

DIAZ RESOURCES LTD.



Q3

Management Discussion and  
Analysis  
For the Nine Month Period  
Ended September 30, 2009



## Management's Discussion and Analysis ("MD&A")

November 5, 2009

The following discussion and analysis is management's assessment of Diaz's historical, financial and operating results. This review should be read in conjunction with the unaudited consolidated financial statements for the nine months ended September 30, 2009, and the audited financial statements for the year ended December 31, 2008. The reader should be aware that historical results are not necessarily indicative of future performance.

The interim report for the nine months ended September 30, 2009, has not been reviewed or audited by the Company's auditor.

## Corporate Profile

Diaz Resources Ltd. is an oil and gas exploration and development company with land holdings and production in Canada and the United States. The Company's principal business is the exploration for oil and natural gas, with the majority of the Company's revenue being generated from gas production in Alberta and Texas. Diaz's current focus is on oil development in Alberta and Saskatchewan.

## Corporate Summary

<i>(Thousands, except per share amounts, unaudited)</i>	Nine Months Ended September 30	
	2009	2008
<b>Financial</b>		
Revenue	\$ 5,405	\$ 11,710
Cash flow from operations	1,522	6,591
per share, diluted	0.02	0.10
Loss for the period	(11,443)	(526)
per share, diluted	(0.17)	(0.01)
Capital additions	2,139	5,737
Dispositions	1,944	19
Net capital additions	195	5,718
Pro forma net current debt, see Note 13, "Subsequent Events"	3,798	7,891
Net current debt	7,218	7,891
Convertible debentures*	6,304	6,027
Total assets	37,725	62,927
Total shares outstanding at period end **	67,178	67,192
<b>Operations</b>		
Production		
Gas (MMcfd)	3.5	4.5
Oil (Bopd)	98	143
BOEd (6 Mcf = 1 Bbl)	680	890
Product Prices		
Gas (\$/Mcf)	\$4.65	\$8.57
Oil (\$/Bbl)	\$53.13	\$93.39

\* Convertible debentures have a face value of \$7.1 million and mature on March 26, 2012. See Note 8, "Convertible Debentures", in the notes to the financial statements for the nine months ended September 30, 2009.

\*\* As of November 5, 2009, Diaz had 76,576,752 common shares issued and outstanding. See Note 13, "Subsequent Events", in the notes to the financial statements for the nine months ended September 30, 2009.



## Message to Shareholders

Diaz recently closed the sale of its Parkman, Saskatchewan, property. Net proceeds from the sale totaled \$2.5 million and were used to reduce bank debt and to accelerate the Company's heavy oil drilling program at Lloydminster, Alberta.

The sale was the fourth transaction which Diaz has completed since April of this year that has provided working capital enabling the Company to increase its exploration and development focus and to reduce its bank debt. These transactions include:

- Sale of a Carmangay, Alberta, oil property for \$1.0 million (May),
- Sale of undeveloped Texas acreage realizing \$0.8 million (September),
- Sale of the Parkman, Saskatchewan, property for \$2.5 million (October), and the
- Closing of a common share private placement for net \$0.92 million (October).

Through these financial transactions Diaz raised \$5.2 million in total. As a result, Diaz has reduced its net current debt from \$8.5 million in January 2009 to approximately \$7.2 million at the end of the third quarter and further reduced pro forma net current debt to approximately \$3.8 million with the sale of the Parkman property and the closing of an equity private placement in October.

The Company plans to continue to rationalize non core assets with the sale of its remaining U.S. producing assets, which, being principally natural gas, will be marketed when natural gas prices recover to what management regards as an acceptable level.

With this substantial improvement in financial condition the Company can increase its heavy oil exploration and development efforts in East Central Albert and West Central Saskatchewan.

During October 2009, Diaz drilled its second oil well at Lloydminster, Alberta. The well was drilled horizontally to 1,513 meters and a production liner was set. Production is expected by mid November once facility tie-in work has been completed. This is the first of a multi-well program in the area. The next well at Lloydminster is planned for late November. Diaz is the operator and holds a 50% working interest.

## Financial

Diaz's revenue and cashflow results for the nine months ended September 30, 2009, were significantly lower when compared with the prior year nine month period, as production declines in Canada and in the U.S. combined with low oil and natural gas prices.

Revenue for the nine month period ended September 30, 2009, decreased to \$5.4 million compared with \$11.7 million for the prior year. Revenue for the third quarter reduced to \$1.2 million compared with \$4.0 million in Q3 2008. Cash flow from operations for the first nine months of 2009 decreased to \$1.5 million or \$0.02 per share compared with \$6.6 million or \$0.10 per share for the prior year. Cash flow for the third quarter of \$86,000 was down compared with \$2.2 million for Q3 2008. Diaz reported a loss for the nine month period of \$11.4 million or (\$0.17) per share versus a loss of \$526,000 or (\$0.01) per share in the prior year nine month period, as it took an impairment write down against its oil and gas assets of \$11.4 million during Q1 2009. For the third quarter, Diaz reported a loss of \$1.1 million compared with a loss of \$277,000 in Q3 2008.

Capital expenditures for the nine month period ended September 30, 2009, totalled \$2.1 million compared with \$5.7 million in the prior year. Capital expenditures and debt retirement were financed from cash flow from operations and the sale of two oil and gas properties. At September 30, 2009, Diaz had net current debt of \$7.2 million versus \$8.5 million at the beginning of the year. Diaz also had convertible debentures outstanding of \$7.1 million (face value) that mature on March 26, 2012.



## Production

The Company's production for the nine month period ended September 30, 2009, decreased 24% to 680 BOEd compared with the prior year average of 890 BOEd. For the third quarter, production rates declined 36% to 578 BOEd compared with 899 BOEd in Q3 2008. The steep production declines in the third quarter resulted in Canada from the shut-in of production at the Big Bend field which will be put back on production in late fall as the location is only accessible during the winter months, and in the U.S. resulting from the abandonment of the Black Owl field combined with declining production rates at the Provident City, Hound Dog and Allen Ranch fields.

## Land Acquisition

During 2009, Diaz has acquired 16,707 acres (12,448 net acres) in Alberta and Saskatchewan. Diaz's primary exploration focus is in Saskatchewan where the Company now has acreage on prospective Shaunavon, Bird Bear, and Viking oil plays.

## Business Outlook

Weak natural gas pricing has led to a sharp reduction in the number of rigs drilling for natural gas over the last year. The drop of rig activity in Canada and the U.S. has resulted in a decrease of domestic supply as production rates from existing wells decline without offsetting new production. However, there is still considerable uncertainty as to when prices will again rise to satisfactory levels due to the current high natural gas storage levels and the slow recovery in demand from the U.S. manufacturing sector. Because of ongoing weakness in the gas market and the underlying economy Diaz expects that natural gas prices will stay in the \$4.50 range per Mcf for the remainder of 2009.

Diaz has successfully undertaken an asset disposal program over the last four months and recently completed a small equity financing. These achievements have strengthened Diaz's fiscal capabilities thus enabling the Company to begin development of its Lloydminster heavy oil property.

On behalf of the Board,

R.W. Lamond, Chairman  
D.K. Clark, Chief Operating Officer

November 5, 2009



### **Basis of Presentation**

The financial data presented herein has been prepared in accordance with accounting principles generally accepted in Canada. All dollar amounts are in Canadian dollars unless otherwise indicated.

**Non-GAAP Measurements** – The Management's Discussion and Analysis contains the term cash flow from operations, which should not be considered an alternative to, or more meaningful as an indicator of the Company's performance than, cash flow from operating activities, as determined in accordance with accounting principles generally accepted in Canada. Diaz's determination of cash flow from operations may not be particularly comparable to that reported by other companies especially those in other industries. Management uses cash flow from operations as a measure of operating performance as the measure is not exposed to non-cash working capital movements, which for a small company, could be material and misleading. The reconciliation of cash flow from operating activities and cash flow from operations is as follows:

(\$ Thousands, unaudited)	Three Months Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
Cash provided by (used for) Operating Activities:	\$ (432)	\$ 3,408	\$ 2,378	\$ 7,276
Adjusted for:				
Abandonments	24	\$ 126	\$ 33	\$ 243
Change in non-cash working capital	494	(1,325)	(889)	(928)
Cash flow from operations	\$ 86	\$ 2,209	\$ 1,522	\$ 6,591

The Company also presents annualized cash flow from operations which equals four times the quarterly cash flow from operations. Cash flow from operations per share is calculated using the weighted average shares outstanding consistent with the calculation of earnings per share. In addition, the Company presents "Net current debt", which is calculated as the aggregate of current assets and current liabilities.

**BOE Presentation** – The term barrels of oil equivalent (BOE) may be misleading, particularly if used in isolation. A BOE conversion ratio of 6 Mcf: 1 Bbl is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. All BOE conversions in this report are derived by converting gas to oil in the ratio of six Mcf of gas to one Bbl of oil.

**Forward-looking Statements** – Certain of the statements contained herein including, without limitation, financial and business prospects and financial outlook, reserve and production estimates, drilling and re-completion plans, timing of drilling, completion and tie-in of wells and capital expenditures and the timing thereof may be forward-looking statements. Words such as "may", "will", "should", "could", "anticipate", "believe", "expect", "intend", "plan", "potential", "continue" and similar expressions may be used to identify these forward-looking statements. These statements reflect management's beliefs at the date of the report and are based on information available to management at that time. Forward-looking statements involve significant risk and uncertainties.

A number of factors could cause actual results to differ materially from the results discussed in the forward-looking statements including, but not limited to, risks associated with oil and gas exploration, development, exploitation, production, marketing and transportation, loss of markets, volatility of commodity prices, currency fluctuations, imprecision of reserve estimates, environmental risks, competition from other producers, inability to retain drilling rigs and other services, incorrect assessment of the value of acquisitions, failure to realize the anticipated benefits of acquisitions, delays resulting from or inability to obtain required regulatory approvals and ability to access sufficient capital from internal and external sources and the risk factors outlined under "Risk Factors" in the Company's Annual Information



Form and elsewhere herein. The recovery and reserve estimates of Diaz's reserves provided herein are estimates only and there is no guarantee that the estimated reserves will be recovered. As a consequence, actual results may differ materially from those anticipated in the forward-looking statements. Readers are cautioned that the foregoing list of factors is not exhaustive. Additional information on these and other factors that could effect Diaz's operations and financial results are included in reports on file with Canadian securities regulatory authorities and may be accessed through the SEDAR website ([www.sedar.com](http://www.sedar.com)) or at Diaz's website ([www.diazresources.com](http://www.diazresources.com)). Although the forward-looking statements contained herein are based upon what management believes to be reasonable assumptions, including but not limited to assumptions as to the price of oil and natural gas, interest rates, exchange rates and the regulatory and legal environment in which Diaz operates, the producibility of Diaz's reserves, the capital expenditures program and future operations and other matters, management cannot assure that actual results will be consistent with these forward-looking statements. Investors should not place undue reliance on forward-looking statements. These forward-looking statements are made as of the date hereof and the Company assumes no obligation to update or review them to reflect new events or circumstances except as required by applicable securities laws.

Forward-looking statements and other information contained herein concerning the oil and gas industry and the Company's general expectations concerning this industry is based on estimates prepared by management using data from publicly available industry sources as well as from reserve reports, market research and industry analysis and on assumptions based on data and knowledge of this industry which the Company believes to be reasonable. However, this data is inherently imprecise, although generally indicative of relative market positions, market shares and performance characteristics. While the Company is not aware of any misstatements regarding any industry data presented herein, the industry involves risks and uncertainties and is subject to change based on various factors.



## Operations

Diaz is primarily a natural gas producer with 85% of its production for the nine month period ended September 30, 2009, coming from natural gas wells. Diaz owns interests in producing properties in Alberta and Saskatchewan in Canada, and in Texas in the United States. Where meaningful, the following production information has been segmented for each of the Company's geographic areas of operations.

Oil & Gas Production	Three Months Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
<b>Gas - Canada</b>				
Retlaw	761	833	818	886
Enchant	440	428	433	475
Leahurst	269	500	292	205
Big Bend	-	305	171	239
Therien	178	171	151	171
Jaslan	126	164	113	142
Carmangay	83	146	93	143
Other	502	941	609	692
Gas - Canada (Mcf)	2,359	3,488	2,680	2,953
<b>Oil &amp; Liquids - Canada</b>				
Parkman	26	(9)	26	28
Lloydminster	21	7	24	15
Carmangay	-	12	2	15
Red Earth	9	7	9	6
Hays	-	11	1	8
Harmattan	5	4	7	5
Other	20	78	24	54
Oil & Liquids - Canada (Bopd)	81	111	93	131
BOEd - Canada (6 Mcf = 1 Bbl)	474	692	540	623
<b>Gas - U.S.</b>				
Provident City	306	310	362	540
Hound Dog	114	298	141	348
Black Owl	-	173	94	325
Allen Ranch	63	128	72	135
Other	124	265	138	182
Gas - U.S. (Mcf)	607	1,174	807	1,530
<b>Oil &amp; Liquids - U.S.</b>				
Provident City	3	4	3	5
Black Owl	-	7	2	6
Other	-	-	-	1
Oil & Liquids - U.S. (Bopd)	3	11	5	12
BOEd - U.S. (6 Mcf = 1 Bbl)	104	207	140	267
<b>Gas - Company (Mcf)</b>	<b>2,966</b>	<b>4,662</b>	<b>3,487</b>	<b>4,483</b>
<b>Oil and Liquids - Company (Bopd)</b>	<b>84</b>	<b>122</b>	<b>98</b>	<b>143</b>
<b>BOEd - Company</b>	<b>578</b>	<b>899</b>	<b>680</b>	<b>890</b>

The Company's total production for the nine months ended September 30, 2009, decreased 24% to 680 BOEd compared with the prior year average of 890 BOEd. For the third quarter, total production declined 36% to 578 BOEd compared with 899 BOEd in Q3 2008.

In Canada, natural gas production rates in the quarter were 32% lower than in the prior year, averaging 2.4 MMcf compared with 3.5 MMcf in Q3 2008. A significant event during the second quarter was the shut-in of the Big Bend field pending higher natural gas prices. Canadian oil production in the third



quarter decreased to 81 Bopd from 111 Bopd in Q3 2008 as the shut-in of the Hays field and the sale of the Carmangay oil property (12 Bopd in the prior year) were offset by increased production at the Lloydminster oil field resulting from a workover during the quarter and steady production from the Parkman oil field. Diaz plans to conduct two workover operations during the fourth quarter. The first operation planned is a workover to replace a pump at the Hays field which should result in an increase in production of approximately 150 Mcfd (120 Mcfd net) of natural gas and 8 Bopd (6 Bopd net). The second operation planned is at the Big Bend field where water handling facilities will be added and the well can then be brought back on stream. For the nine month period, natural gas rates were down only 9% from the prior year mainly due to the third quarter timing of first production of the Leahurst field in the prior year.

In the U.S., natural gas production rates in the third quarter and in the nine month period decreased by 47% and 48% respectively compared with the prior year periods with declines in all producing areas. Also, during the second quarter the Black Owl field was shut-in and has been subsequently abandoned.

Product Prices	Three Months Ended		Nine Months Ended	
	September 30		September 30	
	2009	2008	2009	2008
<b>Canada</b>				
Gas (\$/Mcf)	\$ 3.63	\$ 7.70	\$ 4.78	\$ 8.11
Oil & Liquids (\$/Bbl)	\$ 62.76	\$ 105.54	\$ 52.92	\$ 91.43
\$/BOE	\$ 28.83	\$ 55.61	\$ 32.84	\$ 57.59
<b>U.S.</b>				
Gas (\$/Mcf)	\$ 3.23	\$ 10.23	\$ 4.23	\$ 9.45
Oil & Liquids (\$/Bbl)	\$ 73.29	\$ 135.49	\$ 57.20	\$ 113.83
\$/BOE	\$ 20.86	\$ 65.32	\$ 26.48	\$ 59.38
<b>\$/BOE - Company</b>	<b>\$ 27.40</b>	<b>\$ 57.84</b>	<b>\$ 31.53</b>	<b>\$ 58.13</b>

In Canada and in the U.S., average BOE oil prices for the third second quarter and for the nine month period were approximately 53% and 46% lower respectively than realized in the comparative prior year periods.

Canada Natural Gas Prices Adjusted For Fixed Gas Contracts	Three Months Ended		Nine Months Ended	
	September 30		September 30	
	2009	2008	2009	2008
<b>Canada</b>				
Gas price without contracts \$/Mcf	\$ 2.75	\$ 7.53	\$ 5.87	\$ 7.84
Fixed gas contract benefit (cost) \$/Mcf	\$ 0.88	\$ 0.17	\$ (1.09)	\$ 0.27
Gas price with contracts \$/Mcf	\$ 3.63	\$ 7.70	\$ 4.78	\$ 8.11
Fixed gas contract benefit (cost) \$ '000	\$ 189	\$ (55)	\$ 796	\$ (217)

As detailed above, Diaz added \$796,000 to its revenue for the nine month period ended September 30, 2009, compared with a cost of \$217,000 in the prior year as a result of committing to fixed gas contracts. For the third quarter, Diaz added \$189,000 to its revenue compared with a cost of \$55,000 in Q3 2008.



Revenue from Oil and Gas Production (\$ Thousands)	Three Months Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
<b>Canada</b>				
Natural gas	\$ 782	\$ 2,470	\$ 3,501	\$ 6,561
Oil and natural gas liquids	465	1,065	1,331	3,263
<b>Total - Canada</b>	<b>1,247</b>	<b>3,535</b>	<b>4,832</b>	<b>9,824</b>
<b>U.S.</b>				
Natural gas	178	1,105	932	3,960
Oil and natural gas liquids	19	137	77	390
<b>Total - U.S.</b>	<b>197</b>	<b>1,242</b>	<b>1,009</b>	<b>4,350</b>
<b>Total Production Revenue - Company</b>	<b>\$ 1,444</b>	<b>\$ 4,777</b>	<b>\$ 5,841</b>	<b>\$ 14,174</b>

For the three and nine month periods ended September 30, 2009, the approximate 50% reduction in average natural gas and oil prices combined with declines in production to yield a drop in revenues of 70% in the third quarter and a reduction of revenues of 59% for the nine month period compared with the prior year periods.

Production and price declines in the U.S. were larger than in Canada during the third quarter and nine month periods resulting in a sharper drop in U.S. revenues compared with the prior year periods than was realized in Canada.

Royalties (\$ Thousands, except per BOE and percentage amounts)	Three Months Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
<b>Canada</b>				
Crown	\$ 10	\$ 357	\$ 93	\$ 1,023
Freehold	89	250	270	505
<b>Royalties</b>	<b>\$ 99</b>	<b>\$ 607</b>	<b>\$ 363</b>	<b>\$ 1,528</b>
per BOE	\$ 2.28	\$ 9.56	\$ 2.46	\$ 8.96
Royalties as a percentage of revenue	8.4%	16.8%	7.3%	15.1%
<b>U.S.</b>				
Royalties	\$ 50	\$ 295	\$ 189	\$ 1,222
per BOE	\$ 5.37	\$ 15.46	\$ 4.98	\$ 16.67
Royalties as a percentage of revenue	26.0%	23.7%	18.8%	28.1%
<b>Total Royalties - Company</b>	<b>\$ 149</b>	<b>\$ 902</b>	<b>\$ 552</b>	<b>\$ 2,750</b>
per BOE	\$ 2.83	\$ 10.92	\$ 2.98	\$ 11.28

In Canada, royalty expense decreased overall as a result of weak natural gas and oil prices which in Alberta also results in a reduced royalty rate. During the second quarter of 2009, the annual gas cost allowance adjustment resulted in a credit to Diaz further reducing crown royalties. Diaz anticipates royalty rates should average approximately 10% to 14% of Canadian revenue for the fourth quarter of 2009 as natural gas prices are expected to recover to the \$4.50 - \$5.50 per Mcf range.

In the United States, royalties decreased in the second quarter resulting from the receipt of a refund from the Railroad Commission for royalty paid on a deep gas well that qualified for a temporary exemption. This has resulted in a lower than expected royalty rate for the nine month period. Royalty's are generally fixed rates in the U.S. and Diaz expects royalty rates to average 28% to 31% of U.S. revenue during the fourth quarter of 2009.



Operating and Transportation Expense (\$ Thousands, except per BOE amount)	Three Months Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
<b>Canada</b>	\$ 507	\$ 902	\$ 2,247	\$ 2,652
per BOE	11.71	14.19	15.27	15.56
<b>U.S.</b>	36	136	172	319
per BOE	3.67	7.16	4.50	4.35
<b>Total Expense - Company</b>	<b>543</b>	<b>1,038</b>	<b>2,419</b>	<b>2,971</b>
per BOE	\$ 10.27	\$ 12.57	\$ 13.05	\$ 12.19

In Canada and in the U.S., the three and nine month period operating costs per BOE were lower than the comparable prior year periods. In Canada, operating cost reductions were realized from the correction of a facility fee at its Parkman property, yielding a one time lump sum recovery from partners – the property was sold during October. In the U.S., operating cost savings have resulted from a reduction in the Company's estimate for property taxes which are based on natural gas revenues.

In total, operating costs for Q3 2009 decreased by 48% to \$543,000 compared with \$1.0 million in Q3 2008. Operating costs for the nine month period reduced by 19% to \$2.4 million compared with \$3.0 million in the prior year.

Overhead & Stock Based Compensation (\$ Thousands, except per BOE amounts)	Three Months Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
Cash compensation costs	\$ 279	\$ 321	\$ 967	\$ 996
Cash compensation recovered	(53)	(49)	(147)	(162)
Net cash compensation	226	\$ 272	\$ 820	\$ 834
Other overhead costs	410	376	1,059	1,011
Other overhead recovered	(56)	(60)	(181)	(166)
Net other overhead	354	316	878	845
Total cash overhead	580	588	1,698	1,679
Stock based compensation costs	38	171	79	195
Recovered from third parties	(204)	(103)	(847)	(304)
Capitalized	(72)	(43)	(155)	(148)
Net overhead	342	613	775	1,422
per BOE	\$ 6.48	\$ 5.36	\$ 4.18	\$ 6.50

Cash compensation and other overhead costs of \$580,000 for Q3 2009 and \$1.7 million for the nine month period closely matched the Q3 2008 and nine month prior year period results. However, net overhead costs for the nine month period were significantly reduced compared with the prior year period as Diaz's recoveries from third parties of \$847,000 were much higher than the comparable prior year periods. The increased recovery resulted from a one-time adjustment to Management fees charged to a related third party in Q2 2009 of \$389,000.



Interest Expense (\$ Thousands, except per BOE and percentage amounts)	Three Months Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
Interest expense	\$ 268	\$ 271	\$ 735	\$ 877
Debenture accretion and issue costs	70	66	210	194
Interest expense	338	337	945	1,071
per BOE	6.42	4.08	5.10	4.39
Average interest rate on bank debt	4.5%	5.5%	3.9%	5.8%
Average bank debt	6,768	8,458	7,554	8,965
Interest rate on convertible debentures	8.75%	8.75%	8.75%	8.75%
Convertible debentures - face value	\$ 7,085	\$ 7,085	\$ 7,085	\$ 7,085

Total interest expense for the third quarter was the same as the prior year period. For the nine month period, interest expense decreased to \$945,000 compared with \$1.1 million for the prior year. The decreases for the year to date comparatives resulted from lower average interest rates and lower average bank debt in the current year.

Income Taxes (\$ Thousands)	Three Months Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
<b>Canada</b>				
Current tax expense	\$ 12	\$ (3)	\$ 17	\$ 6
Future tax expense (recovery)	(273)	(82)	(4,084)	(93)
Total - Canada	(261)	(85)	(4,067)	(87)
<b>U.S.</b>				
Current tax expense	13	7	16	37
Future tax expense (recovery)	(187)	30	(573)	235
Total - U.S.	(174)	37	(557)	272
<b>Total - Company</b>	<b>\$ (435)</b>	<b>\$ (48)</b>	<b>\$ (4,624)</b>	<b>\$ 185</b>

Current taxes paid in Canada consist of capital tax and Saskatchewan provincial tax, which are based on the Company's balance sheet and gross revenue in the province. In Canada, the Company has estimated income tax pools that, together with its planned exploration and development expenditures, should be sufficient to allow Diaz to defer current taxes payable during 2009. Future tax recoveries in Canada result from reduced tax rates anticipated in future years plus the impact of the impairment of assets charged to income in Q1 2009.

In the United States, the Company was cash taxable in 2006 but due to increased capital spending during 2007 and 2008 did not have any current Federal tax. Diaz's plans to incur additional costs to develop several of its properties during 2009 have been deferred, which may result in taxes payable in 2009. Future tax recoveries in the U.S. result from net losses during the nine month period.



Depletion, Depreciation & Accretion (\$ Thousands, except per BOE Amounts)	Three Months Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
<b>Canada</b>				
Depletion and depreciation	\$ 928	\$ 1,682	\$ 3,547	\$ 4,523
ARO accretion	73	66	214	195
<b>Total - Canada</b>	<b>1,001</b>	<b>1,748</b>	<b>3,761</b>	<b>4,718</b>
per BOE	<b>23.17</b>	27.50	<b>25.57</b>	27.66
<b>U.S.</b>				
Depletion and depreciation	502	474	2,157	1,736
ARO accretion	1	1	4	4
<b>Total - U.S.</b>	<b>503</b>	<b>475</b>	<b>2,161</b>	<b>1,740</b>
per BOE	<b>53.06</b>	24.96	<b>56.67</b>	23.75
<b>Total - Company</b>	<b>1,504</b>	<b>2,223</b>	<b>5,922</b>	<b>6,458</b>
per BOE	<b>\$ 28.55</b>	\$ 26.91	<b>\$ 31.97</b>	\$ 26.48

In Q3 2009, the Company's depletion, depreciation and accretion costs have increased to \$28.55 per BOE compared with \$26.91 per BOE for Q3 2008. For the nine month period, the rate increased to \$31.97 per BOE from \$26.48 BOE for the prior year. Depletion expense is calculated based on the Company's proved reserves.

In Canada, the Company took an impairment write down on its assets of \$11.4 million in Q1 2009 which resulted in a 16% reduction in the depletion rate per BOE for the third quarter compared with Q3 2008. For the nine month period, the impairment write down resulted in an 8% reduction in the depletion rate compared with the prior year.

In the U.S., Diaz's substantial probable reserves value (which is used to determine asset impairment) results in a high carrying value of its oil and gas assets when compared with the proved reserves associated with it.



### Quarterly Financial Information

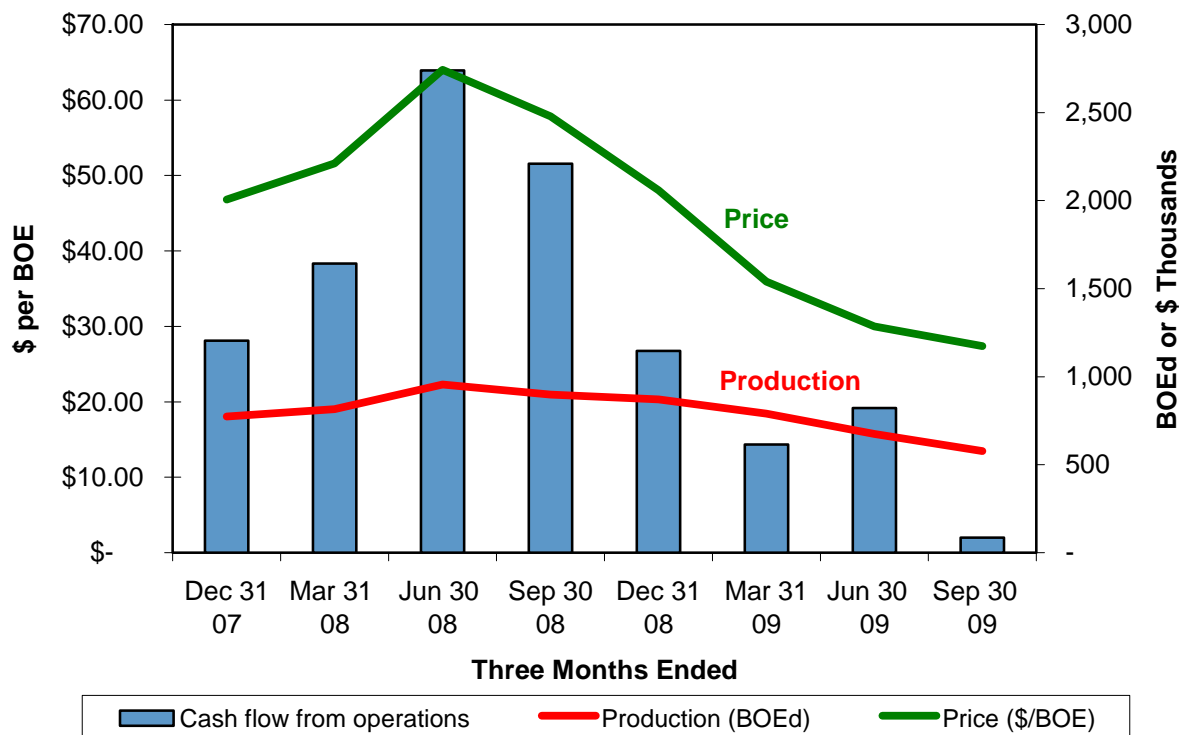
(\$ Thousands, except production and per share amounts)	Three Months Ended							
		2009			2008			2007
	Sep 30	Jun 30	Mar 31	Dec 31	Sep 30	Jun 30	Mar 31	Dec 31
Production (BOEd)	578	675	791	871	899	955	816	773
Price (\$/BOE)	\$ 27.40	\$ 29.98	\$ 35.93	\$ 48.06	\$ 57.84	\$ 63.99	\$ 51.59	\$ 46.82
Total revenue	1,225	1,932	2,248	3,389	3,964	4,576	3,170	2,970
Cash flow from operations per share (basic and diluted)	86 0.00	822 0.01	614 0.01	1,146 0.02	2,209 0.03	2,739 0.04	1,643 0.02	1,204 0.02
Cash provided by operating activities per share (basic and diluted)	(432) 0.00	1,007 0.01	1,816 0.03	573 0.01	3,408 0.05	2,090 0.04	1,778 0.03	1,157 0.02
Earnings (loss) per share (basic and diluted)	(1,070) (0.02)	(619) (0.01)	(9,754) (0.15)	(3,561) (0.05)	(277) 0.00	132 0.00	(381) (0.01)	(168) 0.00
Overhead	304	(55)	447	567	442	398	387	472
Net capital additions (dispositions)	(451)	(190)	836	2,074	1,504	1,735	2,479	2,384
Total assets	37,725	39,826	43,264	56,761	62,927	61,114	61,221	60,794
Convertible debentures*	6,304	6,233	6,163	6,094	6,027	5,961	5,896	5,832
Net current debt	7,218	7,695	8,657	8,449	7,891	8,481	9,404	8,542

\* Convertible debentures have a face value of \$7.1 million and mature on March 26, 2012. See Note 8, "Convertible Debentures", in the notes to the financial statements for the nine months ended September 30, 2009.

Diaz's production rate peaked at 955 BOEd in Q2 2008 and declined during the last five quarters. Q2 2008 also had the highest average price per BOE. Since Q2 2008, prices have dropped by over 50% resulting in a significant reduction in cashflow. As demonstrated by the following graph, the relative change in price per BOE has had a greater impact on cashflow than the change in production rates.



### Cashflow, Production and Price - Eight Quarters



### Liquidity and Capital Resources

Diaz completed the nine months ended September 30, 2009, with a net current debt of \$7.2 million compared with \$8.5 million at the beginning of the year.

In May 2009, Diaz completed the sale of its interest in a non-operated oil property in the Carmangay, Alberta area for \$1.0 million. In September, Diaz sold a 43.75% working interest in its Eagle Ford shale property in Texas for \$810,000 while retaining a 6.25% working interest with the next gross \$4.3 million of work expenditures to be paid by the purchaser. In October, Diaz completed the sale of its Parkman, Saskatchewan, oil property for \$2.5 million.

A total of \$1.9 million has been received for all property disposals for the nine month period ended September 30, 2009, and \$4.4 million to date if the Parkman sale is included. The proceeds from the sales were used to reduce Diaz's bank debt. On September 30, 2009, the Company had an \$8.0 million secured loan with a Canadian financial institution; however, the Carmangay and Parkman property's were included in the bank's borrowing base. The reassessed borrowing base has been adjusted down to \$6.35 million.

In early October, Diaz completed a \$920,000 equity private placement, net of expenses. Also, in October, the Company completed the sale of its Parkman property yielding an additional \$2.5 million. Net current debt at September 30, 2009, was \$7.2 million but if adjusted for the equity private placement and for the sale of the Parkman property, net current debt would be \$3.8 million on a pro forma basis.

As of November 5, 2009, Diaz had 76,576,752 common shares issued and outstanding.



In addition, at September 30, 2009, the Company had convertible debentures of \$7.1 million (face value) that mature on March 26, 2012.

The Company's capital expenditure plans for 2009 are based on estimated cash flow from operations for the year plus a portion of the available working capital needed for the drilling of three wells at the Company's Lloydminster property during Q4 2009. See Note 1, "Going Concern", in the notes to the financial statements for the nine month period ended September 30, 2009.

### **Normal Course Issuer Bid ("NCIB")**

During the nine months ended September 30, 2009, Diaz did not repurchase any of its Common Shares.

Diaz's NCIB expired on September 25, 2009. Shares repurchased pursuant to the bid are cancelled.

### **Business Risk**

The Company is engaged in the exploration, development, production and acquisition of crude oil and natural gas. Diaz's business is inherently risky and there is no assurance that hydrocarbon reserves will be discovered and economically produced.

Financial risks associated with the petroleum industry include fluctuations in commodity prices, interest rates and currency exchange rates. Operational risks include competition, environmental factors, reservoir performance uncertainties, a complex regulatory environment and safety concerns.

Natural gas prices on September 30, 2009, closed at spot prices of \$4.84 USD/Mcf at Henry Hub and \$2.74 CDN/Mcf in Alberta (AECO). Natural gas prices at these levels in Canada and in the United States will cause the Company to have poor forward results.

The Company minimizes its business risks by focusing on a select group of properties. This enables Diaz to have more control over the timing, direction and costs related to exploration and development opportunities. The geological focus is on areas in which the prospects are well understood by management. Technological tools are regularly used to reduce risk and increase the probability of success. The Company closely follows all government regulations and has an up-to-date emergency response plan that has been communicated to all field operations by management. Diaz also carries insurance coverage to protect itself against potential losses.

Employing a highly motivated and experienced staff of petroleum and natural gas professionals further minimizes the business risk.

The Company is exposed to commodity price and market risk for its principal products of petroleum and natural gas. Commodity prices are influenced by a wide variety of factors of which most are beyond the control of Diaz. To manage this risk, the Company has entered into a number of fixed price sales contracts in relation to natural gas prices in Canada.

### **Contractual Obligations and Commitment**

In the normal course of business, Diaz is obligated to make future payments. These obligations represent contracts and other commitments that are known and non-cancelable. Diaz has an obligation with respect to an operating lease covering its office space for a minimum payment of \$61,000 in Q4 2009 and 180,000 in calendar 2010.

The Company also has asset retirement obligations with respect to the abandonment and reclamation of wells and facilities owned by the Company. Diaz includes the present value of the estimated liabilities for such costs on its balance sheet. The total estimated undiscounted cost of these liabilities at September 30, 2009, was \$5.1 million (2008 – \$5.0 million).



### **Off Balance Sheet Arrangements**

Diaz does not currently utilize any off balance sheet arrangements with unconsolidated entities to enhance liquidity and capital resource positions or for any other purpose.

### **Application of Critical Accounting Estimates**

Diaz's financial statements have been prepared in accordance with generally accepted accounting principles in Canada. The significant accounting policies used by Diaz are disclosed in Note 2 to the audited Consolidated Financial Statements for the year ended December 31, 2008. Certain accounting policies require that management make appropriate decisions with respect to the formulation of estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. The following discusses such accounting policies and is included in Management's Discussion and Analysis to aid the reader in assessing the critical accounting policies and practices of the Company and the likelihood of materially different results being reported.

Diaz's management reviews its estimates regularly. The emergence of new information and changed circumstances may result in actual results or changes to estimated amounts that differ materially from current estimates.

The following assessment of significant accounting policies is not meant to be exhaustive. The Company might realize different results from the application of new accounting standards promulgated, from time to time, by various rule-making bodies.

### **Full Cost Accounting for Oil and Gas Activities**

#### ***Depletion Expense***

The Company uses the full cost method of accounting for exploration and development activities. In accordance with this method of accounting, all costs associated with exploration and development are capitalized whether successful or not. The aggregate of net capitalized costs and estimated future development costs less estimated salvage values is amortized using the unit of production method based on estimated proved oil and gas reserves before royalty.

An increase in estimated proved oil and gas reserves would result in a corresponding reduction in depletion expense. A decrease in estimated future development costs would result in a corresponding reduction in depletion expense.

#### ***Withheld Costs***

Certain costs related to unproved properties and major development projects may be excluded from costs subject to depletion until proved reserves have been determined or their value is impaired. These properties are reviewed quarterly and any impairment is transferred to the costs being depleted.

#### ***Impairment of Long-Lived Assets***

The Company is required to review the carrying value of all property, plant and equipment, including the carrying value of oil and gas assets, for potential impairment. Impairment is indicated if the carrying value of the long-lived asset or oil and gas cost center is not recoverable by the future undiscounted cash flows. If impairment is indicated, the amount by which the carrying value exceeds the estimated fair value of the long-lived asset is charged to earnings.



### ***Asset Retirement Obligations***

The Company is required to provide for future removal and site restoration costs. The Company must estimate these costs in accordance with existing laws, contracts or other policies. These estimated costs are charged to earnings and the appropriate liability account over the expected service life of the asset.

When the future removal and site restoration costs cannot be reasonably determined, a contingent liability may exist. Contingent liabilities are charged to earnings when management is able to determine the amount and the likelihood of the future obligation.

### ***Legal, Environmental Remediation and Other Contingent Matters***

The Company is required to both determine whether a loss is probable based on judgment and interpretation of laws and regulations and determine that the loss can reasonably be estimated. When the loss is determined it is charged to earnings.

The Company's management must continually monitor known and potential contingent matters and make appropriate provisions by charges to earnings when warranted by circumstance.

### **Income Tax Accounting**

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

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

During 2008, the CICA Accounting Standards Board ("ACSB") confirmed the changeover to IFRS from Canadian GAAP will be required for publicly accountable enterprises interim and annual financial statements effective for fiscal years beginning on or after January 1, 2011. The changeover to IFRS represents a change due to new accounting standards. The transition from current Canadian GAAP to IFRS is a significant undertaking that may materially affect the Company's reported financial position and operations.

To date, the CFO, the primary sponsor for the project, has prepared a summary level changeover plan for IFRS conversion that has been presented to the Audit Committee of the Board of Directors. Hallmarks of the changeover plan include, initial definition of the tasks required for conversion, a timeline for the completion of the tasks, an estimate of the effort and duration associated with the conversion, prioritization of tasks, and the assignment of key personnel within the organization.

The conversion plan has been divided into three distinct phases and management is currently in phase two as described below.

#### *Phase One:*

Identification of a project work plan that outlines potential conversion issues unique to our industry. This phase assigns ownership responsibility for each of those issues, estimates the time, duration and costs associated with each major deliverable within the plan, and presents an overall project timeline and in-progress reporting from key deliverable owners and assigned employees.

*Phase Two:*

Identification of the significant accounting policies that relate to each of the major conversion items within the firm. This phase identifies the changes to the accounting policies that will be required with IFRS, and adjusts the plan identified in Phase One accordingly.

*Phase Three:*

Management of dual reporting under Canadian GAAP and IFRS as required. This phase determines the mapping between the different accounts identified in our chart of accounts and applies this mapping to generate the IFRS reporting. Dual reporting capability will be required as of January 1, 2010, so that the Company can prepare comparative information for IFRS reporting which will begin the first quarter of 2011.

**Internal Controls over Financial Reporting (ICFR)**

The Chief Executive Officer and Chief Financial Officer of Diaz (the “Certifying Officers”) have designed internal controls over financial reporting or caused them to be designed under their supervision in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP. The Certifying Officers have assessed the design and effectiveness of the Company’s ICFR at September 30, 2009.

As at September 30, 2009, there were no changes to the controls over financial reporting that occurred during the issuer’s most recent interim period that has materially affected, or is reasonably likely to materially affect, the issuer’s internal control over financial reporting.

The Certifying Officers have evaluated the internal controls over financial reporting and have determined that the ICFR is effective.

**Disclosure Controls and Procedures (DC&P)**

The Chief Executive Officer and Chief Financial Officer of Diaz (the “Certifying Officers”) have designed disclosure controls and procedures or caused them to be designed under our supervision, to provide reasonable assurance that:

- (i) material information relating to the issuer is made known to the Certifying Officers by others, particularly during the period in which the annual filings are being prepared; and
- (ii) information required to be disclosed by the issuer in its annual filings, interim filings or other reports filed or submitted by it under securities legislation is recorded, processed, summarized and reported within the time periods specified in securities legislation.

The Certifying Officers have evaluated the disclosure controls and procedures and have determined that the DC&P are effective as at September 30, 2009.



### **Outlook**

Weak natural gas pricing has led to a sharp reduction in the number of rigs drilling for natural gas over the last year. The drop of rig activity in Canada and the U.S. has resulted in a decrease of domestic supply as production rates from existing wells decline without offsetting new production. However, there is still considerable uncertainty as to when prices will again rise to satisfactory levels due to the current high natural gas storage levels and the slow recovery in demand from the U.S. manufacturing sector. Because of ongoing weakness in the gas market and the underlying economy Diaz expects that natural gas prices will stay in the \$4.50 range per Mcf for the remainder of 2009.

Diaz has successfully undertaken an asset disposal program over the last four months and recently completed a small equity financing. These achievements have strengthened Diaz's fiscal capabilities thus enabling the Company to begin development of its Lloydminster heavy oil property.



## CORPORATE INFORMATION

### **Directors**

Robert W. Lamond  
Calgary, Alberta

Charles A. Teare  
Calgary, Alberta

Donald K. Clark  
Calgary, Alberta

Clive M. Stockdale <sup>(1)(2)</sup>  
Vancouver, British Columbia

Raj Agrawal <sup>(1)</sup>  
Calgary, Alberta

John G.F. McLeod <sup>(2)</sup>  
Okotoks, Alberta

Robert L. McPherson <sup>(1)(3)</sup>  
Calgary, Alberta

- <sup>(1)</sup> Member of the Audit Committee  
<sup>(2)</sup> Member of the Compensation Committee  
<sup>(3)</sup> Member of the Corporate Governance Committee

### **Legal Counsel**

Burnet, Duckworth & Palmer LLP  
Calgary, Alberta

### **Registrar and Transfer Agent**

Computershare Trust Company of Canada  
Calgary, Alberta  
Toronto, Ontario

### **Officers**

R.W. Lamond  
President, Chairman of the Board & CEO

D.K. Clark  
Vice President, Operations & COO

B.R. Perry  
Chief Financial Officer

C.A. Teare  
Executive Vice President

C.S. Cohen  
Corporate Secretary

R.D. Arsenault  
Controller

### **Subsidiaries**

Diaz Resources, Inc.  
Orbit Oil & Gas Inc.

### **Auditors**

PricewaterhouseCoopers LLP  
Calgary, Alberta

### **Stock Exchange Listing**

Toronto Stock Exchange  
Trading Symbol: DZR

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