senior notes	(256,931)	-
Redemptions of convertible debentures	(180,193)	-
Change in non-cash working capital	1,952	-
	<b>212,527</b>	<b>2,422,688</b>
<b>Investing Activities</b>		
Additions to property, plant and equipment	(475,249)	-
Business acquisition	(23,400)	(2,422,688)
Property acquisitions, net of dispositions	(152,861)	-
Construction advance <i>[Note 18e]</i>	(31,141)	-
Acquisition deposit <i>[Note 19]</i>	(40,000)	-
Change in non-cash working capital	93,331	-
	<b>(629,320)</b>	<b>(2,422,688)</b>
Change in cash and cash equivalents	13,461	-
Effect of exchange rate changes on cash	5,445	-
Cash and cash equivalents, beginning of period	-	-
Cash and cash equivalents, end of period	\$ 18,906	\$ -
Interest paid	\$ 66,917	\$ -
Large corporation tax and other tax received, net	\$ (212)	\$ -

See accompanying notes to these consolidated financial statements.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

For the year ended December 31, 2010 and for the period from incorporation on October 9, 2009 to December 31, 2009  
(tabular amounts in thousands of Canadian dollars)

**1. Nature of Operations and Structure of the Company**
**(a) Nature of Operations**

Harvest Operations Corp. is an integrated energy company with petroleum and natural gas operations focused on the operation and further development of assets in western Canada including the BlackGold oil sands asset (“upstream operations”) and a medium gravity sour crude hydrocracking refinery and a retail and wholesale petroleum marketing business both located in the Province of Newfoundland and Labrador (“downstream operations”).

**(b) Structure of the Company**

On December 22, 2009, KNOC Canada Ltd. (“KNOC Canada”), a wholly owned subsidiary of Korea National Oil Corporation (“KNOC”), acquired all of the issued and outstanding trust units of Harvest Energy Trust (the “Trust”) for \$10.00 per unit. The acquisition of all the issued and outstanding trust units of the Trust resulted in a change of control in which KNOC Canada became the sole equity owner of the Trust.

The aggregate consideration for the acquisition of the Trust consists of the following:

	Amount
Cash paid to Trust unitholders	\$ 1,822,688
Repayment of debt	600,000
	<u>\$ 2,422,688</u>

This acquisition was accounted for using the purchase method whereby the assets acquired and the liabilities assumed are recorded at fair value with the excess of the consideration over the fair value of the identifiable net assets allocated to goodwill. The following summarizes the allocation of the consideration to the fair value of the Trust’s assets and liabilities:

	Amount
Property, plant and equipment	\$ 4,090,653
Inventories	86,819
Goodwill	404,943
Net working capital (deficiency)	(20,531)
Total debt	(1,624,461)
Asset retirement obligations	(284,042)
Future income tax liability	(211,188)
Funding deficiency of pension and other benefit plans	(17,453)
Fair value of risk management contract	(2,052)
	<u>\$ 2,422,688</u>

On May 1, 2010, an internal reorganization was completed pursuant to which the Trust was dissolved and the Trust’s wholly owned subsidiary and manager of the Trust, Harvest Operations Corp., was amalgamated with KNOC Canada to continue as one corporation under the name Harvest Operations Corp (“Harvest” or the “Company”). The recorded amounts of Harvest’s assets and liabilities were determined from the existing carrying values of KNOC Canada’s assets and liabilities.

KNOC Canada was incorporated on October 9, 2009 and did not have any results from operations or cash flows in the period from October 9, 2009 to the acquisition date of December 22, 2009 aside from capital injections from Korea National Oil Corporation to finance the purchase of the Trust.

The following unaudited pro forma consolidated results of operations have been prepared as if the acquisition of the Trust and the subsequent reorganization occurred on January 1, 2009:

<i>(thousands of Canadian dollars)</i>	<b>Year Ended 31, 2009</b>			Pro Forma
	Harvest Energy Trust	Pro Forma Adjustments	Notes	Harvest Operations Corp.
<b>Revenue</b>				
Petroleum, natural gas, and refined product sales	\$ 3,267,945	-		\$ 3,267,945
Royalty expense	(128,860)	-		(128,860)
	3,139,085	-		3,139,085
<b>Expenses</b>				
Purchased products for processing and resale	2,015,671	-		2,015,671
Operating	500,586	(47,488)	(e)	453,098
Transportation and marketing	26,237	-		26,237
General and administrative	38,045	-		38,045
KNOC acquisition costs	18,393	-		18,393
Realized gains on risk management contract	(62,803)	-		(62,803)
Unrealized net losses on risk management contract	37,904	-		37,904
Interest and other financing charges on short term debt, net	8,896	(9,214)	(b)(c)	(318)
Interest and other financing charges on long term debt	110,943	(33,066)	(b)(c)	77,877
Depletion, depreciation, amortization and accretion	527,579	24,992	(a)	552,571
Goodwill impairment	884,077	(884,077)	(d)	-
Currency exchange gains	(2,265)	-		(2,265)
Large corporations tax (recovery) and other tax	(509)	-		(509)
Future income tax (reduction )	(28,035)	31,917	(f)	3,882
	4,074,719	(916,936)		3,157,783
<b>Net income (loss)</b>	(935,634)	916,936		(18,698)
<b>Other comprehensive income</b>				
Change to cumulative translation adjustment	(172,058)	18,942	(g)	(153,116)
<b>Comprehensive income (loss)</b>	\$ (1,107,692)	\$ 935,878		\$ (171,814)

The following are summaries of the significant pro forma adjustments:

- Additional depletion, depreciation, amortization and accretion based on the fair value adjustments to property, plant, and equipment.
- Adjustment of the interest and other financing charges to reflect the estimated carrying cost of the debt assumed on acquisition.
- The terms of the credit facility were amended on December 22, 2009 and again on April 30, 2010. Pro forma adjustments were made to adjust interest expense to apply the revised terms from the beginning of January 1, 2009.
- Reversal of goodwill impairment expense recorded by the Trust.
- Operating expense was adjusted to reflect Harvest's capitalization policy on turnaround and catalyst costs.
- Taxes have also been adjusted for the effect of the items discussed.
- Change to cumulative translation adjustment has been adjusted for the effect of the above items.

## 2. Significant Accounting Policies

These financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles.

### **(a) Consolidation**

These consolidated financial statements include the accounts of Harvest and its subsidiaries. All inter-entity transactions and balances have been eliminated upon consolidation.

### **(b) Use of Estimates**

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingencies, if any, as at the date of the financial statements and the reported amounts of revenues and expenses during the period. Specifically, amounts recorded in the purchase price equations and for depletion, depreciation, amortization and accretion expense, asset retirement obligations, fair value of risk management contracts, employee future benefits, income taxes and amounts used in the impairment tests for goodwill, inventory and property, plant and equipment are based on estimates. These estimates include petroleum and natural gas reserves, future petroleum and natural gas prices, future refined product prices, future interest and currency exchange rates and future costs required to develop those reserves as well as other fair value assumptions. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future years could be material.

### **(c) Revenue Recognition**

Revenues associated with the sale of crude petroleum, natural gas, natural gas liquids and refined products are recognized when title passes to customers and payment has either been received or collection is reasonably certain. Concurrent with the recognition of revenue from the sale of refined products and included in purchased products for resale and processing are associated transportation charges. Revenues for retail services are recorded when the services are provided.

The sales price of residential home heating fuels and automotive gasoline and diesel within the Province of Newfoundland and Labrador is subject to regulation under the Petroleum Products Act. The Petroleum Products Pricing Commissioner sets the maximum wholesale and retail prices that a wholesaler and a retailer may charge and sets the maximum mark-up between the wholesale price to the retailer and the retail price to the consumer. Prices are set biweekly using a price adjustment formula based on an allowable premium with an interruption formula. The full effect of rate regulation is reflected in the product sales revenue as recorded by Harvest.

### **(d) Cash and Cash Equivalents**

Cash and cash equivalents are comprised of cash and investments with a maturity date of three months or less and are recorded at fair value.

### **(e) Inventories**

Inventories are carried at the lower of cost or net realizable value. The costs of inventory are determined using the weighted average cost method. The valuation of inventory is reviewed at the end of each month. When the circumstances that previously caused inventories to be written down below cost no longer exist or when there is clear evidence of an increase in net realizable value because of changed economic circumstances, the amount of the write-down is reversed. The reversal is limited to the amount of the original write-down. The costs of parts and supplies inventories are determined under the average cost method.

### **(f) Joint Interest and Partnership Accounting**

The subsidiaries of Harvest conduct substantially all of their petroleum and natural gas production activities through joint interests and through partnerships. The consolidated financial statements reflect only Harvest's proportionate interests in such activities.

**(g) Property, Plant, and Equipment**

*Upstream Operations*

Harvest follows the full cost method of accounting for its petroleum and natural gas activities. All costs of acquiring petroleum and natural gas properties, whether productive or unproductive, related development costs, and overhead charges directly related to these activities, are capitalized and accumulated in one cost centre. Major capital maintenance projects are capitalized but general maintenance and repair costs that do not extend or enhance the recoverable reserves are charged against income.

Proceeds from the sale of petroleum and natural gas properties are applied against capital costs. Gains and losses are not recognized on the disposition of petroleum and natural gas properties unless that disposition would alter the rate of depletion and depreciation by 20% or more.

Provision for depletion and depreciation of petroleum and natural gas assets is calculated using the unit-of-production method, based on proved reserves net of royalties as evaluated by independent petroleum engineers. The cost basis used for the depletion and depreciation provision is the capitalized costs of petroleum and natural gas assets including undeveloped property plus the estimated future development costs of proved undeveloped reserves. Reserves are converted to equivalent units on the basis of six thousand cubic feet of natural gas to one barrel of petroleum, reflecting the approximate relative energy content.

Harvest places a limit on the aggregate carrying amount of property, plant and equipment associated with petroleum and natural gas activities which may be amortized to depletion and depreciation in future periods. Impairment is recognized when the carrying amount of the petroleum and natural gas assets exceeds the sum of the undiscounted future cash flows expected from the proved reserves.

To recognize impairment, Harvest would then measure the amount of impairment by comparing the carrying amounts of the petroleum and natural gas assets to an amount equal to the estimated net present value of future cash flows from proved plus probable reserves using the risk-free discount rate. Any excess carrying amount above the net present value of Harvest's future cash flows would be a permanent impairment and reflected as a charge to net income for the period. Present value of cash flows are calculated based on future price estimates, adjusted for Harvest's contractual arrangements related to pricing and quality differentials.

The cost of unproved properties is excluded from the impairment test calculation described above and subject to a separate impairment test. An impairment of unproved properties is recognized when the cost base exceeds the fair value determined by a reference to market prices, historical experience or a third party independent evaluation.

The BlackGold oil sands central processing facility is expected to be completed in the fourth quarter of 2012. BlackGold assets have been excluded from the provision for depletion and depreciation and are tested separately for impairment.

*Downstream Operations*

Property, plant and equipment related to the refining assets are recorded at cost. Depreciation of recorded cost less salvage value is provided on a straight-line basis over the estimated useful life of the assets as set out below. Any gains or losses on disposal of individual assets are recognized in the year of disposal.

Asset	Period
Refining and production plant:	
Processing equipment	5 – 35 years
Structures	15 – 20 years
Catalysts	2 – 8 years
Tugs	25 years
Vehicles	2 – 7 years
Office and computer equipment	3 – 5 years

General maintenance and repair costs, including major maintenance activities, are expensed as incurred. Major replacements and capital maintenance projects such as turnaround costs are capitalized. Improvements that increase or prolong the service life or capacity of an asset are capitalized.

Property, plant and equipment related to refining assets are tested for recovery whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. Property, plant and equipment related to refining assets are not recoverable if their carrying amounts exceed the sum of the undiscounted cash flows expected to result from their use and eventual disposition. If property, plant and equipment related to refining assets are not recoverable, an impairment loss is recognized in an amount by which their carrying amount exceeds their fair value, with fair value determined based on discounted estimated net cash flows.

**(h) Capitalized Interest**

Interest on major development projects are capitalized until the project is complete using the weighted-average interest rate on all of Harvest's borrowings.

**(i) Goodwill**

Goodwill is recognized when the purchase price of an acquired business exceeds the fair value of the net identifiable assets and liabilities of the acquired business. Goodwill is carried at cost less impairment and is not amortized. The carrying amount of goodwill is assessed for impairment annually at year-end or more frequently if events occur that could result in an impairment. The goodwill impairment test is a two-step test. In the first step, the carrying amount of the assets and liabilities, including goodwill, is compared to the fair value of the reporting unit. The fair value of a reporting unit is determined by calculating the present value of the expected future cash flows from the reporting unit. If the fair value is less than the carrying amount of the reporting unit, a potential impairment of goodwill may exist requiring the second test to be performed. Impairment is measured by allocating the fair value of the reporting unit, as determined in the first test, over the fair value of the identifiable assets and liabilities. The excess of the fair value of the reporting unit over the fair value of the identifiable assets and liabilities represents the fair value of goodwill. The excess of the book value of goodwill over this implied fair value is then recognized as an impairment and charged to income in the period in which it occurs.

**(j) Asset Retirement Obligations**

Harvest recognizes the fair value of any asset retirement obligations as a liability in the period in which it incurs a legal obligation associated with the retirement of tangible long-lived assets that result from the acquisition, construction, development, and normal use of the assets. Harvest uses a credit-adjusted risk free discount rate to estimate this fair value. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset and depleted and depreciated using the method described under "Property, Plant and Equipment". Subsequent to the initial measurement of the asset retirement obligation, the obligation is adjusted at the end of each subsequent period to reflect the passage of time and changes in the timing and amount of estimated future cash flows underlying the obligation. Actual costs incurred upon settlement of the retirement obligation are charged against the obligation to the extent of the liability recorded.

**(k) Income Taxes**

Harvest follows the asset and liability method of accounting for income taxes. Under this method, income tax liabilities and assets are recognized for the estimated tax consequences attributable to differences between the amounts reported in the financial statements and their respective tax bases, using enacted or substantively enacted income tax rates. The effect of a change in income tax rates on future tax liabilities and assets is recognized in income in the period in which the change occurs. A valuation allowance is recorded against any future income tax asset if it is more likely than not that the asset will not be realized.

**(l) Employee Future Benefits**

Harvest's downstream operations maintains a defined pension benefit plan and provides certain post-retirement health care benefits, which cover the majority of its employees and their surviving spouses. The cost of providing the defined pension benefits and other post-retirement benefits is actuarially determined based upon an independent actuarial valuation using management's best estimates of discount rates, rate of return on plan assets, rate of compensation increase, retirement ages of employees, and expected health care costs. The cost of

pensions earned by employees is actuarially determined using the projected benefit method prorated on credited service. Funding of the defined benefit pension plans complies with Canadian federal and provincial regulations, and requires contributions to the plans be made based on independent actuarial valuation. Pension plan assets are measured at fair values with the difference between the fair value of the plan assets and the total employee benefit obligation recorded on the balance sheet. For the purpose of calculating the expected return on assets, the fair value of the plan assets is used.

The defined benefit plans provide benefits based on length of service and the best five years of the last ten years' average earnings. There is no recognition or amortization of actuarial gains or losses less than 10% of the greater of the accrued benefit obligations and the fair value of plan assets for the defined benefit pension plans. Actuarial gains and losses over 10% are amortized over the average remaining service period of the plan participants. Actuarial gains or losses related to the other post-retirements benefits are recognized in income immediately. Past service costs are amortized on a straight-line basis over the expected average remaining service life of plan participants.

**(m) Currency Translation**

Monetary assets and liabilities denominated in a currency other than Canadian dollars are translated at the exchange rate in effect at the balance sheet date. Revenues and expenses denominated in a foreign currency are translated at the monthly average rate of exchange. Translation gains and losses are included in income in the period in which they arise.

Harvest's investment in its downstream operations, which is considered a self-sustaining operation with a U.S. dollar denominated functional currency, is translated using the current rate method. Gains and losses resulting from this translation are recorded in other comprehensive income with the cumulative translation adjustments reported in accumulated other comprehensive income.

**(n) Financial Instruments**

Harvest recognizes financial assets and financial liabilities, including derivatives, on the consolidated balance sheet when the Company becomes a party to the contract. Financial liabilities are removed from the consolidated financial statements when the liability is extinguished either through settlement of or release from the obligation of the underlying liability.

The Company initially measures all financial instruments at fair value. Subsequent measurement of the financial instruments is based on their classification. Financial assets are classified into the following categories: held for trading, available for sale, held-to-maturity investments and loans and receivables. Financial liabilities are classified as held for trading or other financial liabilities.

Financial assets and financial liabilities classified as held for trading are measured at fair value with changes in those fair values recognized in net income. Financial assets classified as either held-to-maturity or loans and receivables, and other financial liabilities are measured at amortized cost using the effective interest method of amortization. Financial assets classified as available-for-sale are measured at fair values with changes in those fair values recognized in other comprehensive income. The Company has not designated any financial assets or financial liabilities upon initial recognition as held for trading.

Financial assets and financial liabilities are offset and the net amount reported in the consolidated balance sheets if, and only if, there is a currently enforceable legal right to offset the recognized amounts and there is an intention to settle on a net basis, or to realize the assets and settle the liabilities simultaneously.

Transaction costs relating to financial instruments classified as held for trading are expensed in net income in the period that they are incurred. For transaction costs that are directly attributable to the acquisition or issuance of financial instruments not classified as held for trading, they are included in the costs of the financial instruments upon initial recognition.

Harvest assesses at each reporting date whether there is any objective evidence that a financial asset or a group of financial assets is impaired, as a result of one or more events that has occurred after the initial recognition of the



asset (an incurred 'loss event') and that loss event has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated.

**(o) Hedges**

Harvest uses derivative financial instruments such as foreign currency contracts and financial commodity contracts to hedge its foreign currency risks and commodity price risks. Such derivative financial instruments are initially recognized at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at fair value. Derivatives are carried as financial assets when the fair value is positive and as financial liabilities when the fair value is negative. Any gains or losses arising from changes in the fair value of derivatives are recorded in net income, except for the effective portion of cash flow hedges, which is recognized in other comprehensive income.

At the inception of a hedge relationship, Harvest formally designates and documents the hedge relationship to which the Company intends to apply hedge accounting. The designation document includes the risk management objective and strategy for undertaking the hedge, the identification of the hedging instrument, the hedged item or transaction, the nature of the risk being hedged and how the Company will assess the hedge effectiveness. Upon designation and at each reporting date, Harvest assesses hedge effectiveness by comparing the changes in the hedging instrument's fair value and the changes in the hedged item's fair value or cash flows attributable to the hedged risk. Only if such hedges are highly effective in achieving offsetting changes in fair value or cash flows will Harvest continue to apply hedge accounting.

The effective portion of the gain or loss on the hedging instrument is recognized directly in other comprehensive income, while any ineffective portion is recognized immediately in net income. Amounts recognized in other comprehensive income are transferred to the income statement when the hedged transaction affects net income, such as when the hedged forecasted transaction occurs. Where the hedged item is the cost of a non-financial asset or non-financial liability, the amounts recognized as other comprehensive income are transferred to the initial carrying amount of the nonfinancial asset or liability.

If the forecast transaction is no longer expected to occur, the cumulative gain or loss previously recognized in other comprehensive income is transferred to net income. If the hedging instrument expires or is sold, terminated or exercised without replacement or rollover, or if its designation as a hedge is revoked, any cumulative gain or loss previously recognized in other comprehensive income remains in other comprehensive income until the forecast transaction affects net income.

**(p) Investment Tax Credits**

Harvest is entitled to certain investment tax credits on qualifying manufacturing expenditures relating to its downstream operations. These credits are recorded as a reduction of the related expense or as a reduction of the cost of the related asset. The benefits are recognized when the Company has complied with the terms and conditions of applicable tax legislation provided there is reasonable assurance of realization.

**3. New Accounting Policies**

***Future Accounting Changes***

***Business Combinations, Consolidated Financial Statements and Non-Controlling Interests***

The CICA Handbook Section 1582 "Business Combinations" is effective for business combinations with an acquisition date after January 1, 2011. This standard was amended to require additional use of fair value measurements, recognition of additional assets and liabilities, and increased disclosure. Adopting the standard is expected to have a material effect on the way the Company accounts for future business combinations. Entities adopting Section 1582 will also be required to adopt CICA Handbook Sections 1601 "Consolidated Financial Statements" and 1602 "Non-Controlling Interests". These standards require non-controlling interests to be presented as part of Shareholder's Equity on the balance sheet. In addition, the income statement of the controlling parent will include 100 per cent of the subsidiary's results and present the allocation between the controlling and non-controlling interests. These standards will be effective January 1, 2011, with early adoption permitted. Harvest has not elected to early adopt these standards. The changes resulting from adopting Section 1582 will be applied prospectively and the changes from adopting Sections 1601 and 1602 will be applied retrospectively.



*International Financial Reporting Standards ("IFRS")*

In February 2008, the CICA Accounting Standards Board ("ASB") announced that Canadian public reporting issuers will be required to report under International Financial Reporting Standards ("IFRS") commencing January 1, 2011 which will require comparative IFRS information for the 2010 year end. Harvest will begin reporting under IFRS for the periods starting from January 1, 2011.

**4. Acquisitions**
**(a) Petroleum and natural gas assets**

On September 30, 2010, Harvest acquired a package of petroleum and natural gas assets which included the remaining 40% interest in Red Earth Partnership for total cash consideration of \$146.2 million. As a result of the acquisition, \$161.3 million was added to property, plant and equipment, \$7.4 million to asset retirement obligations and \$7.7 million to future income tax liability. The operating results of the acquired assets were included in the consolidated financial statements commencing on the acquisition date.

**(b) BlackGold Oil Sands Project**

On August 6, 2010, Harvest closed the acquisition of the BlackGold oil sands project ("BlackGold") from KNOC for \$374 million, representing the fair value of the oil and gas assets acquired as determined by an independent valuation. The acquisition was financed with the issuance of shares to KNOC. As KNOC is the sole shareholder of Harvest, they will be retaining control over BlackGold. Given there is no substantive change in the ownership interest of the BlackGold assets, these assets have been recorded by Harvest at the carrying values as previously recorded by KNOC.

The following amounts were added to Harvest's balance sheet at August 6, 2010:

Current assets	500
Property, plant and equipment	365,212
Long-term liabilities	(10)
Common shares	(374,169)
Deficit	8,467

KNOC has injected \$85.7 million of capital for further development of the BlackGold assets since August 6, 2010.

**5. Inventories**

	December 31, 2010	December 31, 2009
Petroleum products		
Upstream – pipeline fill	\$ 1,010	\$ 1,183
Downstream	70,586	81,240
	<b>71,596</b>	<b>82,423</b>
Parts and supplies	3,921	4,396
Total inventories	\$ 75,517	\$ 86,819

For the year ended December 31, 2010, Harvest recognized inventory impairments of \$2.4 million in its downstream operations. Such write-down and recoveries amounts are included as costs in "Purchased products for processing and resale" in the consolidated statements of income (loss).

**6. Property, Plant and Equipment**

	December 31, 2010			December 31, 2009		
	Upstream	Downstream	Total	Upstream	Downstream	Total
Cost	\$ 3,955,539	\$ 1,079,478	\$ 5,035,017	\$ 2,976,911	\$ 1,113,742	\$ 4,090,653
Accumulated depletion and depreciation	(435,239)	(78,501)	(513,740)	-	-	-
Net book value	\$ 3,520,300	\$ 1,000,977	\$ 4,521,277	\$ 2,976,911	\$ 1,113,742	\$ 4,090,653

General and administrative costs of \$14.6 million and borrowing costs of \$0.4 million have been capitalized in upstream property, plant and equipment during year ended December 31, 2010. Capitalized borrowing costs relate to the BlackGold oil sands project.

All costs, except those associated with major spare parts inventory, assets under construction and major development projects, are subject to depletion, depreciation and amortization at December 31, 2010 including future development costs of \$533.2 million. At December 31, 2010 the following costs were excluded from the asset base subject to depreciation, depletion and amortization: Downstream major parts inventory of \$6.8 million, downstream assets under construction of \$68.8 million and upstream BlackGold oil sands project assets of \$385.3 million. For the year ended December 31, 2010, an investment tax credit of \$42.7 million was applied against downstream assets.

The petroleum and natural gas future prices used in the impairment test for petroleum and natural gas assets were obtained from third party engineers and accepted by management. Based on these assumptions, the undiscounted future net revenue from Harvest's proved reserves exceeded the carrying amount of its petroleum and natural gas assets as at December 31, 2010 and 2009, and therefore no impairment was recorded in either of the periods ended on these dates.

Benchmark prices and U.S.\$/Cdn.\$ exchange rate assumptions reflected in the impairment test as at December 31, 2010 were as follows:

Year	WTI Oil <sup>(1)</sup> (US\$/barrel)	Currency Exchange Rate	Edmonton Light Crude Oil <sup>(1)</sup> (CDN\$/barrel)	AECO Gas <sup>(1)</sup> (CDN\$/MMBtu)
2011	85.00	0.975	84.20	4.25
2012	87.70	0.975	88.40	4.90
2013	90.50	0.975	91.80	5.40
2014	93.40	0.975	94.80	5.90
2015	96.30	0.975	97.70	6.35
Thereafter (escalation)	2%	0%	2%	2%

<sup>(1)</sup> Actual prices used in the impairment test were adjusted for commodity price differentials specific to Harvest.

**7. Accounts Payable and Accrued Liabilities**

	December 31, 2010	December 31, 2009
Trade accounts payable	\$ 146,223	\$ 71,309
Accrued interest	18,481	16,530
Other accrued liabilities	195,783	117,538
Current portion of asset retirement obligations	16,148	11,186
Total	\$ 376,635	\$ 216,563

**8. Asset Retirement Obligations**

Harvest's asset retirement obligations result from its net ownership interest in petroleum and natural gas assets including well sites, gathering systems and processing facilities and the estimated costs and timing to reclaim and abandon them. Harvest estimates the total undiscounted amount of cash flows required to settle its asset retirement obligations to be approximately \$1,242 million which will be incurred between 2011 and 2070. A credit-adjusted risk-free discount rate of 8% - 10% and inflation rate of approximately 2% were used to calculate the fair value of the asset retirement obligations. A reconciliation of the asset retirement obligations is provided below:

	December 31, 2010	December 31, 2009
Balance, beginning of year	\$ 295,228	\$ 277,318
Incurred on business acquisition of a private corporation	-	1,411
Liabilities incurred	1,623	1,351
Revision of estimates	1,724	7,219
Net liabilities acquired (settled) through acquisition (disposition)	9,694	(2,538)
Liabilities settled	(20,257)	(14,270)
Accretion expense	25,241	24,737
Balance, end of year <sup>(1)</sup>	\$ 313,253	\$ 295,228

<sup>(1)</sup> Current portion of the asset retirement obligation is included in accounts payable and accrued liabilities [Note 7]

Harvest has undiscounted asset retirement obligations of approximately \$14.9 million (2009 – \$14.9 million) relating to the refining and marketing assets. The fair value of this obligation cannot be reasonably determined because the timing of retiring the assets is uncertain.

**9. Bank Loan**

At the time of the purchase of the Trust by KNOC Canada on December 22, 2009, the Trust had renegotiated a temporary credit facility of \$600 million with the maturity date of April 30, 2010. On April 30, 2010, Harvest entered into an amended and extended credit facility maturing April 30, 2013 and the facility was reduced from \$600 million to \$500 million. Harvest continues to pay a floating interest rate plus a risk premium that changes based on the Company's secured debt (excluding 6<sup>7/8</sup>% senior notes and convertible debentures) to earnings before interest, taxes, depletion, amortization and other non-cash items ("EBITDA") ratio. The minimum rate charged on the credit facility is 200 bps over bankers' acceptance rates as long as Harvest's secured debt to EBITDA ratio remains below or equal to one. In addition, the credit facility requires standby fees on undrawn amounts.

The credit facility is secured by a first floating charge over all of the assets of Harvest's operating subsidiaries plus a first mortgage security interest on the downstream operation's refinery assets. The most restrictive covenants of Harvest's credit facility include an aggregate limitation of \$25 million on financial assistance and/or capital contributions to parties other than those included in the first floating charge, a limitation to carrying on business in countries that are not members of the Organization of Economic Co-operation and Development and a limitation on the payment of distributions to shareholders of an amount greater than EBITDA minus capital expenditures by Harvest and its subsidiaries. In addition, the capacity under this facility is limited to an amount as outlined in the limitations on liens covenant of the 6<sup>7/8</sup>% senior notes described in Note 10 and availability is subject to the following quarterly financial covenants:

	Covenant	As at December 31, 2010
Senior debt <sup>(1)</sup> to EBITDA	3.0 to 1.0 or less	0.06
Total debt <sup>(2)</sup> to EBITDA	3.5 to 1.0 or less	2.39
Senior debt <sup>(1)</sup> to Capitalization <sup>(3)</sup>	50% or less	1%
Total debt <sup>(2)</sup> to Capitalization <sup>(3)</sup>	55% or less	31%

<sup>(1)</sup> Senior debt consists of letters of credit, bank debt and guarantees.

<sup>(2)</sup> Total debt consists of secured debt and convertible debentures and notes.

<sup>(3)</sup> Capitalization consists of total debt and shareholders' equity.

Harvest's bank debt is recorded net of transaction costs. At December 31, 2010, \$14 million (2009 - \$428 million) was drawn from the \$500 million (2009 - \$600 million) available under the credit facility.

#### 10. Senior Notes

On October 14, 2004, Harvest issued US\$250 million of 7<sup>7/8</sup>% senior notes for cash proceeds of \$312 million. On September 17, 2010, Harvest issued an Offer To Purchase And Consent Solicitation Statement (the "Offer") to purchase all of the outstanding 7<sup>7/8</sup>% senior notes and solicit consent for amendments of the related indenture. Harvest offered US\$983.50 for each US\$1,000 principal amount of notes tendered; in addition, for consent to the amendments of the indenture a payment of US\$20.00 was offered for each US\$1,000 principal amount of notes tendered by September 30, 2010. On October 4, 2010, all conditions of the tender offer were met and Harvest accepted the offer and redeemed US\$178.3 million of the US\$209.6 million principal amount outstanding for total consideration of \$179.0 million. On October 19, 2010, Harvest redeemed the remaining US\$31.3 million senior notes at par under the terms of the amended indenture.

On October 4, 2010, Harvest completed an offering of US\$500 million principal amount of 6<sup>7/8</sup>% senior notes for net cash proceeds of US\$484.6 million. The 6<sup>7/8</sup>% senior notes are unsecured, incur interest payments semi-annually on April 1 and October 1 each year, mature on October 1, 2017 and are unconditionally guaranteed by Harvest and all of its wholly-owned subsidiaries that guarantee the revolving credit facility and every future restricted subsidiary that guarantees certain debt. Prior to maturity, the notes are redeemable at a redemption price equal to 100% of the principal amount of the notes being redeemed, plus a make-whole redemption premium and accrued and unpaid interest to the redemption date. Harvest may also redeem the notes at any time in the event that certain changes affecting Canadian withholding taxes occur.

There are also covenants restricting, among other things, the sale of assets and the incurrence of additional indebtedness if such issuance would result in an interest coverage ratio, as defined, of less than 2.0 to 1. Notwithstanding the interest coverage ratio limitation, the incurrence of additional secured indebtedness may not exceed the greater of \$1.0 billion and 15% of total assets as outlined in the limitation on liens covenant. In addition, the covenants of the senior notes limit the amount of restricted payments, including dividends to our shareholders, should our defined leverage ratio, be greater than 2.50 to 1. No dividend was paid during the year ended December 31, 2010.

#### 11. Convertible Debentures

Harvest has a series of convertible unsecured subordinated debentures outstanding (the "convertible debentures"). Interest on the debentures is payable semi-annually in arrears in equal installments on dates prescribed by each series.

As a result of the Trust's acquisition, the debentures are no longer convertible into units but investors would receive \$10.00 for each unit notionally received based on each series conversion rate. Because every series of debentures carry a conversion price that exceeds \$10.00 per unit, it is assumed that no investor would exercise their conversion option. The debentures may be redeemed by Harvest at its option in whole or in part prior to their respective redemption dates. The redemption price for the first redemption period is at a price equal to \$1,050 per debenture and at \$1,025 per debenture during the second redemption period. With the exception of the 7.50% debentures due 2015, Harvest may redeem the debentures at par after the second redemption period. Any redemption will include accrued and unpaid interest at such time.

The following table lists a summary of the outstanding convertible debentures at December 31, 2010:

Series	Conversion price / share	Maturity	First redemption period	Second redemption period
6.40% Debentures Due 2012	\$ 46.00	Oct. 31, 2012	Nov. 1/08-Oct. 31/09	Nov. 1/09-Oct. 31/10
7.25% Debentures Due 2013	\$ 32.20	Sept. 30, 2013	Oct. 1/09-Sept. 30/10	Oct. 1/10-Sept. 30/11
7.25% Debentures Due 2014	\$ 27.25	Feb. 28, 2014	Mar. 1/10-Feb. 28/11	Mar. 1/11-Feb. 29/12
7.50% Debentures Due 2015	\$ 27.40	May 31, 2015	Jun. 1/11-May 31/12	Jun. 1/12-May 31/13

The following table summarizes the face value, carrying amount and fair value of the convertible debentures:

	December 31, 2010			December 31, 2009		
	Face Value	Carrying Amount	Fair Value	Face Value	Carrying Amount	Fair Value
6.50% Debentures Due 2010	\$ -	\$ -	\$ -	\$ 37,062	\$ 37,562	\$ 37,562
6.40% Debentures Due 2012	106,796	107,544	108,291	174,626	176,460	176,460
7.25% Debentures Due 2013	330,548	334,804	339,142	379,256	385,703	385,703
7.25% Debentures Due 2014	60,050	60,851	61,912	73,222	74,467	74,467
7.50% Debentures Due 2015	236,579	242,058	248,763	250,000	256,875	256,875
	<b>\$ 733,973</b>	<b>\$ 745,257</b>	<b>\$ 758,108</b>	<b>\$ 914,166</b>	<b>\$ 931,067</b>	<b>\$ 931,067</b>

The “change of control” provision included within the convertible debentures’ indentures required Harvest to make an offer to purchase 100% of the outstanding convertible debentures for cash consideration of 101% of the principal amount thereof plus accrued and unpaid interest. Harvest made these offers on January 20, 2010 and by March 4th all of the offers had expired. The following redemptions were made:

- 6.50% Debentures due 2010 – \$13.3 million principal amount tendered, with the remaining principal balance of \$23.8 million maturing on December 31, 2010
- 6.40% Debenture due 2012 – \$67.8 million principal amount tendered leaving a principal balance of \$106.8 million outstanding
- 7.25% Debentures due 2013 – \$48.7 million principal amount tendered leaving a principal balance of \$330.5 million outstanding
- 7.25% Debentures due 2014 – \$13.2 million principal amount tendered leaving a principal balance of \$60.1 million outstanding
- 7.50% Debentures due 2015 – \$13.4 million principal amount tendered leaving a principal balance of \$236.6 million outstanding

## 12. Shareholder’s Capital

### (a) Authorized

The authorized capital consists of an unlimited number of common shares and an unlimited number of preferred shares issuable in series.

### (b) Number of Common Shares Issued

Outstanding at October 8, 2009	-
Common share issue to KNOC on incorporation at \$1 per share	1
Common shares issued to KNOC at \$10.00 per share to fund the Trust acquisition	242,268,801
Outstanding at December 31, 2009	242,268,802
Common shares issued to KNOC at \$10.00 per share to fund debt repayment	46,567,852
Common shares issued to KNOC at \$10.00 per share for BlackGold consideration [Note 4]	37,416,913
Common shares issued to KNOC at \$10.00 per share to fund BlackGold project development [Note 4]	8,568,600
Common shares issued to KNOC at \$10.00 per share to fund Global Technology & Research Centre development	712,880
Outstanding at December 31, 2010	<b>335,535,047</b>

**13. Capital Structure**

Harvest considers its capital structure to include its credit facilities, senior notes, convertible debentures and shareholder's equity.

	<b>December 31, 2010</b>	December 31, 2009
Bank debt <sup>(1)</sup>	\$ <b>14,000</b>	\$ 428,017
6 <sup>7/8</sup> % Senior Notes <sup>(2)</sup>	<b>497,300</b>	-
7 <sup>7/8</sup> % Senior Notes <sup>(2)</sup>	-	262,750
Principal amount of convertible debentures	<b>733,973</b>	914,166
<b>Total Debt</b>	<b>1,245,273</b>	1,604,933
Shareholder's equity	<b>3,250,942</b>	2,422,688
<b>Total capitalization</b>	<b>\$ 4,496,215</b>	\$ 4,027,621

<sup>(1)</sup> Excludes capitalized financing fees

<sup>(2)</sup> Face value converted at the period end exchange rate

Harvest's primary objective in its management of capital resources is to have access to capital to fund its financial obligations as well as future growth. Harvest monitors its capital structure and makes adjustments according to market conditions to remain flexible while meeting these objectives. Accordingly, Harvest may adjust its capital spending programs, issue equity, issue new debt or repay existing debt.

Harvest evaluates its capital structure using the following non-GAAP financial ratios: bank debt to twelve month trailing EBITDA; secured debt to net present value of the Company's proved petroleum and natural gas reserves discounted at 10%; and total debt to total debt plus shareholder's equity. These ratios are also included in the externally imposed capital requirements per the Company's credit facility, senior notes and convertible debentures. Harvest was in compliance with all debt covenants at December 31, 2010.

**14. Income Taxes**

The future income tax ("FIT") provision reflects the net tax effects of temporary differences between the carrying amounts of assets and liabilities of the legal entities of Harvest and their corresponding income tax bases. Changes in the temporary differences are reflected in FIT expense (recovery).

As KNOC Canada acquired the Trust, the opening FIT liability is calculated as part of the purchase price allocation recorded at that date. The opening FIT liability of \$211.2 million represents a tax liability based on the excess book over tax value of net assets and the related tax impact is calculated at corporate tax rates applicable to the relevant provinces.

At the end of the year ended December 31 2010, Harvest had a net FIT liability of \$177.2 million comprised of a \$80 million (2009 – \$112.5 million) FIT liability for the downstream corporate entities and \$97.2 million (2009 – \$98.7 million) FIT liability for the upstream entities.

FIT liability (asset)	
Opening FIT Liability, January 1, 2010 (from PPA)	\$ 211,188
Ending FIT Liability, net December 31, 2010	177,168
	<b>(34,020)</b>
Consists of:	
FIT recovery for period ended December 31, 2010	(39,897)
FIT liability associated with partnership acquisition	7,709
FIT recovery associated with the effective portion of hedge accounting	(1,832)
<b>Total</b>	<b>(34,020)</b>

The provision for future income taxes varies from the amount that would be computed by applying the relevant Canadian income tax rates to reported income before taxes as follows:

	<b>December 31, 2010</b>
Loss before taxes	\$ (84,670)
Combined Canadian Federal and Provincial statutory income tax rate	28.25%
Computed income tax recovery at statutory rates	(23,919)
Increased recovery resulting from the following:	
Difference between current and expected tax rates	(11,639)
Non-taxable portion of capital gain	(2,997)
Non-deductible expenses and other	(1,342)
FIT recovery	<b>\$ (39,897)</b>

The components of the FIT liability (asset) are as follows:

	<b>December 31, 2010</b>	December 31, 2009
Net book value of petroleum and natural gas assets in excess of tax pools	\$ 563,247	\$ 559,063
Asset retirement obligation	<b>(79,664)</b>	(75,784)
Net unrealized gains related to risk management contracts and currency exchange positions – current	<b>(1,633)</b>	(3,248)
Net unrealized losses related to risk management contracts and currency exchange positions – long-term	<b>1,643</b>	6,681
Non-capital loss carry forwards for tax purposes	<b>(303,116)</b>	(274,067)
Deferral of taxable income in partnership		681
Future employee retirement costs	<b>(3,542)</b>	(2,094)
Working capital and other items	<b>233</b>	(44)
FIT liability, net	<b>\$ 177,168</b>	\$ 211,188

The expiry dates on the consolidated non-capital losses and downstream operations' ITC are as follows:

Year of Expiry	<b>Non-capital losses</b>	<b>Investment tax credits</b>
2013	\$ 9,768	\$ -
2014	40,411	-
2018	-	1,932
2019	-	3,753
2020	-	3,042
2021	-	2,976
2022	-	3,850
2023	366	5,792
2024	902	3,346
2025	97,444	5,533
2026	40,698	1,701
2027	449,517	3,356
2028	344,376	3,561
2029	110,572	1,616
2030	249,061	2,017
	<b>\$ 1,343,115</b>	<b>\$ 42,475</b>

**15. Employee Future Benefit Plans**

The measurement of the accrued benefit obligation and annual expense for the defined benefit plans requires actuarial calculations and several assumptions. These assumptions are as follows:

	December 31, 2010		December 31, 2009	
	Pension Plans	Other Benefit Plans	Pension Plans	Other Benefit Plans
Discount rate	5.25%	5.25%	5.5%	5.5%
Expected long-term rate of return on plan assets	7.0%	-	7.0%	-
Rate of compensation increase	3.5%	-	3.5%	-
Employee contribution of pensionable income	6.0%	-	6.0%	-
Annual rate of increase in covered health care benefits	-	8%	-	9.0%
Expected average remaining service lifetime (years)	12.0	10.3	12.2	10.5

The assets of the defined benefit plan are invested and maintained in the following asset mix:

	December 31, 2010	December 31, 2009
Bonds/fixed income securities	32%	31%
Equity securities	68%	69%

Total cash payments for employee future benefits, consisting of cash contributed by Harvest to the pension plans and other benefit plans was \$3.9 million for the year ended December 31, 2010; expected contributions in 2011 are \$3.4 million for the pension plans and \$0.3 million for the other benefit plan.

The expected long-term rates of return are estimated based on many factors, including the expected forecast for inflation, risk premiums for each class of asset, and current and future financial market conditions.

The defined benefit pension plans were subject to an actuarial valuation on December 31, 2010, and the next valuation report will be as at December 31, 2011. The post-retirement health care benefits plan was last subject to an actuarial valuation on December 31, 2010.

	December 31, 2010	
	Pension Plans	Other Benefit Plans
Employee benefit obligation, beginning of year	\$ 56,476	\$ 7,047
Current service costs	2,189	291
Interest	3,258	397
Actuarial losses	3,776	593
Benefits paid	(1,908)	(427)
Employee benefit obligation, end of year	63,791	7,901
Fair value of plan assets, beginning of year	46,070	-
Actual return on plan assets	2,034	-
Employer contributions	3,605	257
Employee contributions	1,526	170
Benefits paid	(1,908)	(427)
Fair value of plan assets, end of year	51,327	-
Funded status - deficit	\$ (12,464)	\$ (7,901)
Unamortized net actuarial losses	3,493	-
Carrying amount	\$ (8,971)	\$ (7,901)



	December 31, 2010	December 31, 2009
Summary:		
Pension plans	\$ 8,971	\$ 10,406
Other benefit plans	7,901	7,047
	<b>\$ 16,872</b>	<b>\$ 17,453</b>

Estimated pension and other benefit payments to plan participants which reflect expected future service, expected to be paid from 2011 to 2020, are as follows:

	Pension Plans	Other Benefit Plans
2011	\$ 1,930	\$ 520
2012	2,147	732
2013	2,421	875
2014	2,891	1,060
2015	3,277	1,248
2016 to 2020	23,963	10,519
Total	<b>\$ 36,629</b>	<b>\$ 14,954</b>

The table below shows the components of the net benefit plan expense:

	Year ended December 31, 2010	
	Pension Plans	Other Benefit Plans
Current service cost	\$ 2,189	\$ 291
Interest costs	3,258	397
Expected return on assets	(3,277)	-
Amortization of net actuarial losses	-	423
Net benefit plan expense	<b>\$ 2,170</b>	<b>\$ 1,111</b>

A 1% change in the expected health care cost trend rate would have the following impacts as at December 31, 2010:

	1% Increase	1% Decrease
Impact on post-retirement benefit expense	\$ 1	\$ (2)
Impact on projected benefit obligation	5	(5)

## 16. Financial Instruments

### (a) Fair Values

Financial instruments of Harvest consist of accounts receivable, accounts payable and accrued liabilities, bank loan, risk management contracts, convertible debentures and the senior notes.

The carrying value and fair value of these financial instruments at December 31, 2010 are disclosed below by financial instrument category, as well as any related gains or losses and interest income or expense for the year ended December 31, 2010:

December 31, 2010					
	Carrying Value	Fair Value	Gain / (Losses)	Interest Income / (Expense)	Other Comprehensive Income (Loss)
<b>Financial Assets</b>					
Loans and Receivables					
Accounts receivable	\$ 215,795	\$ 215,795	\$ -	\$ 108 <sup>(3)</sup>	\$ -
Held for Trading					
Fair value of risk management contracts	1,007	1,007	1,252 <sup>(4)</sup>	-	-
<b>Total Financial Assets</b>	<b>216,802</b>	<b>216,802</b>	<b>1,252</b>	<b>108</b>	<b>-</b>
<b>Financial Liabilities</b>					
Held for Trading					
Fair value of risk management contracts	\$ 7,553	\$ 7,553	\$ (702) <sup>(4)</sup>	\$ -	\$ (5,020) <sup>(6)</sup>
Measured at Amortized Cost					
Accounts payable and accrued liabilities	360,487	360,487	-	-	-
Bank loan	11,379	14,000	-	(5,696)	-
7 <sup>7/8</sup> % senior notes <sup>(1)</sup>	-	-	-	(11,992)	-
6 <sup>7/8</sup> % senior notes <sup>(2)</sup>	482,389	507,246	-	(8,905)	-
Convertible debentures	745,257	758,108	-	(51,530)	-
<b>Total Measured at Amortized Costs</b>	<b>1,599,512</b>	<b>1,639,841</b>	<b>-</b>	<b>(78,123)<sup>(5)</sup></b>	<b>(5,020)</b>
<b>Total Financial Liabilities</b>	<b>\$ 1,607,065</b>	<b>\$ 1,647,394</b>	<b>\$ (702)</b>	<b>\$ (78,123)</b>	<b>\$ (5,020)</b>

<sup>(1)</sup> The face value of the 7<sup>7/8</sup>% Senior Notes at December 31, 2010 is \$nil (December 31, 2009 - \$262.8 million or US\$250 million).

<sup>(2)</sup> The face value of the 6<sup>7/8</sup>% Senior Notes at December 31, 2010 is \$497.3 million or US\$500 million (December 31, 2009 - \$nil).

<sup>(3)</sup> Included in petroleum, natural gas, and refined product sales in the statement of income and comprehensive income.

<sup>(4)</sup> Included in risk management contracts - realized and unrealized gains (losses) in the statement of income and comprehensive income.

<sup>(5)</sup> Included in interest and other financing charges on short term/long term debt in the statement of income and comprehensive income; net of capitalized interests.

<sup>(6)</sup> Net of deferred tax of \$1.8 million

Due to the KNOC acquisition, the carrying value of all financial assets and financial liabilities was equal to the fair value at December 31, 2009.

Harvest enters into risk management contracts with various counterparties, principally financial institutions with investment grade credit ratings. Derivatives valued using valuation techniques with market observable inputs include foreign exchange contracts and financial commodity contracts. The most frequently applied valuation techniques include forward pricing and swap models, using present value calculations. The models incorporate various inputs including the credit quality of counterparties, foreign exchange spot and forward rates, interest rate curves and forward rate curves of the underlying commodity.

The fair values of the risk management contracts are net of a credit valuation adjustment attributable to derivative counterparty default risk. The changes in counterparty credit risk had no material effect on the hedge effectiveness assessment for derivatives designated in hedge relationships and other financial instruments recognized at fair value.

The fair values of the convertible debentures and the senior notes are based on quoted market prices as at December 31, 2010. The fair value of the bank loan approximates to the carrying value (excluding deferred financing charges) as the bank loan bears floating market rates. The carrying value of the bank loan includes \$2.6 million of deferred financing charges at December 31, 2010. Due to the short term maturities of accounts receivable, deposits and accounts payable and accrued liabilities, their carrying values approximate their fair values.

Harvest's financial assets and liabilities recorded at fair value have been classified according to the following hierarchy based on the amount of observable inputs used to value the instrument:

Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities. Active markets are those in which transactions occur in sufficient frequency and volume to provide pricing information on an ongoing basis.

Level 2: other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly

Level 3: techniques which use inputs that have a significant effect on the recorded fair value that are not based on observable market data

Harvest's cash and cash equivalents and risk management contracts have been assessed on the fair value hierarchy described above. Cash and cash equivalents are classified as Level 1 and risk management contracts as Level 2. During the year ended December 31, 2010, there were no transfers among Levels 1, 2 and 3.

**(b) Risk Management Contracts**

Harvest purchases electricity for consumption in its facilities. As a result, the Company is exposed to electricity price volatility. Harvest uses electricity price swap contracts to manage some of its price risk exposures. These swap contracts are not designated as hedges and are entered into for periods consistent with forecast electricity purchases. The total realized loss and unrealized gain recognized in the consolidated statement of income relating to the electricity price swap contracts was \$1.8 million and \$3.1 million respectively.

Harvest is exposed to fluctuations in crude prices relating to its petroleum sales. The Company enters into crude oil swap contracts to reduce the volatility of cash flows from some of its forecast sales. The swaps were designated as cash flow hedges and are entered into for periods consistent with the forecast petroleum sales. The effective portion of the unrealized loss of \$5.0 million (net of deferred tax asset of \$1.8 million) was included in other comprehensive income for the year ended December 31, 2010. The amount removed from accumulated other comprehensive income during the period and included in petroleum, natural gas, and refined product sales was \$nil for the year ended December 31, 2010. The Company expects that the \$5.0 million of losses reported in accumulated other comprehensive income will be released to net income within the next 12 months. The ineffective portion of the cash flow hedges recognized in the consolidated income statement for the year ended December 31, 2010 was \$0.7 million.

The following is a summary of Harvest's risk management contracts outstanding at December 31, 2010:

<b>Contracts not Designated as Hedges</b>				
<b>Contract Quantity</b>	<b>Type of Contract</b>	<b>Term</b>	<b>Contract Price</b>	<b>Fair value</b>
30 MWh	Electricity price swap contracts	Jan - Dec 2011	Cdn \$46.87	\$ 1,007

<b>Contracts Designated as Hedges</b>				
<b>Contract quantity</b>	<b>Type of Contract</b>	<b>Term</b>	<b>Contract Price</b>	<b>Fair value</b>
8200 bbls/day	Crude oil price swap contract	Jan - Dec 2011	US \$91.23/bbl	\$ (7,553)

**(c) Risk Exposures**

Harvest is exposed to market risks resulting from fluctuations in commodity prices, currency exchange rates and interest rates in the normal course of operations. Harvest is also exposed, to a lesser extent, to credit risk on accounts receivable and price risk management contracts and to liquidity risk relating to the Company's debt.

**(i.) Credit Risk**
Upstream Accounts Receivable

Accounts receivable in Harvest's upstream operations are due from crude oil and natural gas purchasers as well as joint venture partners in the petroleum and natural gas industry and are subject to normal industry credit risks. Concentration of credit risk is mitigated by having a broad customer base, which includes a significant number of companies engaged in joint operations with Harvest. Harvest periodically assesses the financial strength of its crude oil and natural gas purchasers and will adjust its marketing plan to mitigate credit risks. This assessment involves a review of external credit ratings; however, if external ratings are not available, Harvest requests a guarantee from the parent company that does have a credit rating. If this is not possible, Harvest performs an internal credit review based on the purchaser's past financial performance. The credit risk associated with joint venture partners is mitigated by reviewing the credit history of partners and requiring some partners to provide cash prior to incurring significant capital costs on their behalf. Additionally, most agreements have a provision enabling Harvest to use the proceeds from the sale of production that would otherwise be taken in kind by the partner to offset amounts owing from the partner that is in default. Generally, the only instances of impairment are when a purchaser or partner is facing bankruptcy or extreme financial distress.

Risk Management Contract Counterparties

Harvest is exposed to credit risk from the counterparties to its risk management contracts. This risk is managed by diversifying Harvest's risk management portfolio among a number of counterparties limited to lenders in its syndicated credit facilities; Harvest has no history of losses with these counterparties.

Downstream Accounts Receivable

The supply and offtake agreement exposes Harvest to the credit risk of Vitol Refining S.A. ("Vitol") as all feedstock purchases and the majority of product sales are made with Vitol. Pursuant to the agreement, Vitol is required to maintain a minimum B+ credit rating as assessed by Standard and Poor's Rating Services. If the credit rating falls below this line, additional security is required to be supplied to Harvest. This credit risk is also mitigated by the amounts owing to Vitol for feedstock purchases that are offset against amounts receivable from Vitol for product sales with the balance being net settled. Harvest is in a net payable position with Vitol at December 31, 2010 accordingly the outstanding balance is included in current trade accounts payable in the liability liquidity table.

Harvest's maximum exposure to credit risk relating to the above classes of financial assets at December 31, 2010 is the carrying value of accounts receivable. The table below provides an analysis of Harvest's current financial assets and the age of its past due but not impaired financial assets by type of credit risk.

	Current AR	≤ 30 days	Overdue AR		
			> 30 days, ≤ 60 days	> 60 days, ≤ 90 days	> 90 days
Upstream accounts receivable	\$ 119,853	\$ 662	\$ 283	\$ 824	\$ 8,891
Downstream accounts receivable	79,340	4,503	845	312	283
<b>Total</b>	<b>\$ 199,193</b>	<b>\$ 5,165</b>	<b>\$ 1,128</b>	<b>\$ 1,136</b>	<b>\$ 9,174<sup>(1)</sup></b>

<sup>(1)</sup> Includes a \$4.1 million allowance for doubtful accounts.

**(ii.) Liquidity Risk**

Harvest is exposed to liquidity risk due to the Company's borrowings under its credit facilities, convertible debentures and 6<sup>7/8</sup>% senior notes. This risk is mitigated by managing the maturity dates on the Company's obligations, complying with covenants and managing the Company's cash flow by entering into price risk management contracts. Additionally, when Harvest enters into price risk management contracts it selects counterparties that are also lenders in its syndicated credit facility thereby using the security provided in the credit agreement eliminating the requirement for margin calls and the pledging of collateral.

The following table provides an analysis of Harvest's financial liability maturities based on the remaining terms of its liabilities as at December 31, 2010 and includes the related interest charges:

	≤1 year	>1 year ≤3 years	>4 years ≤5 years	>5 years	Total
Trade accounts payable and accrued liabilities	\$ 342,006	\$ -	\$ -	\$ -	\$ 342,006
Settlement of risk management contracts	7,553	-	-	-	7,553
Bank loan and interest	114	14,600	-	-	14,714
Convertible debentures and interest	52,897	529,120	322,417	-	904,434
7 <sup>7/8</sup> % senior notes and interest	34,189	68,379	68,379	557,131	728,078
<b>Total</b>	<b>\$ 436,759</b>	<b>\$ 612,099</b>	<b>\$ 390,796</b>	<b>\$ 557,131</b>	<b>\$ 1,996,785</b>

**(iii.) Market Risks and Sensitivity Analysis**

Harvest is exposed to three types of market risks: interest rate risk, currency exchange rate risk and commodity price risk. Harvest has performed sensitivity analysis on the three types of market risks identified, assuming that the volatility of the risks over the next year will be similar to that experienced in the past year. Harvest has determined that a reasonably possible price or rate variance over the next reporting period for a given risk variable can be estimated by calculating two standard deviations for each three month period in the last year for the relevant daily price/rate settings and using an average of the standard deviation as a reasonable estimate of the expected variance. This variance is then applied to the relevant period end rate or price to determine a reasonable percentage increase and decrease in the risk variable which can then be applied to the outstanding risk exposure at period end. Using twelve months of data, Harvest factors in the seasonality of the business and the price volatility therein.

Interest Rate Risk

Harvest is exposed to interest rate risk on its bank borrowings as interest rates are determined in relation to floating market rates plus an incremental charge based on the Company's secured debt to EBITDA ratio. Harvest's convertible debentures and 6<sup>7/8</sup>% senior notes have fixed interest rates and therefore do not have any additional interest rate risk. Harvest manages its interest rate risk by targeting appropriate levels of debt relative to its expected cash flow from operations.

For the year ended December 31, 2010, interest charges on bank loans aggregated to \$5.7 million reflecting an effective interest rate of 3.7%.

If the interest rate applicable to Harvest's bank borrowings at December 31, 2010 increased or decreased by 40 basis points (0.4%) with all other variables held constant, after-tax net income for the year would decrease by \$0.9 million or increase by \$0.3 million respectively as a result of change in interest expense on variable rate borrowing.

Currency Exchange Rate Risk

Harvest is exposed to the risk of changes in the U.S. dollar exchange rate on its U.S. dollar denominated revenues as well as Canadian dollar revenues that are based on a U.S. dollar commodity price. In addition, Harvest's 6<sup>7/8</sup>% senior notes are denominated in U.S. dollars (U.S.\$500 million) and interest on these notes is payable semi-annually in U.S. dollars and accordingly the principal and any interest payable at the balance sheet date are also subject to currency exchange rate risk. Harvest is also exposed to currency exchange rate risk on its net investment in its downstream operations which is a self sustaining subsidiary that has a U.S. dollar functional currency. Harvest manages these exchange rate risks by occasionally entering into fixed rate currency exchange contracts on future U.S. dollar payments and U.S. dollar sales receipts.

At December 31, 2010, if the U.S. dollar strengthened or weakened by 8% relative to the Canadian dollar, the impact on net income and other comprehensive income due to the translation of monetary financial instruments would be as follows:

	<b>Impact on Net Income</b>	<b>Impact on Other Comprehensive income</b>
U.S. Dollar Exchange Rate - 8% increase	\$ 39,418	\$ (3,384)
U.S. Dollar Exchange Rate - 8% decrease	\$ (39,418)	\$ 3,384

Harvest's downstream operations operates with a U.S. dollar functional currency which gives rise to currency exchange rate risk on the Company's Canadian dollar denominated monetary assets and liabilities, such as Canadian dollar bank accounts and accounts receivable and payable, as follows:

	<b>Impact on Net Income</b>
Canadian Dollar Exchange Rate - 8% increase	\$ (4,864)
Canadian Dollar Exchange Rate - 8% decrease	\$ 4,864

Commodity Price Risk

Harvest is exposed to electricity and crude oil price movements as part of its normal business operations. The Company uses price risk management contracts to hedge a portion of the Company's future cash flows and net income against unfavorable movements in commodity prices. These contracts are recorded on the balance sheet at their fair value as of the reporting date. Changes from the prior period's fair value for electricity contracts are reported in net income. The effective portion of the changes from the prior period's fair value for crude oil contracts are reported in other comprehensive income. These fair values are generally determined as the difference between the stated fixed price of the contract and an expected future price of power and oil. Variances in expected future prices expose Harvest to commodity price risk as changes will result in a gain or loss that Harvest will realize on settlement of these contracts. This risk is mitigated by continuously monitoring the effectiveness of these contracts.

If the following changes in expected forward prices were applied to the fair value of risk management contracts in place at December 31, 2010, net income would be impacted as follows:

	<b>Impact on Net Income</b>	<b>Impact on Other Comprehensive Income</b>
Forward price of electricity – 75% increase	\$ 9,993	\$ -
Forward price of electricity – 75% decrease	\$ (6,755)	\$ -
Forward price of crude oil – 10% increase	\$ (2,844)	\$ (25,058)
Forward price of crude oil – 10% decrease	\$ 1,336	\$ 11,490

**17. Segment Information**

Harvest operates in Canada with two reportable operating segments, upstream and downstream. Harvest's upstream operations consist of development, production and subsequent sale of petroleum, natural gas and natural gas liquids, while its downstream operations include the purchase of crude oil, the refining of crude oil, the sale of the refined products including a network of retail operations and the supply of refined products to commercial and wholesale customers.

	Year Ended December 31, 2010		
	Downstream <sup>(1)</sup>	Upstream <sup>(1)</sup>	Total
Revenue <sup>(2)</sup>	\$ 2,949,930	\$1,007,005	\$3,956,935
Royalties	-	(154,757)	(154,757)
Less:			
Purchased products for resale and processing	2,733,019	-	2,733,019
Operating	220,823	265,593	486,416
Transportation and marketing	6,366	9,394	15,760
General and administrative	1,764	44,974	46,738
Depletion, depreciation, amortization and accretion	83,091	448,091	531,182
	\$ (95,133)	\$ 84,196	\$ (10,937)
Realized losses on risk management contracts			(1,808)
Unrealized gain on risk management contracts			2,358
Interest and other financing charges on short term debt, net			(2,103)
Interest and other financing charges on long term debt			(76,020)
Currency exchange gain			3,840
Large corporations tax recovery and other taxes			212
Future income tax reduction			39,897
Net loss			\$ (44,561)
<b>Capital Expenditures</b>			
Development and other activities	\$ 71,234	\$ 404,015	\$ 475,249
Business acquisitions	-	23,400	23,400
Property acquisitions, net of dispositions	-	152,861	152,861
Total expenditures	\$ 71,234	\$ 580,276	\$ 651,510

<sup>(1)</sup> Accounting policies for segments are the same as those described in Note 2 above.

<sup>(2)</sup> Of the total downstream revenue, two customers represent sales of \$2 billion and \$145 million for the year ended December 31, 2010. No other single customer within either segment represents greater than 10% of Harvest's total revenue.

<sup>(3)</sup> There is no intersegment activity.

	2010			2009		
	Downstream <sup>(1)</sup>	Upstream <sup>(1)</sup>	Total	Downstream <sup>(1)</sup>	Upstream <sup>(1)</sup>	Total
<b>Total Assets<sup>(2)</sup></b>	<b>\$ 1,215,352</b>	<b>\$4,151,875</b>	<b>\$5,367,227</b>	\$1,273,881	\$3,504,924	\$4,778,805
<b>Property, plant and equipment</b>						
Cost	\$ 1,079,478	\$3,955,539	\$5,035,017	\$1,113,742	\$2,976,911	\$4,090,653
Less: Accumulated depletion, depreciation, and amortization	(78,501)	(435,239)	(513,740)	-	-	-
Net book value	\$ 1,000,977	\$3,520,300	\$4,521,277	\$1,113,742	\$2,976,911	\$4,090,653
<b>Goodwill</b>						
Beginning of period	\$ -	\$ 404,943	\$ 404,943	\$ -	\$ 404,943	\$ 404,943
Addition (reduction) to goodwill	-	-	-	-	-	-
Impairment of goodwill	-	-	-	-	-	-
End of period	\$ -	\$ 404,943	\$ 404,943	\$ -	\$ 404,943	\$ 404,943

<sup>(1)</sup> Accounting policies for segments are the same as those described in Note 2 above.

<sup>(2)</sup> Total assets on a consolidated basis include \$1 million relating to the fair value of risk management contracts and \$1.6 million relating to future income tax.

## 18. Commitments and Contingencies

From time to time, Harvest is involved in litigation or has claims brought against it in the normal course of business operations. Management of Harvest is not currently aware of any claims or actions that would materially affect Harvest's reported financial position or results from operations. In the normal course of operations, management may also enter into certain types of contracts that require Harvest to indemnify parties against possible third party claims, particularly when these contracts relate to purchase and sale agreements. The terms of such contracts vary and generally a maximum is not explicitly stated; as such the overall maximum amount of the obligations cannot be reasonably estimated. Management does not believe payments, if any, related to such contracts would have a material effect on Harvest's reported financial position or results from operations.

The following are the significant commitments and contingencies at December 31, 2010:

- The downstream operations have a supply and offtake agreement with Vitol for a primary term to October 31, 2011 after which the agreement will revert to an evergreen arrangement. This agreement continues to provide that the ownership of substantially all crude oil feedstock and refined product inventory at the refinery be retained by Vitol and that Vitol will be granted the right and obligation to provide crude oil feedstock for delivery to the refinery, as well as the right and obligation to purchase substantially all refined products produced by the refinery. At December 31, 2010, the downstream operations had commitments totaling approximately \$775 million in respect of future crude oil feedstock purchases and related transportation from Vitol.
- North Atlantic Refinery Ltd. ("North Atlantic"), a wholly-owned subsidiary of Harvest, has an agreement with Newsul Enterprises Inc. whereby North Atlantic has committed to provide Newsul with its inventory and production of sulphur to 2018.
- North Atlantic has been named as a defendant in one of more than 100 methyl tertiary butyl ether U.S. product liability litigation cases that have been consolidated for pre-trial purposes. The plaintiffs seek relief for alleged contamination of ground water from the various defendants' use of the gasoline additives. Although the plaintiffs have not made a particular monetary demand, they are asserting collective and joint liability against all defendants. All consolidated lawsuits are at a preliminary stage and, accordingly, it is too early in the legal process to reach any conclusion regarding the ability of the State of New Hampshire to properly assert jurisdiction over the Company in the lawsuit or to reach any conclusions regarding the substance of the plaintiffs' claims. Accordingly, the evaluation of the risk of liability to the Company is not determinable at this time and no amounts are accrued in the consolidated financial statements in respect of this matter. The Company is indemnified by Vitol Group B.V. in respect of this contingent liability.



- (d) On January 7, 2010 the downstream operations experienced a fire at the refinery in the conversion section of the operating units. As a result, the refinery was shut-down for assessment and repairs for approximately ten weeks. Harvest has submitted an insurance claim relating to the business interruption loss. If successful, the estimated net proceeds of the claim will be approximately \$15 million.
- (e) In August 2010 Harvest entered into two contracts in relation to the engineering, procurement and construction of the production and processing facilities required for its BlackGold oil sands project. An engineering and procurement contract was signed with GS Engineering & Construction Corp. ("GSE") a Korean construction firm, for certain engineering, procurement, fabrication and transportation services. A separate construction and commissioning contract was signed with GSE&C Construction Canada Ltd. ("GSC"), a Canadian incorporated subsidiary of GSE, in respect of work to be performed in Canada. The contracted cost is \$311 million. Together, GSE and GSC will perform all works and services, including commissioning and start-up of the facilities, in order to hand them over to Harvest on a turn-key basis. GSC will provide operational support for a limited duration after hand-over. Completion of the facilities for the purpose of such hand-over is scheduled to take place in the fourth quarter of 2012. Harvest provided a cash deposit of \$31.1 million to GSC of which \$30.6 million remained at December 31, 2010 to be applied to future payments. The remaining balance of the contract is included in the contractual obligation and commitment table below.

The following is a summary of Harvest's contractual obligations and commitments as at December 31, 2010:

	Payments Due by Period						Total
	2011	2012	2013	2014	2015	Thereafter	
Debt repayments	\$ -	\$ 106,796	\$ 344,548	\$ 60,050	\$ 236,579	\$ 497,300	\$ 1,245,273
Debt interest payments <sup>(1)</sup>	87,200	86,395	74,359	52,637	41,530	59,831	401,952
Capital commitments <sup>(2)</sup>	694,651	111,542	-	-	-	-	806,193
Operating leases <sup>(3)</sup>	7,514	7,061	6,294	6,152	1,450	280	28,751
Employee benefits <sup>(4)</sup>	5,318	3,763	3,827	3,892	3,958	4,025	24,783
Transportation agreements <sup>(5)</sup>	3,253	916	90	-	-	-	4,259
Feedstock and other purchase commitments <sup>(6)</sup>	900,131	-	-	-	-	-	900,131
<b>Contractual obligations</b>	<b>\$ 1,698,067</b>	<b>\$ 316,473</b>	<b>\$ 429,118</b>	<b>\$ 122,731</b>	<b>\$ 283,517</b>	<b>\$ 561,436</b>	<b>\$ 3,411,342</b>

<sup>(1)</sup> Interest determined on bank loan balance and rate effective at year end and by using the year end U.S. dollar exchange rate for the senior notes.

<sup>(2)</sup> Relating to drilling contracts, AFE commitments, equipment rental contract, environmental capital projects, BlackGold oil sands project and Hunt Oil acquisition [see Note 19].

<sup>(3)</sup> Relating to building and automobile leases.

<sup>(4)</sup> Relating to expected contributions for employee benefit plans [see Note 15] and long term incentive plan.

<sup>(5)</sup> Relating to oil and natural gas pipeline transportation agreements.

<sup>(6)</sup> Relating to crude oil feedstock purchases and related transportation costs [see Note 18(a) above].

## 19. Subsequent Event

On December 14, 2010 Harvest signed an agreement to purchase the assets of Hunt Oil Company of Canada, Inc. and Hunt Oil Alberta, Inc. (collectively "Hunt") for an initial purchase price of \$525 million. The transaction is expected to close on February 28, 2011. Upon signing the agreement Harvest provided a \$40 million deposit which is held in trust. The agreement contains a mechanism that allows for a subsequent \$25 million payment to Hunt in the event that Canadian natural gas prices exceed certain pre-determined levels over the next 2 years. The Hunt assets include working interests in a third-party operated gas plant that is currently experiencing an outage, which results in reduced production in certain oil and gas properties. Hunt has agreed to reimburse Harvest for costs associated with restoring production as well as the lost production between October 1, 2010 and the earlier of (i) the date when production is resumed, and (ii) October 31, 2011. Subsequent to December 31, 2010, KNOC has provided \$505 million of equity to fund the acquisition.

# Corporate Information

## OFFICERS & SENIOR MANAGEMENT

**John Zahary, P.Eng.**  
President & Chief Executive Officer

**Kyungluck Sohn**  
Chief Financial Officer

**Rob Morgan, P.Eng.**  
Chief Operating Officer, Upstream

**Brad Aldrich**  
Chief Operating Officer, Downstream

**Brian Kwak, M.Sc**  
Deputy Chief Operating Officer, Upstream &  
Vice President, Oil Sands

**Gary Boukall, P. Geol.**  
Vice President, Geosciences

**Les Hogan**  
Vice President, Land

**Phil Reist, C.A.**  
Vice President, Controller

**Jim Sheasby, P.Eng.**  
Vice President, Engineering

**Neil Sinclair**  
Vice President, Operations

**Dean Beacon**  
Vice President, Treasurer

**Jongwoo Kim, MSF**  
Chief Strategy Officer & Corporate Secretary

## DIRECTORS

Dr. Seong-Hoon Kim, Chairman<sup>(4)</sup>  
William Friley<sup>(2)(4)</sup>  
J. Richard Harris<sup>(1)(2)</sup>  
Chang-Koo Kang<sup>(4)</sup>  
William D. Robertson<sup>(1)</sup>  
Brant Sangster<sup>(1)(3)</sup>  
Kang Hyun Shin<sup>(3)</sup>  
Kyungluck Sohn<sup>(3)</sup>  
Myunghuhn Yi<sup>(4)</sup>  
John Zahary<sup>(2)(3)</sup>

- (1) Member of the Audit Committee
- (2) Member of the Upstream Reserves, Safety & Environment Committee
- (3) Member of the Downstream Operations, Safety & Environment Committee
- (4) Member of the Compensation / Corporate Governance Committee

## CONVERTIBLE DEBENTURES LISTINGS

<u>TSX Ticker</u>	<u>Coupon</u>	<u>Price Maturity</u>
HTE.DB.D	6.40%	31-Oct-12
HTE.DB.E	7.25%	30-Sep-13
HTE.DB.F	7.25%	28-Feb-14
HTE.DB.G	7.50%	31-May-15

## REGISTRAR AND TRANSFER AGENT

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## AUDITOR

KPMG LLP

## LEGAL COUNSEL

Canada: Bennett Jones LLP  
U.S: Paul, Weiss, Rifkind, Wharton & Garrison

## RESERVES EVALUATORS

GLJ Petroleum Consultants Ltd.  
McDaniel & Associates Ltd.

## INVESTOR RELATIONS

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