VERMILION ENERGY

Annual Report

VERMILION ENERGY INC.

ANNUAL REPORT

For the Year Ended December 31, 2010

FOR THE YEAR ENDED DECEMBER 31, 2010

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ANNUAL GENERAL MEETING

May 6, 2011 at 10:00 a.m.
The Ballroom
Metropolitan Centre
333 – 4th Avenue S.W.
Calgary, Alberta

ABBREVIATIONS

API	American Petroleum Institute
bbls	barrels
bbls/d	barrels per day
bcf	billion cubic feet
boe	barrel of oil equivalent
boe/d	barrel of oil equivalent per day
CBM	coalbed methane
CO_2	carbon dioxide
GJ	gigajoules
$m	thousands of dollars
$mm	millions of dollars
mbbls	thousand barrels
mboe	thousand barrels of oil equivalent
mcf	thousand cubic feet
mcf/d	thousand cubic feet per day
mmboe	million barrels of oil equivalent
mmcf	million cubic feet
mmcf/d	million cubic feet per day
MW	megawatt
NGLs	natural gas liquids
NPV	net present value
WTI	West Texas Intermediate

DISCLAIMER

Certain statements included or incorporated by reference in this document may constitute forward-looking statements under applicable securities legislation. Forward-looking statements or information typically contain statements with words such as "anticipate", "believe", "expect", "plan", "intend", "estimate", "propose", or similar words suggesting future outcomes or statements regarding an outlook. Forward looking statements or information in this document may include, but are not limited to:

- capital expenditures;
- business strategy and objectives;
- reserve quantities and the discounted present value of future net cash flows from such reserves;
- net revenue;
- future production levels and rates of average annual production growth;
- exploration plans;
- development plans;
- acquisition and disposition plans and the timing thereof;
- operating and other costs;
- royalty rates;
- Vermilion's additional` future payment in connection with the Corrib acquisition;
- the timing of regulatory proceedings and approvals;
- the timing of first commercial gas from the Corrib field;
- estimate of Vermilion's share of the expected gas rates from the Corrib field; and

Such forward-looking statements or information are based on a number of assumptions all or any of which may prove to be incorrect. In addition to any other assumptions identified in this document, assumptions have been made regarding, among other things:

- the ability of Vermilion to obtain equipment, services and supplies in a timely manner to carry out its activities in Canada and internationally;
- the ability of Vermilion to market oil and natural gas successfully to current and new customers;
- the timing and costs of pipeline and storage facility construction and expansion and the ability to secure adequate product transportation;
- the timely receipt of required regulatory approvals;
- the ability of Vermilion to obtain financing on acceptable terms;
- currency, exchange and interest rates;
- future oil and natural gas prices; and
- Management's expectations relating to the timing and results of development activities

Although Vermilion believes that the expectations reflected in such forward-looking statements or information are reasonable, undue reliance should not be placed on forward looking statements because Vermilion can give no assurance that such expectations will prove to be correct. Forward-looking statements or information are based on current expectations, estimates and projections that involve a number of risks and uncertainties which could cause actual results to differ materially from those anticipated by Vermilion and described in the forward looking statements or information. These risks and uncertainties include but are not limited to:

- the ability of management to execute its business plan;
- the risks of the oil and gas industry, both domestically and internationally, such as operational risks in exploring for, developing and producing crude oil and natural gas and market demand;
- risks and uncertainties involving geology of oil and natural gas deposits;
- risks inherent in Vermilion's marketing operations, including credit risk;
- the uncertainty of reserves estimates and reserves life;
- the uncertainty of estimates and projections relating to production, costs and expenses;
- potential delays or changes in plans with respect to exploration or development projects or capital expenditures;
- Vermilion's ability to enter into or renew leases;
- fluctuations in oil and natural gas prices, foreign currency exchange rates and interest rates;
- health, safety and environmental risks;
- uncertainties as to the availability and cost of financing;
- the ability of Vermilion to add production and reserves through development and exploration activities;
- general economic and business conditions;
- the possibility that government policies or laws may change or governmental approvals may be delayed or withheld;
- uncertainty in amounts and timing of royalty payments;
- risks associated with existing and potential future law suits and regulatory actions against Vermilion; and
- other risks and uncertainties described elsewhere in this document or in Vermilion's other filings with Canadian securities authorities.

The forward-looking statements or information contained in this document are made as of the date hereof and Vermilion undertakes no obligation to update publicly or revise any forward-looking statements or information, whether as a result of new information, future events or otherwise, unless required by applicable securities laws.

Natural gas volumes have been converted on the basis of six thousand cubic feet of natural gas to one barrel equivalent of oil. Barrels of oil equivalent (boe) may be misleading, particularly if used in isolation. A boe conversion ratio of six thousand cubic feet to one barrel of oil is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.

PRESIDENT'S MESSAGE TO SHAREHOLDERS

Dear Shareholders:

Vermilion had a very successful 2010 as we converted from an income trust structure to a corporate structure, expanded our portfolio of organic growth opportunities and revitalized a 5-year strategic plan that targets average annual production growth of 10% while maintaining a stable dividend. Vermilion's strong leverage to oil prices and diversified geographical operations continued to provide an advantage over many of our peers that were faced with weak North American natural gas prices and some weather challenged operating conditions in Western Canada last year.

Development capital expenditures in 2010 focused on the expansion of Vermilion's Cardium light oil development program in Canada, completion of a successful round of development drilling in the Wandoo field in Australia, continued workover and recompletion programs in France, and ongoing development of the Corrib gas project in Ireland. Two wells drilled in late 2009 were tied-in to production facilities in the Netherlands. Development capital spending in 2010 was $432 million compared to $195 million in 2009. These expenditures included $97 million for land acquisition in Canada and $78 million towards the Corrib gas project in Ireland. Vermilion's reserve base continued to grow with the addition of 16.0 million boe of proved plus probable reserves from development activities. Net of production, Vermilion increased its proved plus probable reserves by 3.1% in 2010. Vermilion's proved plus probable reserve life index at the end of 2010 was approximately 11.0 years.

Vermilion generated fund flows from operations in 2010 of $363.5 million, a 14.6% increase over $317.2 million in 2009, due primarily to higher oil prices realized in 2010. We continue to maintain a strong financial position with net debt of $300 million at December 31, 2010 equal to 0.75 times trailing fund flows from operations.

Vermilion continues to be recognized for excellence in its business practices. In 2010, Vermilion was recognized as one of the top 25 Best Workplaces in Canada as compiled by the Great Place to Work® Institute and was similarly recognized as one of the top 15 Best Workplaces in France. Vermilion was also recognized as one of Canada's top three oil and gas companies in terms of corporate governance in the Globe and Mail's annual Board Games survey. Vermilion was one of four companies nominated for the best overall investor relations programs by a mid-cap company in the annual IR Magazine Canada Awards program.

These efforts are all beneficial to shareholders. In 2010, Vermilion generated a total return to investors of 49.6%, bringing the five year compound average rate of return to 16.3%. Both these measures are in the top quartile of Vermilion's peer group.

Operational Year in Review

Canada

Vermilion's activities focused primarily on the expansion and development of the Cardium light oil resource play. In 2010, the Company expanded its Cardium land base to approximately 98,000 net acres including over 75,000 net acres (120 sections) of premium quality lands. Vermilion participated in the drilling of 28 Cardium wells in 2010 including 15 operated wells, and continues to improve and refine drilling and completion methods with the goal of minimizing costs while optimizing well performance and reserve recoveries from this significant resource. Vermilion has categorized its Cardium lands into A, B, and C quality reflecting reservoir thickness, porosity and position relative to the main Cardium fairway. The Company's lands are predominantly located to the west and northwest of the West Pembina Cardium reservoir and hold some of the highest quality Cardium sandstones in the basin. Vermilion's performance from wells drilled to date appears to confirm this assertion and management believes this area will provide for reasonably consistent and highly repeatable results over the life of the program. With over 400 identified prospects, the Cardium is expected to serve as a strong source of production and reserve growth for several years.

Vermilion's extensive land holdings in the Drayton Valley region also contain a number of liquids-rich tight gas 'resource' play opportunities. Vermilion will continue to develop these resource plays at a measured pace, determining the optimum completion methods for the Ellerslie, Notikewin, Fahler and other formations that have been identified in this area. These gas wells derive a significant portion of their value from the associated liquids produced from these wells, with liquids content ranging from 40 to 50 bbls/mmcf and initial flow rates ranging from 3 to 6 mmcf/d per well. With an inventory of over 100 wells, few land retention issues and a well developed gas processing infrastructure, the Drayton Valley region will provide significant opportunity for future growth when this program is accelerated as North American gas prices recover and more capital becomes available.

Australia

Vermilion benefited from strong production from three wells drilled and completed in the fall of 2010. The new wells were all lateral extensions to existing wellbores and were drilled and completed on time and on budget. These wells are being produced at a restricted combined rate of between 2,000 to 3,000 boe/d to minimize water coning and to maximize ultimate recovery from this reservoir. Vermilion has identified over 30 workover/well optimization opportunities and an additional 15 infill drilling opportunities that should allow sustained production from the Wandoo field at approximately 9,000 boe/d for several years exceeding production levels when the field was initially acquired in 2005.

France

In France, Vermilion maintained a steady workover and completion program. Despite this seemingly low level of activity, production in France increased to 8,501 boe/d in 2010 as compared to 8,421 boe/d in 2009, illustrating the additional recovery capacity of these reservoirs. Vermilion continues to pursue the evaluation of a potentially significant shale oil resource play in the Paris Basin. The Lias shale is the source of oil produced from conventional reservoirs in the Paris Basin. However, the shale was never considered as a potentially productive horizon prior to recent advances in well completion technology that are proving effective in the development of other oil shales around the world. Vermilion, along with several other operators in the region are taking steps to determine if the shale could become a commercially productive source of light oil. Vermilion and other operators in the region are currently in the process of gathering requisite technical data and mapping the geological limits of these structures to determine if a commercial development project is technically and commercially feasible. In 2010, Vermilion tested small fracture treatments using existing vertical wellbores to gather pressure and fluid data from this formation. Both wells are producing nominal amounts of oil from the shale as a result of these treatments. No production from this resource is currently included in the Company's 5-year strategic plan.

Netherlands

Vermilion tied-in two gas wells in April 2010 resulting from a successful drilling program in late 2009. Notwithstanding some minor well workovers and facility maintenance operations, most of the 2010 program focused on securing permits for future drilling activity as well as pipeline permits and production licenses for two discovery wells from that same drilling program. The Vinkega-1 well and the De Hoeve-1 well are expected to be brought on production by mid-year 2011.

Ireland

All efforts were focused on providing a suitable solution for the onshore pipeline that will connect the offshore pipeline from the Corrib Field to the Bellanaboy processing facility. Vermilion participated with its partners in the preparation of the proposal and the oral hearings held in September and October of 2010. On January 20, 2011, the regulatory body responsible for significant infrastructure projects in country, An Bord Pleanala, accepted the application from Shell E&P Ireland Ltd. and its partners.

OUTLOOK

Vermilion is poised to deliver strong operational and financial performance over the next several years, and is targeting annual production growth of 10% driven by the organic development of its significant portfolio of opportunities. This growth is identifiable and is not dependent on any future acquisitions, although Vermilion will continue to review opportunities to build its asset base within its core operating areas. Near term growth drivers include light oil production from the Cardium resource play in Western Canada and from high-netback natural gas production from the Netherlands. Mid-term growth will come from the Corrib natural gas project in Ireland while longer term growth is expected to come from the development of resource plays in Canada and Western Europe. Stable production from Australia and France will underpin these growth opportunities. Conservative financial management, supported by a strong balance sheet and significant borrowing capacity will ensure that this growth is reflected on a per share basis for the maximum benefit of its shareholders. Vermilion currently expects average production volumes for 2011 to range between 35,000 boe/d and 36,000 boe/d with exit rates approaching 38,000 boe/d.

In February 2011, Vermilion completed the issuance of $225 million of high yield notes which have a five year term and bear interest at 6.5% per annum. This diversifies the Company's source of debt and places long-term financing on the balance sheet, providing financial flexibility to execute the long-term strategic plan. The Company's conservative fiscal management and sparing use of equity to finance its growth objectives ensure that any gains are realized on a 'per share' basis. The management and directors of Vermilion continue to control approximately 9% of the outstanding shares and remain committed to delivering superior rewards to all stakeholders.

I would like to convey my sincere gratitude to all of Vermilion's employees and the Board of Directors for their diligent efforts that continue to yield outstanding performance. I would also like to thank you, the shareholders, for placing your trust in Vermilion.

("Lorenzo Donadeo")

Lorenzo Donadeo
President & Chief Executive Officer
February 24, 2011

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following is Management's Discussion and Analysis ("MD&A") dated March 10, 2011 of Vermilion Energy Inc.'s ("Vermilion" or the "Company") operating and financial results for the years ended December 31, 2010 and 2009. This discussion should be read in conjunction with Vermilion's audited consolidated financial statements for the years ended December 31, 2010 and 2009, together with accompanying notes.

A discussion of Vermilion's operating and financial results for the fourth quarter of 2010 is included in Vermilion's press release dated February 28, 2011 filed on the System for Electronic Document Analysis and Retrieval ("SEDAR") at www.sedar.com.

The financial data contained within this MD&A has been prepared in accordance with Canadian Generally Accepted Accounting Principles ("GAAP" or "Canadian GAAP") and is reported in Canadian dollars, unless otherwise stated.

CORPORATE CONVERSION

On September 1, 2010, Vermilion Energy Trust (the "Trust") completed the conversion from an income trust to a corporation pursuant to an arrangement under the Business Corporations Act (Alberta). As a result of this conversion, units of the Trust were converted to common shares of Vermilion on a one-for-one basis and holders of exchangeable shares in Vermilion Resources Ltd. received 1.89344 common shares for each exchangeable share held. There were no exchangeable shares outstanding following the conversion.

Vermilion retained the same board of directors and management team which continues to be led by Lorenzo Donadeo as President and Chief Executive Officer. There were no changes in Vermilion's underlying operations associated with the conversion. The consolidated financial statements and related financial information have been prepared on a continuity of interest basis, which recognizes Vermilion as the successor entity and accordingly all comparative information presented for the pre-conversion period is that of the Trust. For the convenience of the reader, when discussing prior periods this MD&A refers to common shares, shareholders and dividends although for the pre-conversion period such items were trust units, unitholders and distributions, respectively.

NON-GAAP MEASURES

This report includes non-GAAP measures as further described herein. These measures do not have standardized meanings prescribed by GAAP and therefore may not be comparable with the calculations of similar measures for other entities.

"Fund flows from operations" represents cash flows from operating activities before changes in non-cash operating working capital and asset retirement obligations settled. Management considers fund flows from operations and per share calculations of fund flows from operations (see discussion relating to per share calculations below) to be key measures as they demonstrate Vermilion's ability to generate the cash necessary to pay dividends, repay debt, fund asset retirement costs and make capital investments. Management believes that by excluding the temporary impact of changes in non-cash operating working capital, fund flows from operations provides a useful measure of Vermilion's ability to generate cash that is not subject to short-term movements in operating working capital. The most directly comparable GAAP measure is cash flows from operating activities. Cash flows from operating activities as presented in Vermilion's consolidated statements of cash flows is reconciled to fund flows from operations below:

	Years Ended December 31	
($M)	2010	2009
Cash flows from operating activities	$ 421,282	$ 230,316
Changes in non-cash operating working capital	(64,656)	76,782
Asset retirement obligations settled	6,861	10,139
Fund flows from operations	$ 363,487	$ 317,237

"Acquisitions, including acquired working capital deficiency" is the sum of "Acquisition of petroleum and natural gas properties" and "Corporate acquisitions, net of cash acquired" as presented in Vermilion's consolidated statements of cash flows plus any working capital deficiencies acquired as a result of those acquisitions. Management considers acquired working capital deficiencies to be an important element of a property or corporate acquisition. Acquisitions, including acquired working capital deficiency is reconciled below:

	Years Ended December 31	
($M)	2010	2009
Acquisition of petroleum and natural gas properties from consolidated statements of cash flows	$ 6,655	$ 159,536
Working capital deficiencies acquired from acquisitions	-	57,507
Acquisitions, including acquired working capital deficiency	$ 6,655	$ 217,043

"Net debt" is the sum of long-term debt and working capital excluding the amount due pursuant to acquisition as presented in Vermilion's consolidated balance sheets. Net debt is used by management to analyze the financial position and leverage of Vermilion. Net debt is reconciled below to long-term debt which is the most directly comparable GAAP measure:

	As at December 31	
($M)	2010	2009
Long-term debt	$ 302,558	$ 159,723
Current liabilities	340,934	217,563
Current assets	(343,099)	(256,886)
Net debt	$ 300,393	$ 120,400

"Cash dividends per share" represents actual cash dividends declared per share by Vermilion during the relevant periods.

"Net dividends" is calculated as dividends declared for a given period less proceeds received by Vermilion pursuant to the dividend reinvestment plan. Dividends both before and after the dividend reinvestment plan are reviewed by management and are also assessed as a percentage of fund flows from operations to analyze how much of the cash that is generated by Vermilion is being used to fund dividends. Net dividends is reconciled below to dividends declared, the most directly comparable GAAP measure:

	Years Ended December 31	
($M)	2010	2009
Dividends declared	$ 189,744	$ 166,385
Issue of shares pursuant to the dividend reinvestment plan	(40,824)	-
Net dividends	$ 148,920	$ 166,385

"Total net dividends, capital expenditures, reclamation fund withdrawals and asset retirement obligations settled" is calculated as net dividends as determined above plus the following amounts for the relevant periods from Vermilion's consolidated statements of cash flows: "Drilling and development of petroleum and natural gas properties", "Withdrawals from the reclamation fund" and "Asset retirement obligations settled." This measure is reviewed by management and is also assessed as a percentage of fund flows from operations to analyze the amount of cash that is generated by Vermilion that is available to repay debt and fund potential acquisitions. This measure is reconciled to the relevant GAAP measures below:

	Years Ended December 31	
($M)	2010	2009
Dividends declared	$ 189,744	$ 166,385
Issue of shares pursuant to the dividend reinvestment plan	(40,824)	-
Drilling and development of petroleum and natural gas properties	432,182	194,666
Withdrawals from the reclamation fund	(812)	-
Asset retirement obligations settled	6,861	10,139
Total net dividends, capital expenditures, reclamation fund withdrawals and asset retirement obligations settled	$ 587,151	$ 371,190

"Netbacks" are per unit of production measures used in operational and capital allocation decisions.

"Adjusted basic shares outstanding" and **"Adjusted basic weighted average shares outstanding"** are different from the most directly comparable GAAP figures in that they include amounts related to outstanding exchangeable shares at the period end exchange ratio. As the exchangeable shares have converted into shares of Vermilion, management believes that their inclusion in the calculation of basic rather than only in diluted per share statistics provides meaningful information.

"Diluted shares outstanding" is the sum of adjusted basic shares outstanding as described above plus outstanding awards under Vermilion's equity based compensation plans, based on current performance factor estimates.

These measures are reconciled to the relevant GAAP measures below:

	As at December 31	
(Number of shares)	2010	2009
Basic weighted average shares outstanding	83,155,116	72,405,606
Shares issuable pursuant to exchangeable shares outstanding	5,057,989	7,279,431
Adjusted basic weighted average shares outstanding	88,213,105	79,685,037

	As at December 31	
(Number of shares)	2010	2009
Shares outstanding	88,998,242	79,523,028
Shares issuable pursuant to exchangeable shares outstanding	-	7,219,261
Adjusted basic shares outstanding	88,998,242	86,742,289
Potential shares issuable pursuant to equity based compensation plans	2,145,427	1,497,422
Diluted shares outstanding	91,143,669	88,239,711

"Diluted adjusted weighted average shares outstanding" is the sum of diluted weighted average shares outstanding as presented on the consolidated statements of earnings, plus the weighted average amount of exchangeables outstanding for the period which were considered anti-dilutive for the purposes of calculating earnings per share.

HIGHLIGHTS

($M except per share amounts or when otherwise stated)	2010	2009	2008
Revenue	$ 727,805	$ 639,751	$ 1,001,905
Net earnings	111,263	185,498	229,189
Per share, basic	1.34	2.56	3.30
Per share, diluted	1.32	2.53	3.23
Fund flows from operations	363,487	317,237	573,966
Per share, adjusted basic	4.12	3.98	7.49
Return on equity (%)	9.5	20.7	33.2
Total assets	2,581,716	2,084,676	1,798,359
WTI (US $/bbl)	79.53	61.80	99.65
AECO ($/mcf)	4.00	3.95	8.13
Realized price ($/boe)	62.06	55.83	83.61
Fund flows netback ($/boe)	$ 30.99	$ 27.69	$ 47.91

2010 Summary of Quarterly Results				
($M except per share)	Q1	Q2	Q3	Q4
Revenue	$ 169,581	$ 169,545	$ 172,253	$ 216,426
Net earnings	42,508	44,027	8,911	15,817
Per share, basic	0.53	0.55	0.11	0.18
Per share, diluted	$ 0.53	$ 0.54	$ 0.10	$ 0.18
2009 Summary of Quarterly Results				
($M except per share)	Q1	Q2	Q3	Q4
Revenue	$ 146,236	$ 162,788	$ 150,183	$ 180,544
Net earnings	19,884	24,880	17,834	122,900
Per share, basic	0.28	0.35	0.25	1.60
Per share, diluted	$ 0.28	$ 0.35	$ 0.25	$ 1.59

VERMILION OVERVIEW

Vermilion aims to provide superior rewards and stability to its stakeholders though the execution of a successful strategy based on quality assets and proven leadership.

Stability

Vermilion's disciplined, value driven strategy has resulted in the delivery of stable dividends to our shareholders. In December 2007, Vermilion increased its dividends by 12% to $0.19 per month and it has maintained that level since. This element of financial stability is further demonstrated by Vermilion's strong balance sheet which provides significant financial flexibility to pursue opportunities as they arise.

Adherence to strong core values at all levels have contributed to Vermilion's success. Vermilion's Board of Directors has been recognized in corporate governance surveys for excellence in governance practices that included board composition, compensation, shareholder rights, disclosure, accountability and total return performance.

Successful Strategy

Vermilion is an oil-leveraged producer that adheres to a value creation strategy through the execution of full cycle exploration and production programs focused on the acquisition, exploration, development and optimization of producing properties in Western Canada, Western Europe and Australia. Vermilion is targeting 10% annual growth in production through the exploitation of conventional resource plays in Western Canada, including Cardium light oil and liquids-rich natural gas, the exploration and development of high impact natural gas opportunities in the Netherlands and through drilling and workover programs in France and Australia. Vermilion also expects to realize a material increase in both production and fund flows at the onset of production from the Corrib gas field in Ireland.

Quality Assets

Vermilion targets acquisition properties that deliver strong cash netbacks and have an abundance of low risk opportunities. In executing its strategy, Vermilion has acquired quality assets in five different countries.

Canada

Vermilion has an interest in over 600 net wells in three core areas, all in Alberta. The properties include a significant light oil field at Utikuma, multiple level, and liquids-rich tight gas reservoirs and Cardium oil opportunities in the Drayton Valley region and a CBM and shallow gas development in Central Alberta. Vermilion controls approximately 269,409 net acres of developed land, 169,905 net acres of undeveloped land and operates a number of oil and natural gas processing facilities with combined throughput of 89 mmcf/d of natural gas. Vermilion maintains a steady program of drilling and recompletions in the Drayton Valley region and is evaluating new completion techniques that are revitalizing certain reservoirs in the area.

France

Vermilion initially acquired its France assets in 1997 and in 2006 added additional and complementary assets to its French asset base. Vermilion's properties in France produce 98% oil and include three large fields at Chaunoy, Cazaux and Parentis. Vermilion is focusing on increasing P50 oil recovery and extending the reserve life from these fields through an active workover program. Vermilion's reserve life index in France is approximately 13 years and these properties represent a core focus of Vermilion's operations and a stable contribution to overall production. Vermilion continues to optimize through the use of water floods and is reviewing future resource development opportunities including an emerging Lias shale oil play in the Paris Basin. Vermilion holds a land position of approximately 176,000 net acres in the heart of this play, which could hold world-class resource potential.

Netherlands
Acquired in 2004, Vermilion's Netherlands assets produce natural gas which is sold in a regulated environment at a primarily oil-based index price. In February 2010, Vermilion announced it had achieved 100% success from its recent four-well drilling program with combined estimated initial production volumes in excess of 4,000 boe/d, net to Vermilion, with approximately 2000 boe/d brought on production during 2010 and the balance scheduled to be on production in 2011. Natural gas prices in the Netherlands are leveraged to a basket of primarily oil-based energy indices providing a strong incentive to increase activity levels over the coming years. Vermilion believes that there are numerous potential prospects in this region and plans to continue drilling in the Netherlands during 2011.

Australia
Vermilion initially acquired a 60% interest in the Wandoo field located offshore the northwest shelf of Australia in 2005. In 2006 and 2007, Vermilion significantly expanded fluid handling and processing capacity on the platform from approximately 114,000 bbls to 150,000 bbls. In 2007, Vermilion acquired the remaining 40% of this oil producing asset. In December 2008, Vermilion announced it had successfully drilled and completed two new 'attic oil' wells. Three additional wells were drilled in 2010 providing better than anticipated production as well as additional infill locations and workover opportunities in 2011 that should help sustain volumes of between 8,000 and 10,000 boe/d through to 2012.

Ireland
Vermilion acquired an 18.5% non-operated interest in the Corrib field located approximately 83 kilometres off the northwest coast of Ireland in 2009. Net production to Vermilion is initially anticipated at approximately 9,000 boe/d when the field is put on production. The Corrib asset will further enhance Vermilion's global asset base and is anticipated to deliver strong, accretive returns. The Corrib acquisition is consistent with Vermilion's focus on Western Europe and will provide another strong foothold in an attractive European energy market and a path for identifiable growth over the next few years.

Proven Leadership
The members of Vermilion's executive management team average more than 25 years of operating experience and are led by Lorenzo Donadeo, President and CEO, who is one of the three co-founders of the predecessor company, Vermilion Resources Ltd. Vermilion and its management team have a strong track record of providing high returns to shareholders.

2010 REVIEW AND 2011 GUIDANCE

The following table summarizes Vermilion's 2010 actual results as compared to guidance and Vermilion's 2011 guidance:

	Date	Capital Expenditures ($MM)	Production (boe/d)
2010 Guidance	November 6, 2009	$295 to $330	29,000 - 31,000
Updated	March 3, 2010	$350	31,000
Updated	May 7, 2010	$450	31,000
Updated	June 3, 2010	$450	31,000 - 32,000
2010 Actual	February 28, 2011	$432.2	32,132
2011 Guidance	November 5, 2010	$460	35,000 - 36,000

Production volumes for 2011 are expected to average between 35,000 and 36,000 boe/d. Development capital expenditures for 2011 are budgeted to be approximately $460 million of which a significant component is to be invested towards Vermilion's Cardium light oil prospects in Drayton Valley and liquids-rich natural gas opportunities and Ireland's onshore pipeline construction and advancement.

OPERATIONAL ACTIVITIES

Canada

In Canada, Vermilion participated in the drilling of 55 wells (40 net) during 2010, resulting in 13 gas wells (8.8 net), 28 oil wells (18.9 net), and 14 standing CBM wells (12.3 net). These wells included 15 operated (13.6 net) Cardium horizontal wells and 13 non-operated (5.4 net) Cardium wells. At year end, 11 operated (10.5 net) Cardium wells were on production and seven non-operated (3.2 net) wells were on production. While drilling activity will remain steady through the first half of 2011, some completions and tie-ins will be deferred until the 15,000 bbls/d oil processing facility is in service, which is expected in August 2011.

France

In France, Vermilion drilled the Les Mimosas-2 well in 2010, a water injection well designed to provide pressure support for the Les Mimosas reservoir which was discovered in 2004. Production from the lone producing well in this field increased more than 200 boe/d in response to water injection. Two small fracture stimulations in the Lias shale play were completed in 2010, primarily to gather pressure, fluid and other technical data from this formation. These zones were perforated in existing vertical wellbores and the completions were not designed to test commerciality. Both wells are producing, but at nominal rates. An active workover and recompletion program included 26 well workovers in 2010, predominantly in the Chaunoy Field in the Paris Basin and the Cazaux Field in the Aquitaine Basin.

Netherlands

In the Netherlands, Vermilion completed the De Hoeve-1 well in early 2010, and tied-in the Middleburen-2 and Middenmeer-3 wells in the spring of 2010. The balance of 2010 operations focused on regular facility and well maintenance and ongoing work to secure pipeline and production permits for the Vinkega-1 and De Hoeve-1 wells. Vermilion plans to commence a four-well exploration program in August 2011 and will continue to pursue drilling permits for 2012.

Australia

Vermilion drilled and completed three wells in September and October of 2010, all of which were lateral extensions of existing wellbores. These complex wells were completed within budget and produced results ahead of expectations. No drilling is scheduled in 2011, but Vermilion will undertake some well workover operations and prepare for the 2012 drilling program.

PRODUCTION

	Year Ended December 31, 2010			Year Ended December 31, 2009			Year Ended December 31, 2008		
	Oil & NGLs (bbls/d)	Natural Gas (mmcf/d)	Total (boe/d)	Oil & NGLs (bbls/d)	Natural Gas (mmcf/d)	Total (boe/d)	Oil & NGLs (bbls/d)	Natural Gas (mmcf/d)	Total (boe/d)
Canada	4,205	43.91	11,524	3,654	47.85	11,629	4,172	51.15	12,696
France	8,347	0.92	8,501	8,246	1.05	8,421	8,514	1.17	8,710
Netherlands	35	28.31	4,753	23	21.06	3,533	24	27.23	4,562
Australia	7,354	-	7,354	7,812	-	7,812	6,773	-	6,773
Total	19,941	73.14	32,132	19,735	69.96	31,395	19,483	79.55	32,741

2010 Quarterly Production (boe/d)	Q1	Q2	Q3	Q4
Canada	11,514	11,434	11,233	11,913
France	8,057	8,472	8,741	8,723
Netherlands	3,519	5,269	5,099	5,105
Australia	7,094	6,522	6,225	9,561
Total	30,184	31,697	31,298	35,302

2009 Quarterly Production (boe/d)	Q1	Q2	Q3	Q4
Canada	12,008	12,288	11,212	11,021
France	8,395	8,628	8,257	8,407
Netherlands	3,936	3,391	3,351	3,464
Australia	8,612	7,931	7,598	7,124
Total	32,951	32,238	30,418	30,016

Average total production in Canada of 11,524 boe/d during 2010 was relatively unchanged as compared to 11,629 boe/d in 2009, as natural declines offset early production increases from the Cardium program. However, fourth quarter 2010 production was 8.1% higher than production levels in the fourth quarter of 2009, providing evidence of the beginnings of a growing production base. Even more noticeable is year over year growth in oil and NGL production of 15.1%, reflecting the onset of new Cardium production. Canadian production is expected to show continued growth in 2011, predominantly related to oil and NGLs as Vermilion increases Cardium oil drilling activities. That growth will become more apparent in the fourth quarter of 2011, once the planned production facility is brought on line.

Production in France averaged 8,501 boe/d in 2010, slightly higher than average 2009 production of 8,421 boe/d. Production is maintained reasonably stable using an active well workover program. Only two new wells are scheduled in 2011, but another active workover program should serve to maintain stable production again this year.

Production in the Netherlands increased by 1,220 boe/d in 2010, a gain of more than 30%, as production from two new wells commenced in April 2010. Two additional wells are expected to add up to 2,000 boe/d of production when they are brought on-stream in mid-2011. Netherlands production is expected to see continued production increases from new drilling, although the timing of those increases is less predictable due to the extensive production permitting process.

Australia production averaged 7,354 boe/d in 2010, compared to 7,812 boe/d in 2009 due to natural declines. Production from three new wells which commenced in early November significantly impacted fourth quarter 2010 volumes which averaged 9,561 boe/d a gain of more than 2,400 boe/d compared to the fourth quarter of 2009. Vermilion expects to sustain annual average production at approximately 9,000 boe/d over the next few years. First quarter 2011 production is expected to be reduced due to cyclone related shut-downs of the production platform. The cyclone season in Australia normally runs from December through March of each year. In the case of severe storms, Vermilion shuts-in all production and evacuates the platform as a security precaution.

FINANCIAL REVIEW

During the year ended December 31, 2010, Vermilion generated fund flows from operations of $363.5 million compared to $317.2 million in 2009. The year over year increase in fund flows from operations of $46.3 million is primarily a result of increased revenue associated with stronger oil prices and higher average production volumes. The GAAP measure, cash flows from operating activities, similarly increased year over year to $421.3 million for the year ended December 31, 2010 from $230.3 million for 2009.

During the year ended December 31, 2010, the price of WTI crude oil averaged US $79.53 per bbl (2009 – US $61.80 per bbl) and the price of Brent crude oil averaged US $79.47 per bbl (2009 – US $61.51 per bbl). The AECO price for gas averaged $4.00 per mcf (2009 – $3.95 per mcf). On a year over year basis, the average price for crude oil was higher in 2010 compared to 2009, while the average AECO price has remained relatively consistent year over year.

At December 31, 2010, Vermilion's net debt was $300.4 million as compared to the net debt of $120.4 million at December 31, 2009. Vermilion's long-term debt has increased to $302.6 million at December 31, 2010 from $159.7 million at December 31, 2009. At December 31, 2010, Vermilion's net debt represented 75.0% of its fourth quarter annualized fund flows from operations. The year over year increases in net debt and long-term debt are a function of Vermilion's capital expenditures largely driven by Canadian land acquisitions during the first half of 2010, continued Cardium light oil development activity during 2010 as well as the Australia drilling program. The impact of these expenditures on net debt was partially offset by the liquidation of the reclamation fund assets in July 2010 (see Reclamation Fund for further information) and proceeds from the dividend reinvestment plan. The low level of net debt at December 31, 2009 reflects that year's trust unit issuance and the sale of the Company's investment in Verenex Energy Inc. ("Verenex").

For the year ended December 31, 2010, total net dividends, capital expenditures (excluding those on the Corrib project), reclamation fund withdrawals and asset retirement obligations settled as a percentage of fund flows from operations was 140% versus 103% for the corresponding period in the prior year. The year over year increase in this ratio relates to Vermilion's land acquisitions, Cardium light oil development and the Australian drilling program during 2010. The year over year increase was partially offset by decreased capital expenditures in the other jurisdictions in which Vermilion operates.

CAPITAL EXPENDITURES

Capital Expenditures by Category ($M)	2010	2009	2008
Land	$ 97,215	$ 15,868	$ 5,183
Seismic	6,600	1,847	10,989
Drilling and completion	167,771	55,989	78,542
Production equipment and facilities	114,369	77,588	56,974
Recompletions	14,798	19,282	19,789
Other	31,429	24,092	15,359
	432,182	194,666	186,836
Acquisitions (excluding acquired working capital deficiency)	6,655	159,536	48,230
Total capital expenditures by category	$ 438,837	$ 354,202	$ 235,066

Capital Expenditures by Country ($M)	2010	2009	2008
Canada	$ 242,900	$ 75,973	$ 103,725
France	54,965	62,457	55,669
Netherlands	11,017	26,338	13,019
Australia	51,457	6,739	62,653
Ireland	78,498	182,695	-
Total capital expenditures by country	$ 438,837	$ 354,202	$ 235,066

Total capital expenditures, including acquisitions for the year ended December 31, 2010 was $438.8 million compared to $354.2 million in 2009.

Capital expenditures excluding acquisitions has increased year over year as a result of the significant land acquisitions and development activity associated with Vermilion's focus on Western Canadian resource plays. Also contributing to the higher levels of capital expenditures were costs incurred related to the 2010 Australian drilling program and post acquisition capital costs on the Corrib project.

Acquisition spending was higher in the prior year as a result of the Corrib acquisition which was completed on July 30, 2009 for $136.8 million as well as Drayton Valley area property acquisitions totalling $15.1 million.

In Ireland, oral hearings related to the amended Corrib onshore pipeline were completed on October 1, 2010. On January 20, 2011, Vermilion announced that An Bord Pleanála had granted permission for the construction of the Corrib gas onshore pipeline in Ireland. The Corrib Gas Partners look forward to completing this strategically important project and delivering the gas to Ireland. At peak production, Corrib gas is expected to supply up to 60% of Ireland's natural gas needs and is consequently expected to play an important role in Ireland's energy security in the years ahead.

FUND FLOWS NETBACKS

2010 Fund Flows Netback ($/boe)	Q1	Q2	Q3	Q4	2010	2009	2008
Oil and gas revenues	$ 62.43	$ 58.78	$ 59.82	$ 66.64	$ 62.06	$ 55.83	$ 83.61
Realized hedging gain or (loss)	0.45	1.31	1.32	1.34	1.12	0.47	(0.89)
Royalties	(10.34)	(4.56)	(4.51)	(9.02)	(7.12)	(8.52)	(10.92)
Transportation	(2.56)	(2.39)	(2.27)	(1.94)	(2.28)	(1.65)	(1.96)
Operating costs	(13.38)	(11.31)	(12.51)	(12.20)	(12.33)	(12.18)	(11.98)
Operating netback	36.60	41.83	41.85	44.82	41.45	33.95	57.86
General and administration	(3.74)	(3.34)	(3.61)	(3.90)	(3.65)	(2.72)	(2.07)
Interest	(1.12)	(1.28)	(1.10)	(1.07)	(1.14)	(1.16)	(1.36)
Current taxes	(3.67)	(6.25)	(5.33)	(9.04)	(6.20)	(2.57)	(6.99)
Proceeds on sale of investments	-	-	-	-	-	0.23	0.01
Other income	-	-	0.20	0.01	0.05	-	-
Foreign exchange	0.77	0.39	0.80	0.02	0.48	(0.04)	0.46
Fund flows netback	$ 28.84	$ 31.35	$ 32.81	$ 30.84	$ 30.99	$ 27.69	$ 47.91

2009 Fund Flows Netback ($/boe)	Q1	Q2	Q3	Q4
Oil and gas revenues	$ 49.31	$ 55.49	$ 53.67	$ 65.38
Realized hedging gain	0.75	0.24	0.39	0.50
Royalties	(7.32)	(6.17)	(8.30)	(12.53)
Transportation	(1.47)	(1.51)	(1.33)	(2.33)
Operating costs	(11.52)	(11.70)	(12.24)	(13.35)
Operating netback	29.75	36.35	32.19	37.67
General and administration	(2.29)	(2.55)	(2.93)	(3.16)
Interest	(0.60)	(0.43)	(1.47)	(2.21)
Current taxes	(3.14)	(3.40)	(2.31)	(1.33)
Proceeds on sale of investments	-	-	-	0.97
Other income	-	-	(0.02)	0.01
Foreign exchange	(0.65)	(0.83)	(0.67)	2.09
Fund flows netback	$ 23.07	$ 29.14	$ 24.79	$ 34.04

REVENUE

	Years Ended December 31	
($M except per boe and per mcf)	2010	2009
Crude oil & NGLs	$ 578,926	$ 496,331
Per boe	$ 79.54	$ 68.90
Natural gas	148,879	143,420
Per mcf	$ 5.58	$ 5.62
Petroleum and natural gas revenue	$ 727,805	$ 639,751
Per boe	$ 62.06	$ 55.83

Revenue for the year ended December 31, 2010 was $727.8 million compared to $639.8 million in 2009. Vermilion's combined crude oil and NGL price was $79.54 per boe in 2010, an increase of 15.4% over the $68.90 per boe reported in 2009. The natural gas price realized was $5.58 per mcf in 2010, a marginal decrease over the $5.62 per mcf reported in 2009. Vermilion's increased revenue year over year resulted from higher crude oil prices and higher average production volumes during 2010 as compared to 2009.

The following table summarizes Vermilion's ending inventory positions for France and Australia for the most recent four quarters:

Ending Inventory Positions (France and Australia)	As at Dec 31, 2010	As at Sep 30, 2010	As at Jun 30, 2010	As at Mar 31, 2010
France (bbls)	158,229	149,268	163,515	179,404
France ($M)	$ 4,599	$ 4,574	$ 4,663	$ 5,448
Australia (bbls)	172,199	107,744	60,146	61
Australia ($M)	$ 6,108	$ 3,529	$ 1,784	$ 2

DERIVATIVE INSTRUMENTS

The following table summarizes Vermilion's outstanding financial derivative positions as at December 31, 2010.

Risk Management: Oil	Funded Cost	bbls/d	US $/bbl
Collar - WTI			
January 2011 to June 2011	US $1.00/bbl	2,400	$ 80.00 - $107.60
January 2011 to June 2011	US $1.00/bbl	2,400	$ 75.00 - $ 97.85
January 2011 to December 2011	US $1.00/bbl	500	$ 78.00 - $ 96.20
January 2011 to December 2011	US $1.00/bbl	500	$ 78.00 - $ 96.25
July 2011 to December 2011	US $1.00/bbl	2,400	$ 80.00 - $110.00
July 2011 to December 2011	US $1.00/bbl	2,400	$ 77.25 - $ 98.50
Collar - BRENT			
January 2011 to December 2011	US $1.00/bbl	1,000	$ 77.75 - $ 96.00
January 2011 to December 2011	US $1.00/bbl	1,000	$ 77.50 - $ 96.00
January 2011 to December 2011	US $0.00/bbl	750	$ 77.00 - $ 95.40
January 2011 to December 2011	US $1.00/bbl	750	$ 78.00 - $ 98.10
January 2011 to December 2011	US $1.00/bbl	500	$ 78.00 - $100.00
January 2011 to December 2011	US $1.00/bbl	500	$ 78.00 - $100.05
January 2011 to December 2011	US $1.00/bbl	500	$ 78.00 - $100.00
January 2012 to June 2012	US $1.00/bbl	750	$ 82.00 - $105.60
January 2012 to June 2012	US $1.00/bbl	750	$ 82.00 - $104.80
January 2012 to June 2012	US $1.00/bbl	750	$ 82.00 - $106.10
Call Spread - BRENT			
January 2011 to December 2011	US $6.08/bbl[1]	960	$ 65.00 - $ 85.00
January 2011 to December 2011	US $5.15/bbl[1]	600	$ 65.00 - $ 85.00
Risk Management: Natural Gas	**Funded Cost**	**GJ/d**	**$/GJ**
SWAP - AECO			
January 2011 to October 2011	$0.00/GJ	700	$5.13
Risk Management: Foreign Exchange		**Notional Principal ($US) / Month**	**Fixed rate ($CDN / $US)**
US Dollar Forward Sale			
January 2011 to December 2011		$750,000	$1.07
January 2011 to December 2011		$750,000	$1.07

[1] The funded amounts for these instruments were paid in a prior period.

The nature of Vermilion's operations results in exposure to fluctuations in commodity prices, interest rates and foreign currency exchange rates. Vermilion monitors and, when appropriate, uses derivative financial instruments to manage its exposure to these risks. All transactions of this nature entered into by Vermilion are related to an underlying financial position or to future petroleum and natural gas production. Vermilion does not use derivative financial instruments for speculative purposes. Vermilion has elected not to designate any of its price risk management activities as accounting hedges and thus accounts for changes to fair value in net earnings for the period. During the normal course of business, Vermilion may enter into fixed price arrangements to sell a portion of its production. Vermilion has elected to exempt these contracts from fair value accounting through the use of the normal purchase and sales exemption. Vermilion does not obtain collateral or other security to support its financial derivatives as management reviews the creditworthiness of the counterparty prior to entering into a derivative contract.

The impact of Vermilion's derivative based risk management activities increased the fund flows netback by $1.12 per boe for the year ended December 31, 2010. This compares to a hedging gain $0.47 per boe in 2009.

ROYALTIES

($M except per boe and per mcf)	Years Ended December 31 2010	2009
Crude oil & NGLs	$ 79,093	$ 92,226
Per boe	$ 10.87	$ 12.80
Natural gas	4,416	5,406
Per mcf	$ 0.17	$ 0.21
Royalties	$ 83,509	$ 97,632
Per boe	$ 7.12	$ 8.52

Consolidated royalties per boe for the year ended December 31, 2010 were $7.12 as compared to $8.52 in 2009. As a percentage of revenue for the year ended December 31, 2010 royalties were 11% as compared to 15% in 2009.

In Australia, royalties as a percentage of revenue for the year ended December 31, 2010 were 18% as compared to 27% in 2009. Royalties are reduced by capital investment in the country and as such, royalties for the year ended December 31, 2010 as a percentage of revenue decreased as compared to 2009 as a result of higher levels of capital expenditures associated with the drilling of new wells in 2010. Pursuant to requirements under International Financial Reporting Standards, commencing in 2011, Vermilion will report royalties paid in Australia as an income tax. Please see International Financial Reporting Standards Transition in this document.

Canadian royalties as a percentage of revenue for the year ended December 31, 2010, have remained consistent at 15% compared to the same period in 2009. The impact of higher oil prices on royalty rates was offset by the effect of changes in the Alberta royalty regime made in 2009 which impacted the wells drilled in 2010 coupled with the impact of lower gas volumes on royalty rates.

In France, the primary portion of the royalties levied is based on units of production and therefore is not subject to changes in commodity prices. Accordingly, as oil prices were higher for the year ended December 31, 2010 compared to 2009 royalties as a percentage of revenue decreased to 6% in 2010 compared to 8% in 2009.

Production in the Netherlands is not subject to royalties.

OPERATING EXPENSE

($M except per boe and per mcf)	Years Ended December 31 2010	2009
Crude oil & NGLs	$ 98,278	$ 91,338
Per boe	$ 13.50	$ 12.68
Natural gas	46,317	48,268
Per mcf	$ 1.73	$ 1.89
Operating expense	$ 144,595	$ 139,606
Per boe	$ 12.33	$ 12.18

Consolidated operating expense per boe for the year ended December 31, 2010 was $12.33 compared to $12.18 for 2009.

Canadian operating expense per boe has decreased to $9.71 compared to $10.13 for the same period in 2009. The decrease is attributable to lower gas processing expense and higher operating fee recoveries partially offset by increased downhole intervention spending.

Operating expense per boe in France increased in 2010 to $14.02 compared to $12.40 for the same period in 2009. The increase is a result of higher levels of downhole maintenance spending in 2010 compared to 2009.

Australian operating expense increased to $15.66 per boe in 2010 from $13.82 per boe for the same period in 2009. The increase is attributable to higher labour expenses combined with lower levels of production.

Operating expense in the Netherlands decreased in 2010 to $10.50 per boe from $14.78 per boe in 2009. The decrease is related to higher levels of production and lower fuel and electricity expenses.

TRANSPORTATION EXPENSE

	Years Ended December 31	
($M except per boe)	2010	2009
Transportation expense	$ 26,698	$ 18,939
Per boe	$ 2.28	$ 1.65

Transportation expense is a function of the point of legal transfer of the product and is dependent upon where the product is sold, product split, location of properties, as well as industry transportation rates that are driven by supply and demand of available transport capacity. For Canadian gas production, legal title transfers at the intersection of major pipelines whereas the majority of Vermilion's Canadian oil production is sold at the wellhead. In France, the majority of Vermilion's transportation expense is made up of shipping charges incurred in the Aquitaine Basin where oil production is transported by tanker from the Ambès terminal in Bordeaux to the refinery. In Australia, oil is sold at the Wandoo B Platform and in the Netherlands, gas is sold at the plant gate, resulting in no transportation expense relating to Vermilion's production in these countries.

Transportation expense increased during the year ended December 31, 2010 compared to the prior year as a result of the ship or pay pipeline tariff charges related to the Corrib project being included in the 2010 results for a full year as compared to only a portion in 2009. As there is a ceiling on the total payments due in relation to the pipeline, these expenses essentially represent a prepayment for future pipeline transportation services.

GENERAL AND ADMINISTRATION EXPENSE

	Years Ended December 31	
($M except per boe)	2010	2009
General and administration expense	$ 42,842	$ 31,192
Per boe	$ 3.65	$ 2.72

General and administration expense per boe for the year ended December 31, 2010 was $3.65 compared to $2.72 in 2009. The increase year over year is associated with the head office relocation as well as higher legal and advisory fees associated with various projects including the conversion from a trust to a corporation and a restructuring of Vermilion's international holding companies that will result in a more efficient corporate structure.

EQUITY BASED COMPENSATION EXPENSE

	Years Ended December 31	
($M except per boe)	2010	2009
Equity based compensation expense	$ 28,170	$ 18,196
Per boe	$ 2.40	$ 1.59

Non-cash equity based compensation expense for the year ended December 31, 2010 was $28.2 million as compared to $18.2 million in 2009. This expense relates to the value attributable to long-term incentives granted to officers, employees and directors under the Vermilion Incentive Plan, formerly the Trust Unit Award Incentive Plan and Vermilion's bonus plan. The year over year increase in equity based compensation expense reflects Vermilion's achievement of a performance factor of two for 2010.

INTEREST EXPENSE

($M except per boe)	Years Ended December 31 2010	2009
Interest expense	$ 13,370	$ 13,268
Per boe	$ 1.14	$ 1.16

Interest expense for the year ended December 31, 2010 at $13.4 million was consistent with the $13.3 million recorded in 2009.

DEPLETION, DEPRECIATION AND ACCRETION EXPENSE

($M except per boe)	Years Ended December 31 2010	2009
Depletion, depreciation and accretion expense	$ 271,556	$ 248,726
Per boe	$ 23.15	$ 21.71

Depletion, depreciation and accretion expense per boe for the year ended December 31, 2010 was $23.15 as compared to $21.71 in 2009. The increase results from the redemption of the remaining exchangeable shares pursuant to the corporate conversion which resulted in an increase to capital assets of $189.9 million (see Note 9 of the consolidated financial statements).

TAXES

($M except per boe)	Years Ended December 31 2010	2009
Current taxes	$ 72,701	$ 29,429
Per boe	$ 6.20	$ 2.57

Vermilion is subject to current taxes in France, the Netherlands and Australia. Current taxes for the year ended December 31, 2010 increased to $72.7 million compared to $29.4 million in 2009. The increases are attributable to the higher year over year revenue associated with increased levels of production and stronger oil prices as well as a one-time adjustment related to the elimination of a tax incentive program in France. As a result of Vermilion's Canadian tax pools, the Company does not presently pay income taxes in Canada.

As at December 31, 2010, Vermilion had the following tax pools:

($M)	Oil & Gas Assets		Tax Losses[5]	Other	Total
Canada	$ 539,625	[1]	$ 343,254	$ 10,528	$ 893,407
France	86,972	[3]	-	-	86,972
Australia	214,590	[1]	-	-	214,590
Netherlands	32,169	[2]	-	-	32,169
Ireland	557,064	[4]	99,927	-	656,991
Total	$ 1,430,420		$ 443,181	$ 10,528	$ 1,884,129

[1] Deduction calculated by various declining balance rates
[2] Deduction calculated by unit of production method
[3] Deduction calculated by combination of straight-line over the assets life and unit of production method
[4] Deduction for development expenditures at 100%
[5] Losses are deductible at 100% against taxable income

FOREIGN EXCHANGE

	Years Ended December 31	
($M except per boe)	2010	2009
Foreign exchange (gain)	$ (26,132)	$ (39,894)
Per boe	$ (2.23)	$ (3.48)

During the year ended December 31, 2010, a combined realized and unrealized foreign exchange gain of $26.1 million was recognized versus $39.9 million in 2009. The gain in 2010 is comprised of a realized gain of $5.6 million associated with cash repatriations and an unrealized, non-cash gain of $20.5 million. The unrealized gain in 2010 is largely related to the translation of foreign currency denominated future income taxes and asset retirement obligations to Canadian dollars. Since December 31, 2009, the Canadian dollar has strengthened against the Euro resulting in this unrealized gain.

NET EARNINGS

Net earnings for the year ended December 31, 2010 were $111.3 million or $1.34 per share as compared to $185.5 million or $2.56 per share for the year ended December 31, 2009. The decrease in earnings is largely related to the absence of the gain on sale of Verenex as well as higher income tax expense during 2010 as compared to 2009.

LIQUIDITY AND CAPITAL RESOURCES

($M except ratios)	2010	2009	2008
Net debt	$ 300,393	$ 120,400	$ 207,753
Bank facilities	$ 675,000	$ 675,000	$ 675,000
Unused bank facilities	$ 374,607	$ 554,600	$ 467,247
Net debt to annual fund flows from operations ratio [1]	0.83	0.38	0.36
Net debt to equity ratio [1]	0.23	0.12	0.28

[1] These are non-GAAP measures and may not be comparable to similar measures for other entities. See "Non-GAAP Measures" for further detail.

Vermilion's net debt as at December 31, 2010 was $300.4 million compared to $120.4 million as at December 31, 2009.

As at December 31, 2010, Vermilion had a syndicated revolving credit facility allowing for maximum borrowings of $675 million. The revolving period under the revolving credit facility is expected to expire in June 2011 and may be extended for an additional period of up to 364 days at the option of the lenders. If the lenders do not extend the term of the revolving facility, the amounts outstanding become repayable 24 months after the expiry of the revolving period. Various borrowing options are available under the facility including prime rate based advances and bankers' acceptance loans.

The revolving credit facility is secured by various fixed and floating charges against subsidiaries of Vermilion. Under the terms of the revolving credit facility, Vermilion must maintain a ratio of total borrowings under the facility to consolidated earnings before interest, income taxes, depreciation, accretion and certain other non-cash items of not greater than 3.0.

The amount available to Vermilion under the facility is reduced by outstanding letters of credit associated with Vermilion's operations totalling $1.9 million as at December 31, 2010.

Effective January 15, 2010, Vermilion reinstated the dividend reinvestment plan. Cash flows from financing activities for the twelve months ended December 31, 2010 included cash flows related to the issuance of shares pursuant to the dividend reinvestment plan of $40.8 million and there were no proceeds related to the program in 2009.

On February 10, 2011, Vermilion closed a private placement offering of $225 million of senior unsecured notes. The notes bear interest at a rate of 6.5% per annum and will mature on February 10, 2016. As direct senior unsecured obligations of Vermilion, the notes rank pari passu with all other present and future unsecured and unsubordinated indebtedness of the Company. Concurrent with the issuance of the notes, the Company's credit facility was reduced from $675 million to $635 million.

Vermilion has a long-term and short-term need for capital. Short-term working capital is required to finance accounts receivable, crude oil inventory and other similar short-term assets. Short-term capital may also be used from time to time to fund cash dividends allowing the Company to maintain consistent monthly cash dividends to shareholders of Vermilion. The acquisition and development of petroleum and natural gas properties requires both short-term and long-term capital. There are essentially three methods of financing the capital needs of Vermilion: internally generated cash, debt and equity.

Internally generated cash is used primarily for dividends and development capital requirements. Internal cash flow is significantly influenced by commodity prices. Other risks include exchange rates, interest rates and marketing opportunities, among others. Vermilion's business model generally maintains total dividends and capital development expenditures below internally generated cash, using the excess to reduce outstanding indebtedness. At times, the volatility of commodity prices and/or requirements of certain capital programs may result in total dividends and capital development expenditures exceeding internally generated cash for short periods.

Future significant acquisitions of producing properties are expected to be financed through additional bank debt combined with the issuance of common shares, if necessary. The Company's ability and desire to finance acquisitions through the issuance of equity is dependent upon the nature of the market for the issuance of equity as well as the size of the potential acquisition. It is Vermilion's preference to finance acquisitions with debt whenever practicable. In the event that Vermilion considers equity financing appropriate, its ability to issue equity is highly dependent on the receptivity of the equity markets.

Payments due by period

($M)	Total	Less than 1 year	1 - 3 years	3 - 5 years	More than 5 years
Long-term debt obligations [1]	$ 304,100	$ -	$ 304,100	$ -	$ -
Amount due pursuant to acquisition	134,271	-	134,271	-	-
Operating lease obligations	78,765	5,864	13,690	13,690	45,521
Total	$ 517,136	$ 5,864	$ 452,061	$ 13,690	$ 45,521

[1] Does not include interest.

RECLAMATION FUND

After an extensive review, Vermilion concluded that the reclamation fund assets would be more effectively employed supporting Vermilion's operations. In July 2010, the reclamation fund assets were liquidated and the proceeds were initially used to reduce outstanding bank indebtedness and will ultimately help support Vermilion's capital programs. Vermilion will fund future reclamation costs out of current resources as they become due, consistent with standard industry practice.

ASSET RETIREMENT OBLIGATIONS

As at December 31, 2010, Vermilion's asset retirement obligations were $274.6 million compared to $237.1 million as at December 31, 2009. The increase is largely attributable to a change in estimate stemming from the availability of better data associated with the abandonment obligations for Vermilion's Netherlands operations as well as accretion on the obligation partially offset by the impact of exchange rates on foreign currency denominated obligations.

DIVIDENDS

Sustainability of Dividends

($M)	Three Months Ended Dec 31, 2010	Year Ended Dec 31, 2010	Year Ended Dec 31, 2009	Year Ended Dec 31, 2008
Cash flows from operating activities	$ 127,191	$ 421,282	$ 230,316	$ 660,135
Net earnings	$ 15,817	$ 111,263	$ 185,498	$ 229,189
Dividends declared	$ 50,664	$ 189,744	$ 166,385	$ 158,674
Excess of cash flows from operating activities over cash dividends declared	$ 76,527	$ 231,538	$ 63,931	$ 501,461
(Shortfall) excess of net earnings over cash dividends declared	$ (34,847)	$ (78,481)	$ 19,113	$ 70,515

Vermilion maintained monthly dividends at $0.19 per share for the year ended December 31, 2010 and declared dividends totalling $189.7 million compared to $166.4 million for the same period in 2009.

Since inception, Vermilion has declared $1.1 billion in dividends to shareholders as compared to shareholders' capital of $1.0 billion at December 31, 2010.

Excess cash flows from operating activities over cash dividends declared are used to fund capital expenditures, asset retirement costs and debt repayments. The current year shortfalls of net earnings over dividends declared is a result of non-cash charges such as depletion, depreciation and accretion which have no immediate impact on dividend sustainability.

Vermilion's policy with respect to dividends is to be conservative and retain a low payout ratio when comparing dividends to fund flows from operations. During low price commodity cycles, Vermilion will initially maintain dividends and allow the payout ratio to rise. Should low commodity price cycles remain for an extended period of time, Vermilion will evaluate the necessity to change the level of dividends, taking into consideration capital development requirements, debt levels and acquisition opportunities.

Over the next two years, the Corrib and Cardium projects will require a significant capital investment by Vermilion. As such, Vermilion's fund flows from operations may not be sufficient during this period to fund cash dividends, capital expenditures and asset retirement costs. Vermilion currently intends to finance any shortfall primarily with debt.

Since Vermilion's conversion to a trust in January 2003, the distribution remained at $0.17 per unit per month until it was increased to $0.19 per unit per month in December 2007. Effective September 1, 2010, Vermilion converted to a dividend paying corporation and dividends have remained at $0.19 per share per month.

SHAREHOLDERS' EQUITY

During the year ended December 31, 2010, 9,475,214 shares were issued pursuant to the conversion of exchangeable shares, the dividend reinvestment plan and Vermilion's equity based compensation programs. Shareholders' capital increased by $334.3 million as a result of the issuance of those shares.

As at March 10, 2011 there were 89,177,604 shares outstanding.

NON-CONTROLLING INTEREST – EXCHANGEABLE SHARES

Vermilion had previously recorded non-controlling interest attributed to the issued and outstanding exchangeable shares.

The non-controlling interest on the consolidated balance sheets represented the book value of exchangeable shares plus accumulated earnings attributable to the outstanding exchangeable shares. The reduction in net income represented the net income attributable to the exchangeable shareholders for the period. As the exchangeable shares were converted to common shares, shareholders' capital was increased for the fair value of Vermilion shares issued.

In connection with the corporate conversion, Vermilion issued 7,586,546 common shares in exchange for the remaining 4,006,753 exchangeable shares in Vermilion Resources Ltd. based on an exchange ratio of 1.89344. The conversion of exchangeable shares was recorded as an acquisition of the non-controlling interest at fair value. The fair value of the common shares issued in consideration for the non-controlling interest represented by the exchangeable shares was $270.6 million. The difference between that amount and the carrying value of the non-controlling interest of $109.0 million resulted in increases to capital assets of $189.9 million, goodwill of $31.7 million and future income tax liability of $60.0 million.

RISKS AND UNCERTAINTIES AND RISK MANAGEMENT

Risk and Uncertainties

Crude oil and natural gas exploration, production, acquisition and marketing operations involve a number of risks and uncertainties. These include fluctuations in commodity prices, exchange rates and interest rates as well as uncertainties associated with reserve volumes, production and sales volumes and governmental regulatory and income tax regime changes. These risks and uncertainties, as well as other important risks and uncertainties are discussed in additional detail below.

<u>Commodity Prices</u>
Vermilion's operational results and financial condition will be dependent on the prices received by Vermilion for oil and natural gas production. Oil and natural gas prices have fluctuated significantly during recent years and are determined by supply and demand factors, including weather and general economic conditions as well as conditions in other oil and natural gas regions.

<u>Exchange Rates</u>
Much of Vermilion's revenue stream is earned in U.S. dollars and as such an increase in the strength of the Canadian dollar relative to the U.S. dollar may result in the receipt of fewer Canadian dollars by Vermilion in respect of its production. In addition, Vermilion incurs expenses and capital costs in U.S. dollars, Euros and Australian dollars and accordingly, the Canadian dollar equivalent of these expenditures as reported by Vermilion in its financial results is impacted by the prevailing foreign currency exchange rates at the time the transaction occurs. Vermilion monitors risks associated with exchange rates and, when appropriate, uses derivative financial instruments to manage its exposure to these risks.

<u>Production and Sales Volumes</u>
The operation of oil and gas wells and facilities involves a number of operating and natural hazards which may result in blowouts, environmental damage and other unexpected or dangerous conditions resulting in damage to Vermilion and possible liability to third parties. Vermilion maintains liability insurance, where available, in amounts consistent with industry standards. Business interruption insurance may also be purchased for selected operations, to the extent that such insurance is available. Vermilion may become liable for damages arising from such events against which it cannot insure or against which it may elect not to insure because of high premium costs or other reasons. Costs incurred to repair such damage or pay such liabilities may materially impact Vermilion's financial results.

Continuing production from a property, and to some extent the marketing of production, are largely dependent upon the ability of the operator of the property. To the extent the operator fails to perform these functions properly, revenue may be reduced. Payments from production generally flow through the operator and there is a risk of delay and additional expense in receiving such revenues if the operator becomes insolvent. Although satisfactory title reviews are generally conducted in accordance with industry standards, such reviews do not guarantee or certify that a defect in the chain of title may not arise to defeat the claim of Vermilion or its subsidiaries to certain properties. Such circumstances could negatively affect Vermilion's financial results.

An increase in operating costs or a decline in Vermilion's production level could have an adverse effect on Vermilion's financial results. The level of production may decline at rates greater than anticipated due to unforeseen circumstances, many of which are beyond Vermilion's control. A significant decline in production could result in materially lower revenues.

Interest Rates

An increase in interest rates could result in a significant increase in the amount Vermilion pays to service debt.

Reserve Volumes

Vermilion's reserve volumes and related reserve values support the carrying value of Vermilion's oil and gas assets on the consolidated balance sheets and provide the basis to calculate the depletion of those costs. There are numerous uncertainties inherent in estimating quantities of reserves and future net revenues to be derived therefrom, including many factors beyond Vermilion's control. These include a number of assumptions relating to factors such as initial production rates, production decline rates, ultimate recovery of reserves, timing and amount of capital expenditures, marketability of production, future prices of crude oil and natural gas, operating expenses, well abandonment and salvage values, royalties and other government levies that may be imposed over the producing life of the reserves. These assumptions were based on estimated prices in use at the date the evaluation was prepared, and many of these assumptions are subject to change and are beyond Vermilion's control. Actual production and income derived therefrom will vary from these evaluations, and such variations could be material.

Asset Retirement Obligations

Vermilion's asset retirement obligations are based on environmental regulations and estimates of future costs and the timing of expenditures. Changes in environmental regulations, the estimated costs associated with reclamation activities and the related timing may impact Vermilion's financial position and results of operations.

Corrib Project

Vermilion is exposed to uncertainties associated with the timing of first gas resulting from the permitting process for a section of the onshore pipeline relating to the Corrib project. The ultimate timing of first gas impacts the final payment due to the vendor and is the main determinant as to when Vermilion will begin to realize its investment in the project.

Governmental Regulatory and Income Tax Regime

Vermilion's operations are governed by many levels of government, including municipal, state, provincial and federal governments, in Canada, France, the Netherlands, Australia and Ireland. Vermilion is subject to laws and regulations regarding health and safety issues, lease interests, taxes and royalties, among others. Failure to comply with the applicable laws can result in significant increases in costs, penalties and even losses of operating licences. The regulatory process involved in each of the countries in which Vermilion operates is not uniform and regulatory regimes vary as to complexity, timeliness of access to, and response from, regulatory bodies and other matters specific to each jurisdiction. If regulatory approvals or permits are delayed or not obtained, there can also be delays or abandonment of projects, decreases in production and increases in costs, and Vermilion may not be able to fully execute its strategy. Governments may also amend or create new legislation and regulatory bodies may also amend regulations or impose additional requirements which could result in increased capital, operating and compliance costs.

There can be no assurance that income tax laws and government incentive programs relating to the oil and gas industry in Canada and the foreign jurisdictions in which Vermilion operates, will not be changed in a manner which adversely affects Vermilion's results of operations.

A change in the royalty regime resulting in an increase in royalties would reduce Vermilion's earnings and could make future capital expenditures or Vermilion's operations uneconomic and could, in the event of a material increase in royalties, make it more difficult to service and repay outstanding debt. Any material increase in royalties would also significantly reduce the value of the associated assets.

Risk Management

To mitigate these risks whenever possible, Vermilion seeks to hire personnel with experience in specific areas. In addition, Vermilion provides continued training and development to staff to further develop their skills. When appropriate, Vermilion uses third party consultants with relevant experience to augment its internal capabilities with respect to certain risks.

Vermilion considers its commodity price risk management program as a form of insurance that protects its cash flow and rate of return. The primary objective of the risk management program is to support Vermilion's dividends and its internal capital development program. The level of commodity price risk management that occurs is highly dependent on the amount of debt that is carried. When debt levels are higher, Vermilion will be more active in protecting its cash flow stream through its commodity price risk management strategy.

When executing its commodity price risk management programs, Vermilion uses financial instruments encompassing over-the-counter financial structures as well as fixed/collar structures to economically hedge a part of its physical natural gas and oil sales. Vermilion has strict controls and guidelines in relation to these activities and contracts only with counter parties that have high credit ratings. For additional information associated with Vermilion's use of financial instruments, please see note 18 of Vermilion's consolidated financial statements for the years ended December 31, 2010 and 2009.

CRITICAL ACCOUNTING ESTIMATES

Vermilion's financial and operating results contain estimates made by management in the following areas:

i. Capital expenditures are based on estimates of projects in various stages of completion;
ii. Revenues, royalties and operating costs include accruals based on estimates of management;
iii. Fair value of derivative instruments are based on estimates that are subject to the fluctuation of commodity prices and foreign exchange rates;
iv. Depletion, depreciation and accretion are based on estimates of oil and gas reserves that Vermilion expects to recover in the future;
v. Asset retirement obligations are based on estimates of future costs and the timing of expenditures;
vi. The future recoverable value of capital assets and goodwill are based on estimates that Vermilion expects to realize;
vii. Equity compensation expense is determined using accepted fair value approaches which rely on historical data and certain estimates made by management; and
viii. The amount recorded as due to the vendor pursuant to the Corrib acquisition is dependent on management's estimate of the timing of first gas.

SENSITIVITIES

Crude oil and natural gas prices may change significantly because of factors Vermilion cannot control. The following table provides a summary of estimated sensitivities to price fluctuations for pro-forma production levels and expenses for the year ended December 31, 2010.

	Change in Cash Available for Dividends Per Share	Change in Cash Available for Dividends
Change in crude oil price by US $1.00/bbl	$ 0.07	$ 6.6 million
Change in natural gas price by $0.10/mcf	$ 0.02	$ 1.4 million
Change in interest rate by one point	$ 0.05	$ 4.9 million
Change in Cdn/US foreign exchange rate by one point	$ 0.04	$ 4.0 million
Change in Cdn/Euro foreign exchange rate by one point	$ -	$ 0.1 million

OFF BALANCE SHEET ARRANGEMENTS

Vermilion has certain lease agreements that are entered into in the normal course of operations. All leases are operating leases and accordingly no asset or liability value has been assigned in the balance sheet as of December 31, 2010.

Vermilion uses a variety of derivatives including puts, calls and forward purchase contracts to manage the risks associated with fluctuating commodity prices and exchange rates. Vermilion does not obtain collateral or other security to support its financial derivatives as Vermilion reviews the creditworthiness of the counterparty prior to entering into a derivative contract.

Vermilion has not entered into any guarantee or off balance sheet arrangements that would adversely impact Vermilion's financial position or results of operations.

ENVIRONMENT, HEALTH AND SAFETY

Vermilion is committed to ensure it conducts its activities in a manner that will protect the health and safety of its employees, contractors and the public. The heath, safety and environment vision is to fully integrate health, safety and environment into Vermilion's business, where its culture is recognized as a model by industry and stakeholders, resulting in a workplace free of incidents.

Vermilion will maintain health, safety and environmental practices and procedures that comply or exceed regulatory requirements and industry standards. It is a condition of employment that Vermilion personnel work safely and in accordance with established regulations and procedures.

In 2010, Vermilion remained committed to the principles of the Environment, Health and Safety Stewardship Program set out by the Canadian Association of Petroleum Producers. This voluntary initiative promotes continual improvement in the areas of environment, health and safety performance, supplemented by progress reports to stakeholders.

Vermilion continued its commitment to reduce impacts to land, water and air, as policies and procedures demonstrating leadership in these areas, were maintained and further developed in 2010. Examples of accomplishments during the year included:

- Continuation of third party audits on our Health Safety and Environment ("HSE") Management System;
- Reducing long-term environmental liabilities through decommissioning, abandoning and reclaiming well leases and facilities;
- Continuous auditing and management inspections;
- Development, communication and measurement against leading and lagging HSE key performance indicators;
- Reducing waste products by reducing, recycling and recovering; and
- Continuing risk management efforts with detailed emergency-response planning.

Vermilion is a member of several organizations concerned with environment, health and safety, including numerous regional co-operatives and synergy groups. In the area of stakeholder relations, Vermilion works to build long-term relationships with environmental stakeholders and communities.

INTERNATIONAL FINANCIAL REPORTING STANDARDS ("IFRS") TRANSITION

Background

Publicly accountable enterprises such as Vermilion must begin to report their financial results under IFRS in 2011. Accordingly, in 2008, Vermilion formed an internal IFRS transition team and retained the services of a large international public accounting firm to advise Vermilion on its IFRS conversion program. Initially, the transition team focused on completing a scoping diagnostic to determine the areas of significant difference between Canadian GAAP and IFRS and the related reporting and information system issues. Since completing the scoping diagnostic, Vermilion's transition team has drafted accounting policy papers which are reviewed by the advising public accounting firm.

Project Status

Vermilion is currently finalizing its IFRS accounting policies and has actively worked with peer entities to select, when appropriate and practicable, consistent accounting policies in an effort to preserve comparability. Vermilion remains focused on the transition to IFRS and is preparing financial statements under both Canadian GAAP and IFRS for 2010 to provide for comparative financial statements after the official changeover in 2011.

The following discussion provides additional information on Vermilion's IFRS conversion. The Company cannot guarantee that this information will not change before its first IFRS financial statements are issued.

Opening Balance Sheet under IFRS

The following table summarizes Vermilion's consolidated balance sheet as at January 1, 2010 under Canadian GAAP and the adjustments required to conform with IFRS. These figures are unaudited and subject to change.

($M)	Canadian GAAP January 1, 2010	IFRS Adjustments	IFRS January 1, 2010
ASSETS			
Current	$ 256,886	$ -	$ 256,886
Non-current	1,827,790	17,855	1,845,645
	$ 2,084,676	$ 17,855	$ 2,102,531
LIABILITIES			
Current	$ 217,563	$ 4,089	$ 221,652
Non-current (includes non-controlling interest)	827,823	283,576	1,111,399
SHAREHOLDERS' EQUITY	1,039,290	(269,810)	769,480
	$ 2,084,676	$ 17,855	$ 2,102,531

In general, the changes associated with IFRS impact the accounting for non-cash items. Accordingly, Vermilion believes that most of its key performance measures such as fund flows from operations, net debt and capital expenditures, will be minimally impacted by the transition to IFRS.

Accounting for Capital Assets Including Impairment

There are a number of significant differences associated with accounting for capital assets under IFRS versus Canadian GAAP which will impact Vermilion. Under Canadian GAAP's full-cost accounting, expenditures related to oil and gas assets are aggregated on a country-by-country basis for depletion and impairment testing purposes. Under IFRS, the unit of account for both depletion ("depletion units") and impairment testing ("cash generating units") must be significantly smaller and accordingly, non-cash impairments are more likely under IFRS than under Canadian GAAP full-cost accounting. In addition, Canadian GAAP specifies a two part impairment test approach which is designed to reduce the frequency of impairment writedowns. IFRS does not permit this two part approach and instead a company must determine the recoverable amount of an asset when there are indications that it may be impaired. Unlike Canadian GAAP, IFRS generally requires that impairments be reversed in future periods if the recoverable amount of an asset increases beyond its carrying amount (as a result of increased commodity prices, for example). At present, Vermilion has identified a total of 72 depletion units and 12 cash generating units.

Vermilion intends to calculate depletion under IFRS using proved plus probable reserves as the reserve base. Under Canadian GAAP, depletion must be calculated using proved reserves. Vermilion believes this approach better reflects the fact that the balance sheet includes costs that are attributable to probable reserves. The effect of the change is a decrease in depletion expense of approximately 20% to 25%.

On July 23, 2009, the International Accounting Standards Board ("IASB") issued amendments to IFRS 1, "First-time Adoption of International Financial Reporting Standards" that greatly reduced the amount of effort required upon transition to IFRS for entities such as Vermilion that have historically applied the full-cost method of accounting. Under the amendment, Canadian GAAP full cost pools are allocated to smaller units of account at the transition date of January 1, 2010 based on either reserve volumes or values and, currently, Vermilion intends to rely on this exemption and perform this allocation based on reserve values.

Vermilion's current accounting systems and processes are capable of accounting for capital assets at the more detailed level required under IFRS.

Functional Currency

Under Canadian GAAP, Vermilion concluded that the functional currency of its foreign operating subsidiaries is the Canadian dollar. As a result of differences in the requirements for functional currency determination, Vermilion has concluded that under IFRS, the functional currency of its foreign operating subsidiaries will be their local currencies. As a consequence of this change, gains and losses related to the translation of the financial statements of these subsidiaries will be recorded through other comprehensive income and will not impact net income. In addition, the capital asset accounts of Vermilion's foreign operating subsidiaries will be translated to Canadian dollars at the foreign exchange rates in effect at the balance sheet date whereas presently, these capital asset accounts are translated at historical rates of exchange.

Income Taxes

Vermilion has evaluated the differences between International Accounting Standard 12, "Income Taxes" and the relevant Canadian GAAP requirements and has concluded that the impact on the deferred tax accounting will be minimal.

Vermilion has concluded that under IFRS, Petroleum Resource Rent Tax ("PRRT") paid in Australia will be classified as an income tax whereas under Canadian GAAP, Vermilion presents PRRT as a royalty. Vermilion will also be required to record deferred taxes related to PRRT.

Accounting for Trust Units and Exchangeable Shares

In Canada, units issued by investment trusts are redeemable by unitholders and under IFRS, unless certain specific criteria are met to receive an exemption, redeemable securities cannot be classified as permanent equity. Although Vermilion converted to a corporation in September 2010, Vermilion needed to determine if it met the criteria for this exemption to conclude on the appropriate presentation for the pre-conversion period. After reviewing this issue, Vermilion believes it meets the required criteria to present its trust units as equity for the period prior to the corporate conversion.

Vermilion has concluded that this exemption does not extend to its exchangeable shares and accordingly, the exchangeable shares will be presented as a liability carried at market value for the period prior to the corporate conversion. This difference will result in a reduction to retained earnings upon transition to IFRS of approximately $117.2 million.

Equity Based Compensation

Vermilion believes that, under IFRS, the redemption feature associated with the trust units require it to present the recognized, but unvested value of equity based compensation awards as a liability through the date of the corporate conversion. The carrying amount of the liability will be remeasured at each reporting date and will be based on the market value of the underlying trust units. The changes in the liability will be reflected as a non-cash expense or recovery in the statement of earnings. Upon conversion to a corporation, the outstanding liability is reclassified to contributed surplus and subsequent changes in Vermilion's share price will not impact total compensation expense recognized.

Under IFRS, Vermilion will estimate the amount of forfeitures expected in relation to its equity based compensation plan and will reflect such estimates in the related expense. Under Canadian GAAP, forfeitures are accounted for as they occur.

Asset Retirement Obligations

The basic fundamental premise underlying the accounting for asset retirement obligations is consistent between Canadian GAAP and IFRS, however under the latter, the liability is remeasured at each reporting date using the current risk free interest rate. As Vermilion is electing to use the IFRS 1 deemed cost accounting exemption noted above, upon transition Vermilion will recognize its asset retirement obligations at the amounts required under IFRS and will record the difference between those amounts, and the Canadian GAAP values, against retained earnings. At present, it is unclear if IFRS permits the inclusion of an adjustment for credit risk as is required under Canadian GAAP. If the asset retirement obligations are measured using a risk-free discount rate excluding an adjustment for credit risk, the impact would be an increase in the liability and a decrease to retained earnings of $137.6 million. The summarized opening balance sheet presented reflects the use of a risk-free rate that excludes credit risk.

Revenue

Under IFRS, Vermilion has concluded that it is appropriate to present revenue net of royalties on the income statement. Vermilion will continue to disclose revenue, gross of royalties, as a non-GAAP measure in its MD&A and in its netback calculations.

Issues Associated with the Initial Adoption of IFRS

In addition to the IFRS 1 deemed cost accounting exemption, Vermilion has concluded that it will use additional exemptions associated with business combinations and cumulative translation differences related to the change in the functional currency of Vermilion's operating subsidiaries as described above.

As noted previously, Vermilion has conducted a review of its accounting systems and processes and, as a result of various upgrades that have been completed over recent years, Vermilion's current systems and processes will accommodate the transition to IFRS.

Vermilion has established internal controls associated with the IFRS transition which include approvals at various stages of the project and Vermilion continues to work closely with its advising public accounting firm in relation to the IFRS conversion.

CORPORATE GOVERNANCE

Vermilion is committed to a high standard of corporate governance practices, a dedication that begins at the Board level and extends throughout the Company. We believe good corporate governance is in the best interest of our shareholders, and that successful companies are those that deliver growth and a competitive return along with a commitment to the environment, to the communities where they operate and to their employees.

We comply with the objectives and guidelines relating to corporate governance adopted by the Canadian Securities Administrators and the Toronto Stock Exchange. In addition, the Board monitors and considers the implementation of corporate governance standards proposed by various regulatory and non-regulatory authorities in Canada. A full examination of our corporate governance policies will be provided in our Management Proxy Circular, which will be filed on SEDAR (www.sedar.com) and mailed to all shareholders on April 8, 2011.

DISCLOSURE CONTROLS AND PROCEDURES

Vermilion's officers have established and maintained disclosure controls and procedures and evaluated the effectiveness of these controls in conjunction with Vermilion's filings.

As of December 31, 2010, Vermilion has evaluated the effectiveness of the design and operation of Vermilion's disclosure controls and procedures. Based on this evaluation, the Chief Executive Officer and Chief Financial Officer have concluded and certified that Vermilion's disclosure controls and procedures are effective.

INTERNAL CONTROL OVER FINANCIAL REPORTING

A company's internal control over financial reporting is a process to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Management has assessed the effectiveness of Vermilion's internal control over financial reporting as defined in Rule 13a-15 under the US Securities Exchange Act of 1934 and as defined in Canada by National Instrument 52-109, Certification of Disclosure in Issuers' Annual and Interim Filings. Management concluded that Vermilion's internal control over financial reporting was effective as of December 31, 2010. The effectiveness of Vermilion's internal control over financial reporting as of December 31, 2010 has been audited by Deloitte & Touche LLP, as reflected in their report for 2010 as filed with the US Securities and Exchange Commission. No changes were made to Vermilion's internal control over financial reporting during the year ending December 31, 2010, that have materially affected, or are reasonably likely to materially affect, the internal controls over financial reporting.

MANAGEMENT'S REPORT TO SHAREHOLDERS

The accompanying consolidated financial statements of Vermilion Energy Inc. are the responsibility of management and have been approved by the Board of Directors of Vermilion Energy Inc. The consolidated financial statements have been prepared in accordance with accounting policies detailed in the notes to the consolidated financial statements and are in accordance with accounting principles generally accepted in Canada. Where necessary, management has made informed judgements and estimates of transactions that were not complete at the balance sheet date. Financial information throughout the Annual Report is consistent with the consolidated financial statements.

Management ensures the integrity of the consolidated financial statements by maintaining high-quality systems of internal control. Procedures and policies are designed to provide reasonable assurance that assets are safeguarded and transactions are properly recorded, and that the financial records are reliable for preparation of the consolidated financial statements.

Deloitte & Touche LLP, Vermilion's external auditors, have conducted an audit of the consolidated financial statements in accordance with Canadian generally accepted auditing standards and have provided their report.

The Board of Directors is responsible for ensuring that management fulfills its responsibility for financial reporting and internal control. The Board carries out this responsibility principally through the Audit Committee, which is appointed by the Board and is comprised entirely of independent Directors. The Committee meets periodically with management and Deloitte & Touche LLP to satisfy itself that each party is properly discharging its responsibilities and to review the consolidated financial statements, the Management's Discussion and Analysis and the external Auditor's Report before they are presented to the Board of Directors.

("Lorenzo Donadeo")

Lorenzo Donadeo
President & Chief Executive Officer
March 10, 2011

("Curtis W. Hicks")

Curtis W. Hicks
Executive Vice President & Chief Financial Officer

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of Vermilion Energy Inc.:

We have audited the accompanying consolidated financial statements of Vermilion Energy Inc. and subsidiaries (the "Company") which comprise the consolidated balance sheets as at December 31, 2010 and 2009, and the consolidated statements of earnings, comprehensive income and retained earnings, and cash flows for the years then ended, and the notes to the consolidated financial statements.

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.

Auditor's 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 the auditor's 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, the auditor considers 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 opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Vermilion Energy Inc. and subsidiaries as at December 31, 2010 and 2009 and the results of their operations and their cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Other matter

On March 10, 2011, we reported separately to the Board of Directors and Shareholders of Vermilion Energy Inc. on our audits, conducted in accordance with Canadian generally accepted auditing standards and the standards of the Public Company Accounting Oversight Board (United States), of the consolidated financial statements for the same periods, prepared in accordance with Canadian generally accepted accounting principles, but which included Note 21, Differences Between Canadian and United States of America Generally Accepted Accounting Principles.

("Deloitte & Touche LLP")

Chartered Accountants
Calgary, Alberta
March 10, 2011

CONSOLIDATED BALANCE SHEETS
DECEMBER 31
(THOUSANDS OF CANADIAN DOLLARS)

	2010	2009
ASSETS		
Current		
Cash and cash equivalents (Note 16)	$ 145,623	$ 99,066
Short-term investments	15,132	15,895
Accounts receivable	147,329	117,051
Crude oil inventory	10,707	5,235
Derivative instruments (Note 12)	10,249	8,217
Prepaid expenses and other	11,157	11,422
Future income taxes (Note 7)	2,902	-
	343,099	256,886
Derivative instruments (Note 12)	942	7,896
Future income taxes (Note 7)	151,477	119,714
Long-term investments	3,108	4,342
Goodwill (Note 9)	51,589	19,840
Reclamation fund (Note 5)	-	69,003
Capital assets (Note 4)	2,031,501	1,606,995
	$ 2,581,716	$ 2,084,676
LIABILITIES		
Current		
Accounts payable and accrued liabilities	$ 253,086	$ 197,633
Dividends or distributions payable	16,910	15,109
Derivative instruments (Note 12)	12,143	1,772
Income taxes payable	58,795	2,366
Future income taxes (Note 7)	-	683
	340,934	217,563
Derivative instruments (Note 12)	1,767	-
Long-term debt (Note 6)	302,558	159,723
Amount due pursuant to acquisition (Note 3)	114,349	111,402
Asset retirement obligations (Note 5)	274,560	237,110
Future income taxes (Note 7)	246,982	218,764
	1,281,150	944,562
Non-controlling interest - exchangeable shares (Note 9)	-	100,824
SHAREHOLDERS' OR UNITHOLDERS' EQUITY		
Shareholders' capital (Note 8)	1,045,930	-
Unitholders' capital (Note 8)	-	711,667
Contributed surplus (Note 8)	39,841	30,413
Retained earnings	214,795	297,210
	1,300,566	1,039,290
	$ 2,581,716	$ 2,084,676

APPROVED BY THE BOARD

("W. Kenneth Davidson")

W. Kenneth Davidson, Director

("Lorenzo Donadeo")

Lorenzo Donadeo, Director

CONSOLIDATED STATEMENTS OF EARNINGS, COMPREHENSIVE INCOME AND RETAINED EARNINGS
YEARS ENDED DECEMBER 31
(THOUSANDS OF CANADIAN DOLLARS, EXCEPT SHARE OR UNIT AND PER SHARE OR UNIT AMOUNTS)

		2010		2009
REVENUE				
Petroleum and natural gas revenue	$	727,805	$	639,751
Royalties		(83,509)		(97,632)
		644,296		542,119
EXPENSES AND OTHER EXPENSE (INCOME)				
Operating		144,595		139,606
Transportation		26,698		18,939
Equity based compensation (Note 10)		28,170		18,196
Loss (gain) on derivative instruments (Note 12)		3,906		(4,526)
Interest		13,370		13,268
General and administration		42,842		31,192
Foreign exchange (gain)		(26,132)		(39,894)
Other expense (income)		2,469		(8,021)
Depletion, depreciation and accretion		271,556		248,726
		507,474		417,486
EARNINGS BEFORE INCOME TAXES AND OTHER ITEMS		136,822		124,633
INCOME TAXES (NOTE 7)				
Future		(55,383)		(30,963)
Current		72,701		29,429
		17,318		(1,534)
OTHER ITEMS				
Non-controlling interest - exchangeable shares (Note 9)		8,241		17,977
(Gain) related to equity method investment (Note 3)		-		(77,308)
		8,241		(59,331)
NET EARNINGS AND COMPREHENSIVE INCOME		111,263		185,498
Retained earnings, beginning of year		297,210		280,959
Distributions declared (Note 8)		(122,236)		(166,385)
Dividends declared (Note 8)		(67,508)		-
Equity-settled distributions on vested equity based awards (Note 8)		(3,934)		(2,862)
RETAINED EARNINGS, END OF YEAR	$	214,795	$	297,210
NET EARNINGS PER SHARE OR UNIT (NOTE 11)				
Basic	$	1.34	$	2.56
Diluted	$	1.32	$	2.53
WEIGHTED AVERAGE SHARES OR UNITS OUTSTANDING (NOTE 11)				
Basic		83,155,116		72,405,606
Diluted		84,497,279		80,569,607

CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31
(THOUSANDS OF CANADIAN DOLLARS)

	2010	2009
OPERATING		
Net earnings	$ 111,263	$ 185,498
Adjustments:		
Depletion, depreciation and accretion	271,556	248,726
Change in unrealized gains and losses and accruals relating to derivative contracts (Note 12)	17,060	863
Equity based compensation	28,170	18,196
(Gain) related to equity method investment	-	(77,308)
Unrealized foreign exchange (gain)	(20,509)	(40,374)
Non-controlling interest - exchangeable shares	8,241	17,977
Change in unrealized gains and losses and accruals included in other expense (income) relating to investments	3,089	(8,052)
Proceeds from held for trading investments	-	2,674
Future income taxes	(55,383)	(30,963)
	363,487	317,237
Asset retirement obligations settled (Note 5)	(6,861)	(10,139)
Changes in non-cash operating working capital (Note 13)	64,656	(76,782)
Cash flows from operating activities	421,282	230,316
INVESTING		
Drilling and development of petroleum and natural gas properties	(432,182)	(194,666)
Acquisition of petroleum and natural gas properties	(6,655)	(159,536)
Proceeds from (purchase of) short-term investments	64,889	(6,404)
Long-term investment (Note 3)	-	136,479
Withdrawals from the reclamation fund (Note 5)	812	-
Changes in non-cash investing working capital (Note 13)	14,073	(1,631)
Cash flows (used in) investing activities	(359,063)	(225,758)
FINANCING		
Increase (decrease) in long-term debt	142,700	(37,053)
Issue of trust units for cash (Note 8)	-	240,178
Issue of common shares or trust units pursuant to the dividend or distribution reinvestment plans	40,824	-
Cash distributions	(121,966)	(164,616)
Cash dividends	(65,977)	-
Cash flows (used in) from financing activities	(4,419)	38,509
Foreign exchange (loss) on cash held in foreign currencies	(11,243)	(11,232)
Net change in cash and cash equivalents	46,557	31,835
Cash and cash equivalents, beginning of year	99,066	67,231
Cash and cash equivalents, end of year (Note 16)	$ 145,623	$ 99,066
Supplementary information - cash payments		
Interest paid	$ 13,585	$ 12,301
Income taxes paid	$ 16,272	$ 84,686

1. BASIS OF PRESENTATION AND CORPORATE CONVERSION

Vermilion Energy Inc. ("Vermilion" or the "Company") is actively engaged in the business of oil and natural gas development, acquisition and production. The Company is the successor entity to Vermilion Energy Trust (the "Trust") following a corporate conversion completed on September 1, 2010 pursuant to an arrangement under the Business Corporations Act (Alberta).

As a result of that conversion, units of the Trust were converted to common shares of Vermilion on a one-for-one basis and holders of exchangeable shares in Vermilion Resources Ltd. received 1.89344 common shares for each exchangeable share held (see Note 9). There were no exchangeable shares outstanding following the conversion.

The conversion was accounted for on a continuity of interests basis, which recognizes Vermilion as the successor entity and accordingly, all comparative information presented for the pre-conversion period is that of the Trust. All transaction costs associated with the conversion were expensed as incurred as general and administration expense.

2. SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation
The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("Canadian GAAP" or "GAAP") and include the accounts of Vermilion and its subsidiaries, all of which are wholly owned, on a consolidated basis. Intercompany account balances and transactions are eliminated upon consolidation.

Vermilion currently has no variable interest entities of which it is the primary beneficiary and accordingly the consolidated financial statements do not include the accounts of any such entities.

Petroleum and Natural Gas Operations
Vermilion uses the full-cost method of accounting for petroleum and natural gas operations and capitalizes all exploration and development costs on a country-by-country basis. These costs include land acquisition, geological and geophysical costs, drilling on producing and non-producing properties, overhead costs related to exploration and development and other carrying charges on unproven properties. Proceeds of disposition are applied against the cost pools with no gain or loss recognized except where the disposition results in a 20% or greater change in the rate of depletion and depreciation.

Amortization of these costs plus future development costs to develop proved reserves is calculated on a country-by-country basis using the unit-of-production method based on estimated proved reserves, before royalties, as determined by independent engineers. The cost of significant unevaluated properties is excluded from the depletion and depreciation base. For the purpose of the depletion and depreciation calculations, oil and gas reserves are converted to a common unit of measure on the basis of their relative energy content based on a conversion ratio of six thousand cubic feet of natural gas to one barrel of oil.

At least annually, the carrying value of Vermilion's petroleum and natural gas properties is compared to the sum of the undiscounted cash flows expected to result from Vermilion's proved reserves on a country-by-country basis (the "ceiling test"). If the carrying value is not fully recoverable, the amount of impairment is measured by comparing the carrying amounts of the assets to the estimated net present value of future cash flows from proved plus probable reserves. This calculation incorporates risks and uncertainties in the expected future cash flows which are discounted using a risk-free rate. Any excess carrying value above the net present value of the future cash flows would be recorded as a permanent impairment which is charged to earnings.

A significant portion of the exploration, development and production activities of Vermilion are conducted jointly with others and, accordingly, the consolidated financial statements reflect only Vermilion's proportionate interest in such activities.

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Vermilion recognizes the estimated liability associated with an asset retirement obligation in the consolidated financial statements at the time the liability is incurred. The estimated fair value of the asset retirement obligation is recorded as a long term liability, with a corresponding increase in the carrying amount of the related asset. The capitalized amount is depleted using the unit-of-production method over estimated proved reserves. The liability amount is increased each reporting period due to the passage of time and this accretion is charged to earnings in the period. The asset retirement obligation can also increase or decrease due to changes in the estimated timing of cash flows or changes in the original estimated undiscounted costs. Actual costs incurred upon settlement of the asset retirement obligation are charged against the asset retirement obligation to the extent of the liability recorded.

The amounts recorded for depletion and depreciation of property, plant and equipment are based on estimates. The ceiling test for the recoverability of Vermilion's petroleum and natural gas properties is based on the cash flows expected to result from Vermilion's reserves. The asset retirement obligation is based on estimated liabilities related to legal obligations associated with future retirement of property, plant and equipment. By their nature, these estimates are subject to measurement uncertainty and the effect on the consolidated financial statements from changes in such estimates in future years could be significant.

Cash and Cash Equivalents
Cash and cash equivalents include monies on deposit and guaranteed investments that have an original maturity date of not more than 90 days.

Short-Term Investments
Short-term investments are comprised of guaranteed investment certificates with an original maturity date of greater than 90 days.

Furniture and Equipment
Furniture and equipment are recorded at cost and are amortized on a declining-balance basis at rates of 20% to 50% per year.

Crude Oil Inventory
Inventories of crude oil, consisting of production for which title has not yet transferred to the buyer are valued at the lower of cost or net realizable value. Cost is determined on a weighted-average basis.

Long-Term Investments
Long-term investments over which Vermilion does not have significant influence are carried at fair value. Dividends received or receivable from the investments are included in Vermilion's net earnings, with no adjustment to the carrying amount of the investment.

In 2009, the Trust's investment in Verenex Energy Inc. ("Verenex") was subject to equity method accounting. On December 21, 2009, the Trust sold its investment in Verenex (see Note 3) and accordingly, as at December 31, 2010 and 2009, the Trust did not have any investments which were subject to equity method accounting.

Goodwill
Goodwill is tested for impairment at least annually by comparing the fair value of the reporting unit with its carrying amount. If the carrying amount exceeds the fair value, an impairment loss is recognized for the excess.

Revenue Recognition
Revenues associated with the sale of crude oil, natural gas and natural gas liquids are recorded when title passes to the customer. For Canadian natural gas production, legal title transfer occurs at the intersection of major pipelines (referred to as the "Hub") whereas the majority of Vermilion's Canadian oil production is sold at the well head. In Australia, oil is sold at the Wandoo B Platform, in the Netherlands natural gas is sold at the plant gate and in France oil is sold when delivered to the pipeline or when delivered to the refinery via tanker.

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Financial Instruments
Cash and cash equivalents and short-term investments are classified as held for trading and are measured at fair value. A gain or loss arising from a change in the fair value is recognized in net earnings in the current period.

Accounts receivable are classified as loans and receivables and are initially measured at fair value and are then subsequently measured at amortized cost. The carrying value approximates the fair value due to the short-term nature of these instruments.

Accounts payable and accrued liabilities, dividends or distributions payable, long-term debt and amount due pursuant to acquisition, have been classified as other financial liabilities and are initially recognized at fair value and subsequently are measured at amortized cost. Transaction costs and discounts are recorded against the fair value of long-term debt on initial recognition.

All derivative, debt and equity security investments not subject to consolidation or equity method accounting have been classified as held for trading and are measured at fair value. Accordingly, gains and losses are reflected in net income in the period in which they arise. Gains and losses associated with Vermilion's investments in debt and equity securities are included in other expense (income) in the consolidated statements of earnings.

Equity Based Compensation
Vermilion has equity based long-term compensation plans for directors, officers and employees of Vermilion and its subsidiaries. The expense recognized for equity based compensation awards is measured as the grant date fair value of the award adjusted for the ultimate number of awards that actually vest as determined by the Company's achievement of a number of performance conditions. Equity based compensation expense is recognized in earnings over the vesting period of the awards with a corresponding adjustment to contributed surplus.

Upon vesting, the amount previously recognized in contributed surplus is reclassified to shareholders' capital. Vermilion has not incorporated an estimated forfeiture rate for awards that will not vest and instead, Vermilion accounts for forfeitures as they occur.

Per Share or Unit Amounts
Net earnings per share or unit are calculated using the weighted-average number of shares or units outstanding during the period. Diluted net earnings per share are calculated using the treasury stock method to determine the dilutive effect of equity based compensation plans and outstanding exchangeable shares. The treasury stock method assumes that the deemed proceeds related to unrecognized equity based compensation expense are used to repurchase shares or units at the average market price during the period. Equity based compensation awards outstanding are included in the calculation of diluted net earnings per share or unit based on estimated performance factors.

Foreign Currency Translation
The financial position and results of foreign subsidiaries, all of which are considered to be integrated, are translated on the following basis:

- Monetary assets and liabilities are translated at the rates of exchange prevailing at the balance sheet dates;
- Non-monetary assets, liabilities and related depreciation and depletion expense are translated at historical rates; and
- Sales, other revenues, royalties and all other expenses are translated at an appropriately weighted average exchange rate.

Any resulting foreign exchange gains and losses are included in earnings.

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Income Taxes

Future income taxes are calculated using the liability method whereby income tax liabilities and assets are recognized for the estimated tax consequences attributable to temporary differences between the amounts reported in the consolidated financial statements of Vermilion and their respective tax bases using substantively enacted income tax rates in the respective jurisdictions that will be in effect when the differences are expected to reverse. The effect of a change in income tax rates on future income tax liabilities and assets is recognized in income in the period in which the related legislation is substantively enacted.

Vermilion is subject to current income taxes based on the tax legislation of each respective country in which Vermilion has operations.

Exchangeable Shares - Non-controlling Interest

The exchangeable shares issued pursuant to the Plan of Arrangement were initially recorded at their pro-rata percentage of the carrying value of the equity of Vermilion Resources Ltd. When the exchangeable shares were converted into shares, the conversion was accounted for as an acquisition of the non-controlling interest at fair value. Upon conversion of the exchangeable shares, the fair value of the shares issued was recorded in shareholders' or unitholders' capital, and the difference between the carrying value of the non-controlling interest and the fair value of the shares was recorded as capital assets or goodwill, as appropriate.

Capitalized Interest

Borrowing costs that are directly attributable to the acquisition or construction of an asset that necessarily takes a substantial period of time to get ready for its intended use are capitalized as part of the cost of that asset.

3. ACQUISITIONS AND DISPOSITIONS

a) Corrib Acquisition

On July 30, 2009, Vermilion completed the acquisition of an 18.5% non-operated interest in the Corrib gas field located off the northwest coast of Ireland for cash consideration of $136.8 million. Pursuant to the terms of the acquisition agreement, Vermilion will make an additional future payment to the vendor, the amount of which will be between US $135 million and US $300 million depending on the date when first commercial gas is achieved. Management expects that first commercial gas would be achieved at the end of 2012 and that the resulting payment to the vendor will be US $135 million.

To reflect the future payment due to the vendor, Vermilion has recognized a non-current liability which was determined by discounting the expected future payment of US $135 million. The discount rate used to present value this obligation was 8%, which is Vermilion's best estimate of the interest rate that would result from an arm's length borrowing transaction associated with the purchase of these assets. The cost of this acquisition, which is not a business combination for accounting purposes, was allocated as follows:

Capital assets	$	228,898
Future income tax assets		86,074
Asset retirement obligation		(9,788)
Working capital		(57,507)
Total consideration	$	247,677

Comprised of:		
Cash	$	136,832
Present value of estimated future payment due to vendor		110,845
Total consideration	$	247,677

3. ACQUISITIONS AND DISPOSITIONS (Continued)

b) Disposition of Verenex and Related Party Transaction

On December 21, 2009, Vermilion completed the previously announced sale of its 18.8 million shares of Verenex, representing Vermilion's entire investment in that entity, at $7.29 per share resulting in net proceeds of $136.5 million. The gain associated with this sale transaction was $80.5 million and is reflected as a gain related to equity method investment on the consolidated statement of earnings. Also included within the gain related to equity method investment on the consolidated statement of earnings is the equity method loss of $3.2 million for the period prior to the sale transaction.

During the first quarter of 2009, Vermilion acquired a gross overriding royalty from Verenex for cash consideration of $4.5 million. At the time, Vermilion owned 42% of Verenex. The transaction was accounted for at the exchange amount and is recorded as acquisition of petroleum and natural gas properties on the consolidated statement of cash flows.

4. CAPITAL ASSETS

2010	Cost	Accumulated Depletion, Depreciation and Amortization	Net Book Value
Petroleum and natural gas properties and equipment	$ 3,593,831	$ 1,576,903	$ 2,016,928
Furniture and equipment	25,840	11,267	14,573
	$ 3,619,671	$ 1,588,170	$ 2,031,501

2009	Cost	Accumulated Depletion, Depreciation and Amortization	Net Book Value
Petroleum and natural gas properties and equipment	$ 2,929,311	$ 1,325,568	$ 1,603,743
Furniture and equipment	12,450	9,198	3,252
	$ 2,941,761	$ 1,334,766	$ 1,606,995

As at December 31, 2010, Vermilion excluded $101.5 million (2009 - $20.4 million) of undeveloped properties from the depletion and depreciation calculation. During the year ended December 31, 2010, Vermilion capitalized $1.3 million (2009 - $4.2 million) of overhead costs related to exploration and development activities and $8.8 million (2009 - $3.2 million) of interest expense associated with the unwinding of the discount on the amount due to the vendor pursuant to the Corrib acquisition (see Note 3). The Company recorded an increase in capital assets of $189.9 million in connection with the corporate conversion and the associated acquisition of the non-controlling interest in 2010 (see Notes 1 and 9).

Vermilion performed ceiling tests at December 31, 2010 and 2009 to assess whether the carrying value of petroleum and natural gas properties and equipment is recoverable. Based on the calculations, the undiscounted future cash flows from Vermilion's proved reserves exceeded the carrying values of Vermilion's petroleum and natural gas properties and equipment in each cost centre at December 31, 2010 and 2009 and therefore, the carrying values are considered recoverable.

4. CAPITAL ASSETS (Continued)

The benchmark prices used in the December 31, 2010 calculations are as follows:

CDN$/BOE	Canada	France	Netherlands	Australia	Ireland
2011	$ 49.36	$ 81.01	$ 61.21	$ 90.31	$ -
2012	$ 52.72	$ 81.21	$ 58.36	$ 90.05	$ -
2013	$ 55.48	$ 81.89	$ 56.92	$ 90.31	$ 57.13
2014	$ 58.52	$ 85.39	$ 58.21	$ 92.35	$ 58.36
2015	$ 60.86	$ 88.21	$ 60.25	$ 95.58	$ 60.32
2016	$ 62.77	$ 90.34	$ 61.78	$ 98.01	$ 61.79
2017	$ 64.85	$ 92.73	$ 63.52	$ 100.78	$ 63.47
2018	$ 66.85	$ 94.95	$ 65.11	$ 103.31	$ 65.00
2019	$ 69.28	$ 97.36	$ 66.86	$ 106.07	$ 66.68
2020	$ 71.55	$ 99.28	$ 68.22	$ 108.23	$ 67.99
Average increase thereafter	2.0%	2.0%	2.0%	2.0%	2.0%

5. ASSET RETIREMENT OBLIGATIONS AND RECLAMATION FUND

The asset retirement obligations were determined based on the estimated future costs and timing to reclaim Vermilion's net interest in all wells and facilities. Vermilion has estimated the net present value of its asset retirement obligations to be $274.6 million as at December 31, 2010 (2009 - $237.1 million) based on a total undiscounted future liability after inflation adjustment of $967.5 million (2009 - $857.2 million). These payments are expected to be made over the next 45 years with most of the costs being incurred between 2011 and 2041. Vermilion used a credit adjusted risk free rate of 8% and inflation rates between 1.4% and 2.6% to calculate the present value of the asset retirement obligations.

The following table reconciles the change in Vermilion's asset retirement obligations:

	2010	2009
Carrying amount, beginning of year	$ 237,110	$ 265,101
Increase in liabilities from drilling activities or acquisitions	885	10,173
Liabilities settled	(6,861)	(10,139)
Changes in estimates	36,301	(24,456)
Accretion expense	18,152	20,255
Foreign exchange	(11,027)	(23,824)
Carrying amount, end of year	$ 274,560	$ 237,110

During the years ended December 31, 2010 and 2009, Vermilion reviewed the estimates underlying its asset retirement obligations. The resulting adjustments are categorized as changes in estimates in the table above. The change in estimate recorded in the current year resulted from the availability of better data associated with the abandonment obligations for Vermilion's Netherlands operations.

Vermilion had previously established a reclamation fund to provide for the ultimate payout of the environmental and site restoration costs on its asset base. After an extensive review, Vermilion concluded that the reclamation fund assets would be more effectively employed supporting Vermilion's operations and in July 2010, the reclamation fund assets were liquidated. During 2010, Vermilion withdrew $0.8 million from the reclamation fund before it was liquidated (2009 - $nil).

As at December 31, 2009 Vermilion's reclamation fund investments consisted of:

	2009
Cash and short term investments, at fair value	$ 22,028
Equity and debt securities, at fair value	46,975
	$ 69,003

6. LONG-TERM DEBT

As at December 31, 2010, Vermilion had a syndicated revolving credit facility allowing for maximum borrowings of $675 million. The revolving period under the revolving credit facility is expected to expire in June 2011 and may be extended for an additional period of up to 364 days at the option of the lenders. If the lenders do not extend the term of the revolving facility, the amounts outstanding become repayable 24 months after the expiry of the revolving period. Various borrowing options are available under the facility including prime rate based advances and bankers' acceptance loans.

The revolving credit facility is secured by various fixed and floating charges against subsidiaries of Vermilion. Under the terms of the revolving credit facility, Vermilion must maintain a ratio of total borrowings under the facility to consolidated earnings before interest, income taxes, depreciation, accretion and other certain non-cash items of not greater than 3.0.

The amount available to Vermilion under this facility is reduced by outstanding letters of credit associated with Vermilion's operations totalling $1.9 million as at December 31, 2010 (2009 - $85.1 million).

7. INCOME TAXES

The net future income tax liability at December 31, 2010 and 2009 is comprised of the following:

		2010		2009
Future income tax liabilities:				
Capital assets	$	(243,337)	$	(223,918)
Derivative contracts		-		(4,346)
Partnership income deferral		(6,427)		-
Asset retirement obligations		(36,810)		(41,602)
Basis difference of investments		(777)		(1,090)
Unrealized foreign exchange		(19,973)		(11,305)
Future income tax assets:				
Derivative contracts		708		-
Capital assets		57,654		67,403
Non-capital losses		112,442		66,145
Partnership loss deferral		-		12,449
Other		1,894		1,298
Share issue costs		2,259		2,011
Asset retirement obligations		39,764		33,222
Net future income tax (liability)	$	(92,603)	$	(99,733)
Comprised of:				
Current future income tax asset	$	2,902	$	-
Non-current future income tax asset		151,477		119,714
Current future income tax liability		-		(683)
Non-current future income tax liability		(246,982)		(218,764)
Net future income tax (liability)	$	(92,603)	$	(99,733)

7. INCOME TAXES (Continued)

The provision for income tax differs from the amount that would have been expected if the reported earnings had been subject only to the statutory Canadian income tax rate of 28.00% (2009 – 29.00%), as follows:

		2010		2009
Earnings before income taxes and non-controlling interest	$	136,822	$	201,941
Canadian corporate tax rate		28.00%		29.00%
Expected tax expense		38,310		58,563
Increase (decrease) in taxes resulting from:				
Income attributable to Unitholders prior to corporate conversion (Note 1)		(34,226)		(48,252)
Tax incentive programs		(1,931)		(5,645)
Foreign tax rate differentials [1]		4,772		4,390
Equity based compensation expense		7,888		5,277
Amended returns and pool estimate variances		2,370		137
Foreign exchange		(9,704)		(11,624)
Statutory rate changes and differences in reconciliation rate from the expected rates at reversal for non-capital losses recognized during the period		4,796		791
Other		4,300		1,526
Adjustment for capitalized interest		2,197		800
Adjustment to provisions for tax positions taken		(1,454)		3,340
Non-taxable portion of capital gains		-		(10,837)
Provision for income taxes	$	17,318	$	(1,534)

[1] The corporate tax rate is 34.4% in France, 43.2% in the Netherlands, 30.0% in Australia and 25.0% in Ireland.

8. SHAREHOLDERS' CAPITAL, UNITHOLDERS' CAPITAL AND CONTRIBUTED SURPLUS

As a result of the conversion from an income trust to a corporation on September 1, 2010 (see Note 1), all of the outstanding units of the Trust were exchanged on a one-for-one basis for common shares of Vermilion. Exchangeable shares of Vermilion Resources Ltd. were converted to common shares of Vermilion at the prevailing exchange ratio of 1.89344 (see Note 9).

Vermilion is authorized to issue an unlimited number of common shares.

Unitholders' Capital	Number of Units		Amount
Balance as at December 31, 2008	70,212,769	$	444,353
Issued on conversion of exchangeable shares (Note 9)	132,569		4,048
Unit rights exercised and issuance of units on vesting of trust unit award plan grants	945,982		2,817
Transfer from contributed surplus for unit based awards	-		16,846
Units issued for bonus plan	23,790		635
Unit-settled distributions on vested unit based awards	116,918		2,862
Unit issuance	8,091,000		240,106
Balance as at December 31, 2009	79,523,028	$	711,667
Distribution reinvestment plan	718,424		23,185
Issued on conversion of exchangeable shares (Note 9)	4,547		151
Issuance of units on vesting of trust unit award plan grants	555,459		17,733
Trust units issued for bonus plan	28,624		1,009
Unit-settled distributions on vested unit based awards	113,527		3,934
Trust units exchanged pursuant to corporate conversion	(80,943,609)		(757,679)
Balance as at August 31, 2010	-	$	-

8. SHAREHOLDERS' CAPITAL, UNITHOLDERS' CAPITAL AND CONTRIBUTED SURPLUS (Continued)

Shareholders' Capital	Number of Shares		Amount
Balance as at August 31, 2010	-	$	-
Issuance of common shares for trust units pursuant to corporate conversion	80,943,609		757,679
Dividend reinvestment plan	468,087		17,639
Issuance of common shares for exchangeable shares pursuant to corporate conversion (Note 9)	7,586,546		270,612
Balance as at December 31, 2010	88,998,242	$	1,045,930

		2010		2009
Contributed Surplus				
Opening balance	$	30,413	$	29,698
Equity based compensation expense (excluding bonus plan)		27,161		17,561
Transfer to shareholders' capital for equity based awards		(17,733)		(16,846)
Ending balance	$	39,841	$	30,413

On October 30, 2009, Vermilion completed the sale of 7,282,000 trust units at $30.90 per trust unit which resulted in net proceeds of $213.8 million after deducting the underwriters' fee. The underwriters subsequently exercised the over-allotment option associated with the offering resulting in the issuance of an additional 809,000 trust units for $23.8 million in net proceeds.

Vermilion's dividend reinvestment plan allows eligible shareholders to purchase additional shares at a 5% discount to market by reinvesting their cash dividends. The plan had previously been suspended in May 2008 and was reinstated by Vermilion effective January 15, 2010.

The total of cash distributions and dividends declared for the year ended December 31, 2010 was $189.7 million (2009 - $166.4 million).

Dividends are determined and declared by the Board of Directors after considering the Company's earnings as well as current and anticipated financial requirements. Dividends are subject to solvency tests imposed by the Business Corporations Act (Alberta) and are paid monthly.

9. NON-CONTROLLING INTEREST – EXCHANGEABLE SHARES

Vermilion had previously recorded non-controlling interest attributed to the issued and outstanding exchangeable shares.

The non-controlling interest on the consolidated balance sheets consisted of the book value of the exchangeable shares upon issuance plus the accumulated earnings attributable to the non-controlling interest. The net earnings attributable to the non-controlling interest on the consolidated statement of earnings represented the share of net earnings attributable to the non-controlling interest based on the trust units issuable for exchangeable shares in proportion to total trust units issued and issuable at each period end.

As a result of the corporate conversion (see Note 1), Vermilion issued 7,586,546 common shares in exchange for all remaining 4,006,753 exchangeable shares based on an exchange ratio of 1.89344. There were no exchangeable shares outstanding following the conversion.

The conversion of exchangeable shares was accounted for as an acquisition of the non-controlling interest at fair value. The fair value of the common shares issued in consideration for the non-controlling interest represented by the exchangeable shares was $270.6 million. The difference between that amount and the carrying value of the non-controlling interest of $109.0 million resulted in increases to capital assets of $189.9 million, goodwill of $31.7 million and future income tax liability of $60.0 million.

9. NON-CONTROLLING INTEREST – EXCHANGEABLE SHARES (Continued)

The following table summarizes the changes in the outstanding exchangeable share balance:

	Dec 31, 2010	Dec 31, 2009
Exchangeable Shares		
Opening number of exchangeable shares	4,009,253	4,085,605
Exchanged for trust units (Note 8)	(2,500)	(76,352)
Exchanged for common shares pursuant to corporate conversion (Notes 1 and 8)	(4,006,753)	-
Ending balance	-	4,009,253
Ending exchange ratio	-	1.80065
Units issuable upon conversion	-	7,219,261

The following table summarizes the changes in the non-controlling interest as presented on the consolidated balance sheets:

	Dec 31, 2010	Dec 31, 2009
Non-controlling interest, beginning of year	$ 100,824	$ 84,523
Current year net earnings attributable to the non-controlling interest	8,241	17,977
Reduction of book value for conversion to trust units	(64)	(1,676)
Reduction of book value for conversion to common shares	(109,001)	-
Non-controlling interest, end of year	$ -	$ 100,824

10. EQUITY BASED COMPENSATION PLANS

Vermilion Incentive Plan

The Vermilion Incentive Plan (the "VIP Plan"), formerly the Trust Unit Award Plan (the "TAP Plan") is the Company's long-term incentive plan for directors, officers, employees and consultants under which grantees receive awards representing unvested shares of Vermilion. At vesting, the ultimate number of unrestricted shares received by the grantee is adjusted for the cumulative dividends which notionally accrue to the awards during the vesting period and the resulting total is multiplied by a performance factor which ranges from zero to two times the number of awards originally granted.

The performance factor is determined by the Board of Directors after consideration of a number of key corporate performance measures including, but not limited to shareholder return, capital efficiency metrics, production and reserves growth as well as safety performance. The total expense recognized over the vesting period for a VIP Plan award is based on the fair value of the unvested share at the date of grant adjusted for the performance factor ultimately achieved.

The following table summarizes information about the awards granted under the TAP plan and the VIP Plan. The table does not reflect the exchange of TAP plan awards for VIP plan awards as the exchange was completed on a one-for-one basis.

Number of Awards	2010	2009
Opening balance	1,417,314	1,208,255
Granted	845,199	663,113
Vested	(447,714)	(382,239)
Forfeited	(131,023)	(71,815)
Closing balance	1,683,776	1,417,314

Compensation expense of $27.2 million was recorded during the year ended December 31, 2010 (2009 - $17.6 million) related to the VIP and TAP Plans.

10. EQUITY BASED COMPENSATION PLANS (Continued)

Phantom Award Incentive Plan

For certain employees that are not eligible to participate in the VIP Plan, the Company's Phantom Award Incentive Plan provides for cash payments based on the market value of a share. The cash consideration paid is adjusted to reflect cumulative dividends which notionally accrue to the awards during the vesting period and the resulting total is multiplied by a performance factor which ranges from zero to two times the number of awards originally granted. The performance factor is determined in the same manner as that applied to the VIP Plan.

Compensation expense recognized is based on the closing market price of a share adjusted to reflect the Company's best estimate of the performance factors which will ultimately be achieved. The resulting liability is remeasured at each reporting date. The total expense is amortized over the relevant vesting periods and the amount payable is recorded as a liability until settlement.

Compensation expense for this cash settled plan of $3.4 million was recorded during the year ended December 31, 2010 (2009 - $1.2 million).

11. PER SHARE OR UNIT AMOUNTS

Basic and diluted net earnings per share or unit have been determined based on the following:

	2010	2009
Net earnings	$ 111,263	$ 185,498
Non-controlling interest - exchangeable shares	-	17,977
Net earnings for diluted net earnings per share or unit calculation	$ 111,263	$ 203,475
Basic weighted average shares or units outstanding	83,155,116	72,405,606
Dilutive impact of units issuable on conversion of exchangeable shares	-	7,279,431
Dilutive impact of equity based award plans	1,342,163	884,570
Diluted weighted average shares or units outstanding	84,497,279	80,569,607

Basic net earnings per share or unit has been calculated based on net earnings divided by the basic weighted average shares or units outstanding. All outstanding potential shares or units related to incentive plans were dilutive for the years ended December 31, 2010 and 2009 and therefore have been included in the calculations of diluted earnings per share or unit for both periods. Outstanding potential units related to the exchangeable shares were only dilutive for the year ended December 31, 2009 therefore have only been included in the calculation of diluted earnings per unit in that period.

When outstanding share or units related to exchangeable shares are included in the diluted earnings per share or unit calculation, earnings attributable to the non-controlling interest related to those exchangeable shares are added back to net earnings in the calculation.

12. DERIVATIVE INSTRUMENTS

Risk Management Activities

The nature of Vermilion's operations results in exposure to fluctuations in commodity prices, interest rates and foreign currency exchange rates. Vermilion monitors and, when appropriate, uses derivative financial instruments to manage its exposure to these risks. All transactions of this nature entered into by Vermilion are related to an underlying financial position or to future petroleum and natural gas production. Vermilion does not use derivative financial instruments for speculative purposes. Vermilion has elected not to designate any of its price risk management activities as accounting hedges and thus accounts for changes to fair value in net earnings for the period. During the normal course of business, Vermilion may enter into fixed price arrangements to sell a portion of its production. Vermilion has elected to exempt these contracts from fair value accounting through the use of the normal purchase and sales exemption. Vermilion does not obtain collateral or other security to support its financial derivatives as management reviews the creditworthiness of the counterparty prior to entering into a derivative contract.

The following table summarizes Vermilion's outstanding financial derivative positions as at December 31, 2010.

Risk Management: Oil	Funded Cost	bbls/d	US $/bbl
Collar - WTI			
January 2011 to June 2011	US $1.00/bbl	2,400	$ 80.00 - $107.60
January 2011 to June 2011	US $1.00/bbl	2,400	$ 75.00 - $ 97.85
January 2011 to December 2011	US $1.00/bbl	500	$ 78.00 - $ 96.20
January 2011 to December 2011	US $1.00/bbl	500	$ 78.00 - $ 96.25
July 2011 to December 2011	US $1.00/bbl	2,400	$ 80.00 - $110.00
July 2011 to December 2011	US $1.00/bbl	2,400	$ 77.25 - $ 98.50
Collar - BRENT			
January 2011 to December 2011	US $1.00/bbl	1,000	$ 77.75 - $ 96.00
January 2011 to December 2011	US $1.00/bbl	1,000	$ 77.50 - $ 96.00
January 2011 to December 2011	US $0.00/bbl	750	$ 77.00 - $ 95.40
January 2011 to December 2011	US $1.00/bbl	750	$ 78.00 - $ 98.10
January 2011 to December 2011	US $1.00/bbl	500	$ 78.00 - $100.00
January 2011 to December 2011	US $1.00/bbl	500	$ 78.00 - $100.05
January 2011 to December 2011	US $1.00/bbl	500	$ 78.00 - $100.00
January 2012 to June 2012	US $1.00/bbl	750	$ 82.00 - $105.60
January 2012 to June 2012	US $1.00/bbl	750	$ 82.00 - $104.80
January 2012 to June 2012	US $1.00/bbl	750	$ 82.00 - $106.10
Call Spread - BRENT			
January 2011 to December 2011	US $6.08/bbl[1]	960	$ 65.00 - $ 85.00
January 2011 to December 2011	US $5.15/bbl[1]	600	$ 65.00 - $ 85.00
Risk Management: Natural Gas	**Funded Cost**	**GJ/d**	**$/GJ**
SWAP - AECO			
January 2011 to October 2011	$0.00/GJ	700	$5.13
Risk Management: Foreign Exchange		**Notional Principal ($US) / Month**	**Fixed rate ($CDN / $US)**
US Dollar Forward Sale			
January 2011 to December 2011		$750,000	$1.07
January 2011 to December 2011		$750,000	$1.07

[1] The funded amounts for these instruments were paid in a prior period.

12. DERIVATIVE INSTRUMENTS (Continued)

The following table reconciles the change in the fair value of Vermilion's derivative contracts:

	2010	2009
Fair value of contracts, beginning of year	$ 14,341	$ 15,204
Reversal of opening unrealized (gain) on contracts settled during the year	(6,842)	(11,959)
Realized gain on contracts settled during the year	13,154	5,389
Unrealized (loss) gain during the year on contracts outstanding at the end of the year	(10,218)	11,096
Net (receipt from) counterparties on contract settlements during the year	(13,154)	(5,389)
Fair value of contracts, end of year	(2,719)	14,341
Comprised of:		
Current derivative asset	10,249	8,217
Current derivative liability	(12,143)	(1,772)
Non-current derivative asset	942	7,896
Non-current derivative liability	(1,767)	-
Fair value of contracts, end of year	$ (2,719)	$ 14,341

The loss (gain) on derivative instruments for the years is comprised of the following:

	2010	2009
Realized (gain) on contracts settled during the year	$ (13,154)	$ (5,389)
Reversal of opening unrealized gain on contracts settled during the year	6,842	11,959
Unrealized loss (gain) during the year on contracts outstanding at the end of the year	10,218	(11,096)
Loss (gain) on derivative instruments	$ 3,906	$ (4,526)

13. CASH FLOW INFORMATION

The following details the changes in non-cash working capital:

	2010	2009
Accounts receivable	$ (30,278)	$ 6,743
Crude oil inventory	(5,472)	6,932
Prepaid expenses and other	400	3,555
Accounts payable and accrued liabilities and income taxes payable	111,882	(96,790)
Foreign exchange	2,197	1,147
Changes in non-cash working capital	78,729	(78,413)
Changes in non-cash operating working capital	$ 64,656	$ (76,782)
Changes in non-cash investing working capital	14,073	(1,631)
Changes in non-cash working capital	$ 78,729	$ (78,413)

14. SEGMENTED INFORMATION

Vermilion has operations principally in Canada, France, the Netherlands, Australia and Ireland. Vermilion's entire operating activities are related to exploration, development and production of petroleum and natural gas.

	2010	2009
Petroleum and natural gas revenue		
Canada	$ 185,241	$ 152,087
France	249,031	203,142
Netherlands	73,789	68,087
Australia	219,744	216,435
Ireland	-	-
	$ 727,805	$ 639,751
Net earnings (loss)		
Canada	$ (54,394)	$ 25,635
France	92,495	69,497
Netherlands	19,149	21,319
Australia	60,979	73,380
Ireland	(6,966)	(4,333)
	$ 111,263	$ 185,498
Capital expenditures		
Canada	$ 242,900	$ 75,973
France	54,965	62,457
Netherlands	11,017	26,338
Australia	51,457	6,739
Ireland	78,498	182,695
	$ 438,837	$ 354,202
Total assets		
Canada	$ 906,407	$ 711,435
France	743,119	575,426
Netherlands	190,473	180,803
Australia	293,691	250,780
Ireland	448,026	366,232
	$ 2,581,716	$ 2,084,676

15. COMMITMENTS

Vermilion has the following future commitments associated with its operating leases as at December 31, 2010:

	2011	2012	2013	2014	2015	Thereafter	Total
Payments by period	$5,864	$6,845	$6,845	$6,845	$6,845	$45,521	$78,765

16. COMPONENTS OF CASH AND CASH EQUIVALENTS

Cash and cash equivalents as at December 31, 2010 and December 31, 2009 was comprised solely of monies on deposit with banks.

17. CAPITAL DISCLOSURES

In managing capital, Vermilion reviews whether fund flows from operations, (a non-GAAP measure, defined as cash flows from operating activities before changes in non-cash operating working capital and asset retirement obligations settled) is sufficient to pay for all capital expenditures, dividends and abandonment and reclamation expenditures. To the extent that the forecasted fund flows from operations is not expected to be sufficient in relation to these expenditures, Vermilion will evaluate its ability to finance any excess with debt, an issuance of equity or by reducing some or all categories of expenditures to ensure that total expenditures do not exceed available funds.

As a part of the management of capital which Vermilion defines as net debt and shareholders' capital, Vermilion monitors the ratio of net debt (a non-GAAP measure, which is defined as long-term debt as shown on the consolidated balance sheets plus working capital) to fund flows from operations.

Vermilion typically strives to maintain a ratio of net debt to fund flows from operations near 1.0. In a commodity price environment where prices trend higher, Vermilion may target a lower ratio and conversely, in a lower commodity price environment, the acceptable ratio may be higher. At times, Vermilion will use its balance sheet to finance acquisitions and in these situations, Vermilion is prepared to accept a higher ratio in the short term but will implement a plan to reduce the ratio to acceptable levels within a reasonable period of time, usually considered to be no more than 12 to 18 months. This plan could potentially include an increase in hedging activities, a reduction in capital expenditures, an issuance of equity and the utilization of excess fund flows from operations to reduce outstanding indebtedness.

The following table calculates Vermilion's ratio of net debt to fund flows from operations:

		2010		2009
Long-term debt	$	302,558	$	159,723
Current liabilities		340,934		217,563
Current assets		(343,099)		(256,886)
Net debt [1]	$	300,393	$	120,400
Cash flows from operating activities	$	421,282	$	230,316
Changes in non-cash operating working capital		(64,656)		76,782
Asset retirement obligations settled		6,861		10,139
Fund flows from operations [2]	$	363,487	$	317,237
Ratio of net debt to fund flows from operations ([1] ÷ [2])		0.8		0.4

For 2010 and 2009, the ratio of net debt to fund flows from operations was 0.8 and 0.4, respectively. The 2009 year end figure of 0.4 reflects the sale of Verenex (see Note 3) and the equity offering which closed in the fourth quarter of 2009 (see Note 8). In 2010, as a result of capital expenditures associated with Canadian development activities and the Corrib project (see Note 3), the ratio of net debt to fund flows from operations increased but has remained within Vermilion's target range.

In relation to its long-term debt, Vermilion is subject to a debt to EBITDA ratio test (where debt is defined as long-term debt as presented on the consolidated balance sheet and EBITDA is defined as earnings before interest, taxes, depreciation, accretion and other certain non-cash items). During the periods covered by these consolidated financial statements, Vermilion continued to comply with this externally imposed capital requirement.

18. FINANCIAL INSTRUMENTS

The following table summarizes information relating to Vermilion's financial instruments as at December 31, 2010 and December 31, 2009:

Classification of Financial Instruments

Class of Financial Instruments	Location on Consolidated Balance Sheet	Accounting Designation	Related Income or Expense Account on Statement of Earnings	Carrying Amount and Fair Value of Asset (Liability) as at: Dec 31, 2010	Dec 31, 2009	Fair Value Measurement Hierarchy
Cash	Cash and cash equivalents	HFT-B	Gains and losses on foreign exchange are included in foreign exchange loss (gain)	$ 145,623	$ 99,066	Level 1
Short-term investments	Short-term investments	HFT-A	Gains and losses on foreign exchange are included in foreign exchange loss (gain)	$ 15,132	$ 15,895	Level 1
Receivables	Accounts receivable	LAR	Gains and losses on foreign exchange are included in foreign exchange loss (gain). Impairments are recognized as general and administration expense	$ 147,329	$ 117,051	Not applicable
Derivative assets	Derivative instruments	HFT-B	Loss (gain) on derivative instruments	$ 11,191	$ 16,113	Level 2
Derivative liabilities	Derivative instruments	HFT-B	Loss (gain) on derivative instruments	$ (13,910)	$ (1,772)	Level 2
Reclamation fund investments	Reclamation fund	HFT-A	Other income or expense	$ -	$ 69,003	Level 1
Portfolio investments	Long-term investments	HFT-A	Other income or expense	$ 3,108	$ 4,342	Level 1
Payables	Accounts payable and accrued liabilities. Dividends or distributions payable	OTH	Gains and losses on foreign exchange are included in foreign exchange loss (gain)	$ (269,996)	$ (212,742)	Not applicable
Long-term debt	Long-term debt	OTH	Interest	$ (302,558)	$ (159,723)	Not applicable
Long-term debt	Amount due pursuant to acquisition	OTH	None	$ (114,349)	$ (111,402)	Not applicable

Accounting designations used in the above table:

HFT-A – Designated by Vermilion as "Held for trading" upon initial recognition. Financial assets and liabilities designated as "Held for trading" are carried at fair value on the consolidated balance sheets with gains and losses associated with fair value adjustments recognized in net earnings.

HFT-B – Classified as "Held for trading" in accordance with Section 3855 of the CICA Handbook. As with HFT-A instruments, these financial assets and liabilities are carried at fair value on the consolidated balance sheets with associated gains and losses reflected in net earnings.

LAR – "Loans and receivables" are initially recognized at fair value and subsequently are measured at amortized cost. Impairments and foreign exchange gains and losses are recognized in net earnings.

OTH – "Other financial liabilities" are initially recognized at fair value and subsequently are measured at amortized cost. Interest is recognized in net earnings using the effective interest method. Foreign exchange gains and losses are recognized in net earnings.

Level 1– Fair value measurement is determined by reference to unadjusted quoted prices in active markets for identical assets or liabilities.

Level 2– Fair value measurement is determined based on inputs other than unadjusted quoted prices that are observable, either directly or indirectly.

Level 3– Fair value measurement is based on inputs for the asset or liability that are not based on observable market data.

18. FINANCIAL INSTRUMENTS (Continued)

Determination of Fair Values

The level in the fair value hierarchy into which the fair value measurements are categorized is determined on the basis of the lowest level input that is significant to the fair value measurement. Fair values for derivative assets and derivative liabilities are determined using option pricing models incorporating future prices that are based on assumptions which are supported by prices from observable market transactions and are adjusted for credit risk. Fair values for portfolio investments and reclamation fund investments are determined by reference to published price quotations in active markets. The carrying value of receivables and payables approximate their fair value due to their short maturities. The carrying value of long-term debt approximates its fair value due to the use of short-term borrowing instruments at market rates of interest. The amount due pursuant to acquisition was determined by calculating the expected value of the future payment due to the vendor based on management's best estimates associated with the timing of first commercial gas and discounting the resulting amount. The discount rate which would be used to present value this obligation as at December 31, 2010 would not differ significantly from the discount rate originally used.

The carrying value of amount due pursuant to acquisition is indicative of the fair value as the associated discount rate has remained stable.

Nature and Extent of Risks Arising From Financial Instruments

Vermilion is exposed to the following types of risks in relation to its financial instruments:

Credit risk:
Vermilion extends credit to customers and it may, from time-to-time, be due amounts from counterparties in relation to derivative instruments. Accordingly, there is a risk of financial loss in the event that a counterparty fails to discharge its obligation. For transactions that are financially significant, Vermilion reviews third-party credit ratings and may require additional forms of security. Cash held on behalf of the Company by financial institutions is also subject to credit risk related to the credit profile of those institutions.

Currency risk:
Vermilion conducts business in currencies other than Canadian dollars and accordingly is subject to currency risk associated with changes in foreign exchange rates in relation to cash, receivables, payables and derivative assets and liabilities. The impact related to working capital is somewhat mitigated as a result of the offsetting effects of foreign exchange fluctuations on assets and liabilities. Vermilion monitors its exposure to currency risk and reviews whether the use of derivative financial instruments is appropriate to manage potential fluctuations in foreign exchange rates.

Commodity price risk:
Vermilion uses financial derivatives as part of its risk management program associated with the effects of changes in commodity prices on future cash flows. Changes in the underlying commodity prices impact the fair value and future cash flows related to these derivatives.

Equity price risk:
At December 31, 2010, Vermilion held portfolio investments in equity securities with a fair value of $3.1 million (2009 - $4.3 million). The fair value of these instruments is exposed to changes in the prices of the underlying equities.

Interest rate risk:
Vermilion's debt is primarily comprised of short-term bankers acceptances that bear interest at market rates. Accordingly, Vermilion's exposure to interest rate risk in relation to its long-term debt at the balance sheet date is not material.

Liquidity risk:
Liquidity risk is the risk that Vermilion will encounter difficulty in meeting obligations associated with its financial liabilities. Vermilion does not consider this to be a significant risk as its financial position and available committed borrowing facility provide significant financial flexibility and allow Vermilion to meet its obligations as they come due.

18. FINANCIAL INSTRUMENTS (Continued)

The nature of these risks and Vermilion's strategy for managing these risks has not changed significantly from the prior period.

Summarized Quantitative Data Associated with the Risks Arising from Financial Instruments

Credit risk:
As at December 31, 2010 Vermilion's maximum exposure to receivable credit risk was $158.5 million (2009 - $133.2 million) which is the aggregate value of receivables and derivative assets at the balance sheet date. Vermilion's receivables are due from counterparties that have investment grade third party credit ratings or, in the absence of the availability of such ratings, Vermilion has satisfactorily reviewed the counterparty for creditworthiness.

As at the balance sheet date the amount of financial assets that were past due or impaired was not material.

Liquidity risk:
The following table summarizes Vermilion's undiscounted non-derivative financial liabilities and their contractual maturities as at December 31, 2010 and December 31, 2009:

Due in (from balance sheet date)	Not later than one month	Later than one month and not later than three months	Later than three months and not later than one year	Later than one year and not later than five years
December 31, 2010	89,063	163,110	17,823	438,371
December 31, 2009	117,911	84,911	9,920	302,691

Vermilion's derivative financial liabilities settle on a monthly basis.

Market risk:
Vermilion is exposed to currency risk related to changes in foreign currency denominated financial instruments and commodity price risk related to outstanding derivative positions. The following table summarizes what the impact on net earnings before tax would be for the years ended December 31, 2010 and 2009 given changes in the relevant risk variables that Vermilion considers were reasonably possible at the balance sheet date. The impact on net earnings before tax associated with changes in these risk variables for liabilities that are not considered financial instruments is excluded from this analysis. This analysis does not attempt to reflect any interdependencies between the relevant risk variables.

Year ended December 31, 2010:

Risk	Description of change in risk variable	Effect on net earnings before tax increase (decrease)	
Currency risk – Euro to Canadian	Increase in strength of the Canadian dollar against the Euro by 5% over the relevant closing rates on December 31, 2010	$	(2,473)
	Decrease in strength of the Canadian dollar against the Euro by 5% over the relevant closing rates on December 31, 2010	$	2,473
Currency risk – US$ to Canadian	Increase in strength of the Canadian dollar against the US$ by 5% over the relevant closing rates on December 31, 2010	$	2,527
	Decrease in strength of the Canadian dollar against the US$ by 5% over the relevant closing rates on December 31, 2010	$	(2,527)
Currency risk – AUD$ to Canadian	Increase in strength of the Canadian dollar against the AUD$ by 5% over the relevant closing rates on December 31, 2010	$	773
	Decrease in strength of the Canadian dollar against the AUD$ by 5% over the relevant closing rates on December 31, 2010	$	(773)
Commodity price risk	Increase in relevant oil reference price at December 31, 2010 by US$5.00/bbl within option pricing models used to determine the fair value of derivative positions	$	(11,440)
	Decrease in relevant oil reference price at December 31, 2010 by US$5.00/bbl within option pricing models used to determine the fair value of derivative positions	$	9,950

18. FINANCIAL INSTRUMENTS (Continued)

Year ended December 31, 2009:

Risk	Description of change in risk variable	Effect on net earnings before tax increase (decrease)
Currency risk – Euro to Canadian	Increase in strength of the Canadian dollar against the Euro by 5% over the relevant closing rates on December 31, 2009	$ (3,283)
	Decrease in strength of the Canadian dollar against the Euro by 5% over the relevant closing rates on December 31, 2009	$ 3,283
Currency risk – US$ to Canadian	Increase in strength of the Canadian dollar against the US$ by 5% over the relevant closing rates on December 31, 2009	$ 1,495
	Decrease in strength of the Canadian dollar against the US$ by 5% over the relevant closing rates on December 31, 2009	$ (1,495)
Currency risk – AUD$ to Canadian	Increase in strength of the Canadian dollar against the AUD$ by 5% over the relevant closing rates on December 31, 2009	$ (1,190)
	Decrease in strength of the Canadian dollar against the AUD$ by 5% over the relevant closing rates on December 31, 2009	$ 1,190
Commodity price risk	Increase in relevant oil reference price at December 31, 2009 by US$5.00/bbl within option pricing models used to determine the fair value of derivative positions	$ 1,788
	Decrease in relevant oil reference price at December 31, 2009 by US$5.00/bbl within option pricing models used to determine the fair value of derivative positions	$ (2,264)

Reasonably possible changes in interest rates and natural gas prices would not have had a material impact on net earnings for the years ended December 31, 2010 and 2009.

19. SUBSEQUENT EVENTS

On February 10, 2011, Vermilion closed a private placement offering of $225 million of senior unsecured notes. The notes bear interest at a rate of 6.5% per annum and will mature on February 10, 2016. As direct senior unsecured obligations of Vermilion, the notes rank pari passu with all other present and future unsecured and unsubordinated indebtedness of the Company. Concurrent with the issuance of the notes, the Company's credit facility was reduced from $675 million to $635 million.

20. ACCOUNTING PRONOUNCEMENTS NOT YET ADOPTED

On February 13, 2008, the Accounting Standards Board ("AcSB") confirmed that the transition date to International Financial Reporting Standards ("IFRS") from Canadian GAAP will be January 1, 2011 for publicly accountable enterprises such as Vermilion. Accordingly, all financial statements presented by Vermilion after that date will be prepared under IFRS.

21. DIFFERENCES BETWEEN CANADIAN AND UNITED STATES OF AMERICA GENERALLY ACCEPTED ACCOUNTING PRINCIPLES

The consolidated financial statements have been prepared in accordance with Canadian Generally Accepted Accounting Principles ("GAAP"), which differ in some respects from GAAP in the United States of America. The significant differences in GAAP as applicable to these consolidated financial statements and notes are described in Vermilion's Form 40F, which is filed with the United States of America Securities and Exchange Commission.

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Corporate Information

DIRECTORS

Larry J. Macdonald [1, 2, 3, 4, 5]
Chairman & CEO, Point Energy Ltd.
Calgary, Alberta

W. Kenneth Davidson [2, 3]
Toronto, Ontario

Lorenzo Donadeo
Calgary, Alberta

Claudio A. Ghersinich [2, 4, 5]
Executive Director, Carrera Investments Corp.
Calgary, Alberta

Joseph F. Killi [2, 3]
Chairman,
Parkbridge Lifestyle Communities Inc.
Vice Chairman, Realex Properties Corp.
Calgary, Alberta

William F. Madison [2, 4, 5]
Sugar Land, Texas

Timothy R. Marchant [3, 4, 5]
Calgary, Alberta

[1] Chairman of the Board
[2] Audit Committee
[3] Governance and Human Resources Committee
[4] Health, Safety and Environment Committee
[5] Independent Reserves Committee

ANNUAL GENERAL MEETING

May 6, 2011 at 10:00 a.m.
The Ballroom
Metropolitan Centre
333 – 4th Avenue S.W.
Calgary, Alberta

OFFICERS AND KEY PERSONNEL

CANADA
Lorenzo Donadeo, P.Eng.
President & Chief Executive Officer

John D. Donovan, F.C.A.
Executive Vice President Business Development

Curtis W. Hicks, C.A.
Executive Vice President & CFO

G. R. (Bob) Mac Dougall, P.Eng.
Executive Vice President & COO

Paul L. Beique
Vice President Capital Markets

Mona Jasinski, M.B.A., C.H.R.P.
Vice President People

Raj C. Patel, P.Eng.
Vice President Marketing

Daniel Goulet, P.Eng.
Director Production and Operations

Cameron A. Hercus, MSc
Director Exploitation and New Growth

Dean N. Morrison, CFA
Director Investor Relations

Gerardo Rivera
Director Commercial

Robert (Bob) J. Engbloom, LL.B
Corporate Secretary

EUROPE
Peter Sider, P.Eng.
Vice President European Operations

David Burghardt, P.Eng.
Director Exploitation

Scott Ferguson, P.Eng.
Director European Operations

AUSTRALIA
Bruce D. Lake, P.Eng.
Managing Director
Vermilion Oil & Gas Australia Pty Ltd.

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Calgary, Alberta

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Calgary, Alberta

BNP Paribas (Canada)
Toronto, Ontario

Royal Bank of Canada
Calgary, Alberta

The Bank of Nova Scotia
Calgary, Alberta

Alberta Treasury Branches
Calgary, Alberta

Canadian Imperial Bank of Commerce
Calgary, Alberta

Citibank N.A., Canadian Branch
Calgary, Alberta

EVALUATION ENGINEERS
GLJ Petroleum Consultants Ltd.
Calgary, Alberta

LEGAL COUNSEL
Macleod Dixon LLP
Calgary, Alberta

TRANSFER AGENT
Computershare Trust Company of Canada

STOCK EXCHANGE LISTING
Toronto Stock Exchange
Symbol: VET
US OTC
Symbol: VEMTF

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