

**VELO ENERGY INC.**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**SEPTEMBER 30, 2008**

November 27, 2008

The following is Management's Discussion and Analysis of the financial condition and results of operations of Velo Energy Inc. ("Velo" or the "Company"), to enable a reader to assess material changes in financial condition and results of operations for the nine months ended September 30, 2008. This Management's Discussion and Analysis is intended to supplement and complement the unaudited interim consolidated financial statements and notes thereto for the nine month period ended September 30, 2008. This Management's Discussion and Analysis should also be read in conjunction with the annual financial statements for the year ended December 31, 2007. Additional information relating to the company is available on SEDAR at [www.sedar.com](http://www.sedar.com).

The Company, which was a capital pool company pursuant to the policies of the TSX Venture Exchange (the TSX-V), completed a qualifying transaction in May 2006 in accordance with the policies of the TSX-V. The qualifying transaction was the purchase of Velo Energy Ltd. whereby the Company issued 3,333,334 shares for 100% of the outstanding shares. Subsequent to this transaction, the Company had 19,733,334 common shares outstanding and its name was changed to Velo Energy Inc.

**VELO OVERVIEW**

Velo is a Canadian oil and gas company with a focus in the Southern Alberta area.

The company strives to operate properties while maintaining a high working interest. The company has and continues to source farm out agreements to obtain land for exploration in order to preserve capital for drilling and completion operations.

**FINANCIAL AND OPERATING HIGHLIGHTS**

**Financial Highlights**

The following table summarizes the Company's financial results for the three and nine months ended September 30:

	<b>Three months September 2008</b>	<b>Three months September 2007</b>
Net income (loss)	\$913,717	\$(257,793)
Per share, basic and diluted, income (loss)	\$0.02	\$(0.01)
Total assets	\$1,374,985	\$1,519,048
Capital expenditures:	\$0	\$59,282
Outstanding Common shares at Sept 30	65,608,888	29,618,334
Weighted average – basic	54,002,554	29,618,334

	<b>Nine months September 2008</b>	<b>Nine months September 2007</b>
Net income (loss)	\$870,099	\$(5,874,089)
Per share, basic and diluted, income (loss)	\$0.02	\$(0.20)
Total assets	\$1,374,985	\$1,519,048
Capital expenditures:	\$0	\$1,050,321
Outstanding Common shares at Sept 30	65,608,888	29,618,334
Weighted average – basic	37,835,727	29,618,334

## **GENERAL AND ADMINISTRATIVE EXPENSES**

General and administrative expenses were \$24,107 (2007 - \$164,155) and \$75,337 (2007 - \$437,851) for the three and nine months ended September 30, 2008, respectively. The decrease for the periods reflects the reduced operating activity of the Company. Legal fees were \$15,047 for the three months and \$41,585 for the nine months. Transfer agent, filing fees and press releases totalled \$5,814 for the three and \$17,123 for the nine months.

## **INTEREST AND INDEMNITY PAYABLE**

Interest expense was \$nil (2007 - \$27,988) and \$3,763 (2007 - \$59,070) for the three and nine months ended September 30, 2008, respectively. The decrease is due to the large interest and penalty incurred in 2007 as a result of monies owing to Canada Revenue Agency from the failure to renounce adequate qualifying expenditures for the flow through shares issued in December, 2006.

## **OPERATIONS**

A recovery of \$7,572 was realized in the nine months ended September 30, 2008 as compared to an expense of \$71,096 in 2007. For the three months ended September 30, 2008 there was nil expense (2007 - \$7,087). Both changes were a result of reduced operating activity of the Company.

## **STOCK COMPENSATION EXPENSE**

Stock compensation expense was Nil for the three months (2007 - nil) and Nil for the nine months ended September 30, 2008 (2007 - \$30,724). There were no new options issued during the quarter.

## **GAIN ON SALE OF SUBSIDIARY**

A gain of \$935,314 (2007 - Nil) was realized during the quarter on the sale of the Company's subsidiary, Velo Energy Ltd. Proceeds were nominal with the gain resulting by the removal of the subsidiary's net liability position from the consolidated balance sheet.

## **IMPAIRMENTS**

### **1. Petroleum and natural gas properties**

There was no impairment charge during the current quarter or the nine months ending September 30, 2008. Included in the Company's 2007 quarterly expenses is a non-cash charge of \$59,282 and a non-cash charge of \$4,264,120 for the nine month period, both related to an impairment of the carrying value of petroleum and natural gas properties. The impairment is the result of applying what is commonly known as the ceiling test which is prescribed under generally accepted accounting principles for exploration and production companies that use the full cost accounting method.

An impairment loss is recognized when the carrying value of a cost centre is not recoverable and exceeds its fair value. The carrying amount is not recoverable if the carrying amount exceeds the sum of the undiscounted cash flows expected from its use and eventual disposition.

An impairment loss is then measured as the amount by which the carrying amount of the petroleum and natural gas assets capitalized in a cost centre exceeds the sum of the fair value of proved and probable reserves and the costs of unproved properties that have been subject to a separate test for impairment and contain no probable reserves.

### **2. Goodwill**

There was no goodwill impairment during the current periods. At March 31, 2007, the Company tested goodwill for impairment and determined that based on the impairment of the oil and gas properties that the goodwill was impaired. As a result, a goodwill impairment charge of \$1,026,400 was recorded in the quarter.

#### **DEPLETION AND DEPRECIATION**

Depletion and depreciation expense was Nil for the three months (2007 – 2,757) and Nil for the nine months (2007 – 8,833) ended September 30, 2008. Office furniture and fixtures were sold in 2007.

#### **CAPITAL EXPENDITURES**

Exploration and development for the three and nine months ended September 30, 2008 were Nil (2007 – \$59,282 and \$1,050,321 respectively), as a result of the Company's reduced operating activity.

#### **STATUS OF PETROLEUM AND NATURAL GAS PROPERTIES**

In July, 2008, Velo Energy Ltd. was sold to Daran Energy Services Corp., a private Alberta company, for nominal consideration. The sale included the shares of Velo Energy Ltd. and the debt owing from Velo Energy Ltd. to the Company.

The Blueberry, Pica and Woking wells were properties owned by Velo Energy Ltd. As such, the rights to these properties, along with their respective abandonment costs are no longer a part of the Company.

During the quarter Velo entered into a confidential joint venture and participation agreement (the "Agreement") with a private Alberta company, to jointly participate in a drilling, completion, seismic, recompletion of wells located on certain lands in Southern Alberta. The Company has committed up to a maximum of \$1,000,000 to be expended by the end of 2009 on qualifying Canadian Exploration Expenses or Canadian Development Expenses. Generally, Velo will pay 100% of costs to earn 50% of the private company's working interest in each well.

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

During the second quarter the Company borrowed \$20,000 (2007 - \$Nil) from a corporation controlled by three directors of the Company. The loan is repayable upon demand and bears interest at prime plus 5%.

During the current quarter the loan was repaid without any interest charges.

The above-noted related party transaction was in the normal course of business and was measured at the exchange value which was the amount of consideration established and agreed to by the related parties.

#### **Settlement of December 2006 Flow-Through Obligation**

Having obtained the conditional approval of the TSX Venture Exchange ("TSX-V"), on July 24, 2008 the Company issued 5,990,554 shares from treasury at a price of \$0.075 per share settling \$449,292 of the indemnity obligation. These shares are subject to a 4 month hold period in Canada.

#### **Private Placement**

Velo completed a private placement raising \$1.5 million by issuing 30 million common shares at \$0.05 per share. The Company paid finders fees of \$57,500 (5%) in connection with \$1,150,000 of the financing and \$12,334 of other expenses.

**LIQUIDITY**

At September 30, 2008, the company had positive working capital of \$1,182,071 and cash of 1,373,942. The numerous events completed during the quarter, namely; the share for debt settlement of the indemnity payable, the sale of Velo Energy Ltd. and the completion of the private placement has allowed the Company to eliminate its working capital deficit and with the entering into of the new joint venture, the Company is now in position for renewed exploration and development activity of oil and gas properties.

**FINANCIAL INSTRUMENTS**

The Company's financial instruments consist of cash, receivables, and accounts payable and accrued liabilities. It is management's opinion that the Company is not exposed to significant interest, currency or credit risks arising from these financial instruments and that the fair value of these financial instruments approximates their carrying value.

**SHARE CAPITAL**

The company is authorized to issue an unlimited number of common and preferred shares. As at September 30, 2008, there were 65,608,888 common shares issued and outstanding; Nil common shares issuable upon the exercise of warrants; 100,000 common shares issuable upon exercise of stock options at a price of \$0.25 per share, 200,000 common shares issuable upon exercise of options at a price of \$0.30 per share and 150,000 common shares issuable upon exercise of options at a price of \$.20 per share expiring five years from the date of grant.

In December 2006, the Company granted to the agents of the flow-through share issuance, warrants to purchase 798,500 common shares at a price of \$.20 per common shares. The warrants expired in June 2008.

**COMMITMENTS**

The Energy Utility Board has required a letter of credit be established with them for the abandonment of wells. This was a commitment of Velo Energy Ltd. and has passed with the sale of the subsidiary.

**CONTINGENCY**

The President of the Company was dismissed during the second quarter of 2007. He has filed a wrongful dismissal action against the Company's wholly owned subsidiary. This was a commitment of Velo Energy Ltd. and has passed with the sale of the subsidiary.

**SELECTED QUARTERLY INFORMATION**

The following information refers to the three months ended:

	September 30, 2008 (\$)	June 30, 2008 (\$)	March 31, 2008 (\$)	December 31, 2007 (\$)
Revenue	0	0	0	28,168
Net income (loss)	913,717	(28,241)	(15,377)	(799,159)
Net income (loss) per share basic & diluted	.02	.00	.00	(.02)

	September 30, 2007 (\$)	June 30, 2007 (\$)	March 31, 2007 (\$)	December 31, 2006 (\$)
Revenue	0	9,565	48	13,694
Net loss	257,793	591,949	5,024,347	133,951
Net loss per share-basic & diluted	.01	.02	.17	.01

## ACCOUNTING PRONOUNCEMENTS

### Accounting changes

The CICA amended Handbook Section 1400 “General Standards of Financial Presentation” effective for periods beginning on or after January 1, 2008 to include requirements to assess and disclose the Company’s ability to continue as a going concern. The adoption of this new section did not have an impact on the Company’s financial statements.

In December 2006, the CICA issued Handbook section 1535 “Capital Disclosures” which is effective for years beginning on or after October 1, 2007. The Company manages its capital to ensure it will be able to continue as a going concern while maximizing the return to shareholders largely through equity sales. These stock issues depend on numerous factors including a positive oil and gas environment, positive stock market conditions, a company’s track record, and the experience of management. The capital structure of the Company consists of shareholder’s equity, comprising issued capital and deficit.

In December 2006, the CICA issued Handbook Section 3862, “Financial Instruments – Disclosures” and Handbook Section 3863, “Financial Instruments – Presentation” to replace Handbook Section 3861, “Financial Instruments – Disclosure and Presentation”. Section 3862 expands on the disclosures previously required under Section 3861 that establishes standards for disclosures about financial instruments and non-financial derivatives and identifies the information that should be disclosed about them. Section 3863 is consistent with the presentation requirements of Section 3861 that establishes standards for presentation of financial instruments and non-financial derivatives. These sections apply to interim and annual financial statements for fiscal periods beginning on or after October 1, 2007. The effect on the Company’s financial statements was not material.

### Critical Accounting Estimates

Management is required to make judgments, assumptions and estimates in the application of generally accepted accounting principles that have a significant impact on the financial results of the Company.

Capitalized costs relating to the exploration and development of oil and gas reserves, along with estimated future capital expenditures required in order to develop proved reserves, are depleted and depreciated on a unit-of-production basis using estimated proved reserves.

The carrying value of property, plant and equipment is reviewed at least annually for impairment. Impairment occurs when the carrying value of the assets is not recoverable by the future undiscounted cash flows. The cost recovery ceiling test is based on estimates of proved reserves, production rates, oil and gas prices, future costs and other relevant assumptions. By their nature, these estimates are subject to measurement uncertainty and the impact on the financial statements could be material.

Liability recognition for asset retirement obligations associated with oil and gas well sites and facilities are determined using estimated costs discounted based on the estimated life of the asset. These capitalized costs are amortized on a unit-of-production basis, consistent with depletion and depreciation. Over time, the liability is accreted up to the actual expected cash outlay to perform the abandonment and reclamation.

In order to recognize stock-based compensation expense, the Company estimates the fair value of stock options granted using the Black-Scholes model which uses assumptions related to interest rates, expected life of the option, volatility of the underlying security and expected dividend yields. These assumptions may vary over time.

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

## **FUTURE ACCOUNTING POLICY CHANGES**

In January 2006, the CICA Accounting Standards Board (AcSB) adopted a strategic plan for the direction of accounting standards in Canada. As part of that plan, accounting standards in Canada for public companies are expected to converge with International Financial Reporting Standards ("IFRS") by the end of 2011. The impact of the transition to IFRS on the Company's financial statements has not yet been determined.

## **BUSINESS RISKS**

Velo's exploration and production activities are concentrated in the Western Canadian Sedimentary Basin, where activity is highly competitive and includes a variety of different-sized companies ranging from smaller junior producers, intermediate and senior producers and royalty trust organizations, to the much larger integrated petroleum companies. The Company is subject to a number of risks which are also common to other organizations involved in the oil and gas industry. Such risks include finding and developing oil and gas reserves at economic costs, estimated amounts of recoverable reserves, production of oil and gas in commercial quantities, marketability of oil and gas produced, fluctuations in commodity prices, financial and liquidity risks and environmental and safety risks.

In order to reduce exploration risk, Velo employs highly qualified and motivated professional employees who have demonstrated the ability to generate quality proprietary geological and geophysical prospects. To maximize drilling success, the Company explores in areas that afford multi-zone prospect potential, targeting a range of shallow low-to-moderate-risk prospects.

The company mitigates its risk related to producing hydrocarbons through the utilization of the most advanced technology and information systems. In addition, the Company strives to operate the majority of its prospects, thereby maintaining operational control.

Exploration and production for oil and gas is very capital intensive. As a result, the Company relies on equity markets as a source of new capital. Equity is subject to market conditions and availability may increase or decrease from time to time.

Oil and gas exploration and production can involve environmental risks such as pollution of the environment and destruction of natural habitat, as well as safety risks such as personal injury. The Company conducts its operations with high standards in order to protect the environment and the general public. Velo maintains insurance coverage for comprehensive and general liability as well as limited pollution liability. The amount and terms of this insurance are reviewed on an ongoing basis and adjusted as necessary to reflect current corporate requirements, as well as industry standards and government regulations.

**Advisory Regarding Forward-looking Statements** Certain information with respect to Velo contained herein, including management's assessment of future plans and operations, contain forward-looking statements. These forward-looking statements are based on assumptions and are subject to numerous risks and uncertainties, certain of which are beyond Velo's control, including the impact of general economic conditions, industry conditions, volatility of commodity prices, currency exchange, stock market volatility and ability to access sufficient capital. As a result, Velo's actual results, performance or achievement could differ materially from those expressed in, or implied by, these forward-looking statements and, accordingly, no assurance can be given that any events anticipated by the forward-looking statements will transpire or occur. In addition, the reader is cautioned that historical results are not necessarily indicative of future performance.