



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

**For the years ended December 31, 2010
and 2009**

Dated March 31, 2011

**Epsilon Energy Ltd.
150 Jardin Drive, Suite 9
Concord, ON, Canada L4K 3P9**

(905) 738-7877

www.epsilonenergy ltd.com

EPSILON ENERGY LTD.

MANAGEMENT'S DISCUSSION AND ANALYSIS

FOR THE YEARS ENDED DECEMBER 31, 2010 AND 2009

This Management's Discussion and Analysis ("MD&A") is intended to assist in the understanding of trends and significant changes in or results of operations and the financial condition of Epsilon Energy Ltd. ("Epsilon" or the "Corporation") for the years presented. The MD&A has been prepared by management as at March 31, 2011 in accordance with Canadian Generally Accepted Accounting Principles ("GAAP") and should be read in conjunction with the audited consolidated financial statements as at December 31, 2010 and 2009 and for the years then ended together with accompanying notes, the Statement of Reserves Data and Other Oil and Gas Information at December 31, 2010, the Annual Information Form ("AIF") dated March 31, 2011 and Form 51-101 F3 "Report of Management and Directors on Reserves Data and Other Information" dated March 31, 2011. These documents and additional information about Epsilon are available on SEDAR at www.sedar.com.

Unless otherwise indicated, all dollar values in this MD&A are, with the exception of per unit amounts, expressed in thousands of U.S. dollars. Canadian dollars are expressed as C\$ in this MD&A.

Cautionary Statement Regarding Forward Looking Information and Statements

Certain statements contained in this report constitute forward-looking statements. The use of any of the words "anticipate", "continue", "estimate", "expect", "may", "will", "project", "should", "believe" and similar expressions and statements relating to matters that are not historical facts constitute "forward looking information" within the meaning of applicable Canadian securities legislation. These statements involve known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated. Such forward-looking statements are based on reasonable assumptions but no assurance can be given that these expectations will prove to be correct and the forward-looking statements included in this report should not be unduly relied upon. These statements are made only as of the date of this report.

In particular, this report contains forward-looking statements including, but not limited to, the following:

- oil and natural gas production rates;
- commodity prices for crude oil or natural gas;
- supply and demand for oil and natural gas;
- the estimated quantity of oil and natural gas reserves, including reserve life;
- capital expenditure programs;
- future exploration, development and production costs;
- timing of drilling plans;
- planned construction and expansion of facilities;
- plans for and results of exploration and development activities;
- expectations regarding the Corporation's ability to raise capital and to continually add to oil and natural gas reserves through acquisitions, exploration and development; and
- treatment under governmental regulatory regimes and tax laws.

The Corporation's actual results could differ materially from those anticipated in these forward-looking statements as a result of the risk factors set forth below and elsewhere in this report:

- general economic, political, market and business conditions;
- risks inherent in oil and natural gas operations;
- uncertainties associated with estimating oil and natural gas reserves;
- competition for capital, acquisitions of reserves, undeveloped lands, drilling equipment and skilled personnel;
- geological, technical, drilling and processing problems;
- incorrect assessments of the value of acquisitions;

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Cautionary Statement Regarding Forward Looking Information and Statements (continued)

- the availability of capital on acceptable terms;
- volatility in market prices for oil and natural gas;
- reliance on key operational and management personnel;
- actions by governmental authorities, including regulatory, environmental and taxation policies;
- fluctuations in foreign exchange, interest rates and stock market volatility; and
- other risk factors discussed under “*Risk Factors*” within the Corporation’s AIF dated March 31, 2011.

These factors are not all inclusive. Except as required under applicable securities laws, the Corporation undertakes no obligation to update or revise any forward-looking statements.

Corporate Overview

Epsilon is engaged in the acquisition, exploration, development and production of natural gas reserves targeting the Marcellus shale. The Corporation also has participating interests and production sharing agreements in other natural gas and oil plays within Canada, the US and Ethiopia. Established in 2005, the Corporation has been a producer of natural gas and oil since 2006. Epsilon’s ongoing business strategy involves focused targeting of natural gas and oil properties within the United States and Canada, as well as the high potential oil and gas properties in Africa with the goal of converting its leasehold interests into proven natural gas and oil reserves, followed by production that optimizes cash flow and return on investment. The common shares of the Corporation trade on The Toronto Stock Exchange under the symbol “EPS”. Also refer to “*Risk Factors*” in the Corporation’s Annual Information Form dated March 31, 2011.

Epsilon had another strong year in 2010 as anticipated largely due to the operational results associated with its Marcellus Shale assets in Pennsylvania. The results of operations are discussed on a line by line basis, where appropriate, in order to provide a clear understanding of the Corporation’s performance.

Selected Annual Information

Selected financial data covering the years ended December 31, 2010, 2009 and 2008, respectively, are as follows (amounts rounded to thousands, except number of shares and per share amounts):

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	<u>2010</u>	<u>2009</u>	<u>2008</u>
Revenues	\$ 14,753	\$ 5,439	\$ 8,300
Cost of operations	10,779	28,194	45,482
Operating income (loss)	3,974	(22,755)	(37,182)
Other income (expense)	53	2,526	6,094
Net income (loss) before income taxes	4,027	(20,229)	(31,088)
Future income tax expense	-	-	2,600
Net income (loss)	<u>\$ 4,027</u>	<u>(\$20,229)</u>	<u>(\$33,688)</u>
Net income (loss) per share, basic	0.08	(0.40)	(0.71)
Net income (loss) per share, diluted	0.08	(0.40)	(0.71)
Weighted average number of shares outstanding, basic	49,953,148	50,325,998	47,504,000
Weighted average number of shares outstanding, diluted	51,177,139	50,325,998	47,504,000
Dividends per share	\$ -	\$ -	\$ -
Net cash provided by (used in) operating activities	9,147	(11,588)	(6,596)
Net cash provided by (used in) investing activities	(3,896)	34,634	(72,945)
Net cash provided by (used in) financing activities	(2,309)	(19,171)	49,768
Total assets	63,309	84,381	134,070
Total long-term liabilities	-	-	19

Recent Events

Repurchases of Epsilon's Common Stock

Epsilon has been making repurchases of its own stock pursuant to an acceptance from the Toronto Stock Exchange ("TSX") of the Notice of Intention to make a normal course issuer bid which was announced on October 27, 2010. The Corporation obtained an approval from the TSX to repurchase up to 2,000,000 of the issued and outstanding common shares.

The Corporation has repurchased 100,000 common shares in November 2010, at an average repurchase price of \$2.62, and 25,000 common shares in December 2010, at an average repurchase price of \$2.70. The Corporation might repurchase additional shares up to the amount approved by the TSX at the discretion of senior management. The repurchased shares have been cancelled.

On April 20, 2010, the Corporation signed an agreement with a former director and officer to purchase 1,000,000 or approximately 2% of the 50,625,998 common shares that were then issued and outstanding for C\$2.5 million (US\$2,469,250) or C\$2.50 (US\$2.47) per share.

The shares purchased by Epsilon were canceled. The purchase and cancellation was made as an exempt issuer bid pursuant to section 4.7 Multilateral Instrument 62-104 Take-Over Bids and Issuer Bids ("MI 62-104"). The price per share was calculated to comply with the requirements of section 1.11 of MI 62-104.

Signing of a Participation Agreement

On October 1, 2010, the Corporation signed a Participation Agreement (the "Agreement") with Black Stone Minerals Company, L.P. ("Black Stone") for the development of an oil resource play in Clarke and Wayne Counties, Mississippi.

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Under the principal terms of the Agreement, Epsilon is committed to drill a minimum of two wells at an estimated cost of US\$10 million in return for a lease of 51% of Black Stone's available mineral interests in the approximate 15,800 gross/13,600 net acres it owns or controls. The acreage subject to the proposed joint operating agreement is in the immediate proximity of an existing producing oil fairway. The expenditures on this project are scheduled to commence in the second quarter of 2011.

Sale of Epsilon Energy Yemen Ltd.

By agreement dated January 2, 2010, the Corporation agreed to sell all of the issued and outstanding shares in Epsilon Energy Yemen Ltd. ("**Epsilon Yemen**"). This agreement was most recently amended on July 15, 2010. The Corporation received \$100,000 on August 3, 2010 pursuant to the agreement.

Formation of a Subsidiary

On December 10, 2010, Epsilon Midstream LLC ("**Midstream**") was incorporated in the State of Pennsylvania to hold the Corporation's gas gathering system. Midstream is 100% owned by Epsilon Energy USA, Inc. which, in turn, is wholly owned by the Corporation.

Farmout Agreement with Chesapeake

On February 3, 2010, the Corporation closed a Farmout Agreement with Chesapeake Energy Corporation ("**Chesapeake**"). At closing, Chesapeake paid to the joint venture \$5.0 million in cash and will earn a 50% interest in the Corporation's upstream Marcellus Shale assets by paying a further \$95.0 million over time by carrying the first \$95.0 million of the Corporation's share of leasehold, drilling, completing, equipping and gathering costs attributable to the prospect.

Update on the Curative Related to the Farmout Agreement with Chesapeake Energy Corp.

During the year, the Corporation cured the majority of title defects that existed at the time the farmout agreement was executed. As is typical for a transaction of this size, title defects on certain leases affecting a small percentage of the purchase price (approximately 2%) could not be cured sufficient to meet the Marketable Title standard mandated by the farmout agreement.

OVERALL PERFORMANCE

In 2010, the Corporation generated a net income of approximately \$4.0 million as compared to a \$20.2 million net loss in 2009. At December 31, 2010, the Corporation had surplus working capital (inclusive of \$0.8 million restricted cash) of approximately \$20.3 million, as compared to \$14.2 million of surplus working capital (inclusive of \$0.7 million restricted cash) at December 31, 2009, an increase of 42.96%. The Corporation has net cash flows provided by operations of \$9.1 million in 2010 compared to net cash flows used in operation of \$11.6 million in 2009. Epsilon has no debt.

Operational Outlook and Property Overview

A summary of the Epsilon's projects by country are as follows:

United States

Pennsylvania Marcellus Shale

As of December 31, 2010, the Corporation had approximately 11,500 gross (5,750 net) leasehold acres in Pennsylvania where Chesapeake is the operator. To date, the Corporation has either drilled or participated in the drilling of twenty five wells in the Marcellus shale on its Highway 706 project in northeastern Pennsylvania. Nine of the wells have produced at a combined average rate of 8.2 Mmcf per day in 2010, with two compressors in operation with total capacity of 10 Mmcf per day.

New York

In New York, where the Corporation holds an interest in approximately 23,000 gross (10,700 net) acres, the Corporation's acreage is prospective for natural gas production in both the Marcellus shale, (shallow

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unconventional natural gas play) and the Trenton-Black River formation (deep conventional natural gas play).

NY Marcellus Shale

In NY Marcellus Shale, where the Corporation holds approximately 47% interest in the leasehold and is the operator, it continues to evaluate potential exploration, development and production opportunities in the Marcellus shale, including but not limited to, participating in competitor wells, developing its existing leasehold acreage and/or entering in joint ventures with other companies. As such, the Corporation has commenced the early stages of forming a large Marcellus shale project, including staking well locations, planning infrastructure and seeking regulatory approvals. Marcellus shale drilling permits utilizing larger hydro-fractures are currently on hold pending completion of a Supplemental Generic Environmental Impact Statement by the New York Department of Environmental Conservation. As of the date of this report the Corporation had drilled four wells in New York.

NY Trenton-Black River

The Corporation is also focused on exploration of the prolific Trenton-Black River formation, a deep conventional natural gas reservoir target. The Corporation holds various non-operated working interests with multiple operators in well units from less than 1%, up to approximately 12%.

In 2010, net production from Trenton-Black River formation was approximately 0.3 Mmcf/d. Due to its current focus on the Marcellus shale in Pennsylvania and New York, the Corporation is not allocating a significant amount of capital to fund participation in drilling future wells targeting the Trenton-Black River formation in New York.

Ohio

The Bailey's Mill project is located in Belmont and Monroe counties and consists of approximately 21,600 gross (4,300 net) leasehold acres, in which the Corporation holds a 25% non-operated working interest. Due to its current focus on the Marcellus shale in Pennsylvania and New York, the Corporation does not anticipate allocating a significant amount of funds to continue participating in drilling future wells on its Bailey's Mill project.

Canada

Saskatchewan

On August 28, 2008, the Corporation entered into an agreement with an unrelated public Canadian company covering joint oil and natural gas exploration and development activities in a 63,360 gross acre Area of Mutual Interest ("AMI") covering the Bakken oil play in southeast Saskatchewan province. The project lies within the favorable Saskatchewan province royalty area. The public Canadian company is the operator of the AMI. The Corporation agreed to pay 100% of the costs to drill a minimum of two horizontal wells in order to earn a 50% working interest in approximately 8,960 gross (7,800 net) acres controlled by the unrelated public company.

Drilling operations in the AMI commenced in August 2009. The first well, the Torquay, was drilled horizontally, fractured and is currently in production. As of December 31, 2010, the Corporation paid \$2,180,126 (2009: \$2,213,680) for the cost to drill and complete the first of the two aforementioned earning wells. The second well obligation of \$2.4 million has been partially substituted for a 3D seismic program, which resulted in expenditures to the Corporation of \$1.365 million. The remaining balance after the completion of 3D seismic program will be committed to the next well that is expected to be drilled in 2011.

On October 9, 2008, the Corporation acquired additional prospective Bakken oil play interests in approximately 31,370 gross (13,800 net) acres jointly with the same public Canadian company via a

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competitive bid at the Saskatchewan crown lease sale. In this acreage, the Corporation plans to drill one well on the Ceylon Project area and a second well in the Weyburn Project area at a total cost of approximately \$1.0 million. The drilling on the first well is scheduled to commence during the second quarter of 2011. See "*Commitments and Contingencies – Bakken Shale Drilling Commitment*".

Quebec

The Corporation has an elective participating interest of up to 25% in a portion of Gastem Inc.'s (TSXV: **GMR**) leasehold acreage in the St. Lawrence Lowlands (covering Utica shale and Trenton-Black River targets) and in the Gaspé Peninsula (covering Silurian and Devonian targets). Within Gastem Inc.'s St. Lawrence Lowlands leasehold acreage, Forest Oil Corporation recently spent CDN\$10.0 million to earn a 60% interest in what is now referred to as the Yamaska project. The Corporation elected not to participate on the first two exploratory wells drilled within the Yamaska project, while electing to participate in future operations with a 5% working interest.

Ethiopia – Northwest Area Study Agreement

On May 14, 2009, the Corporation announced that it had signed a Production Sharing Agreement ("**PSA**") with the Ministry of Mines and Energy (the "**Ministry**") in Democratic Republic of Ethiopia. The PSA covers an area of 82,500 square kilometers (31,853 square miles) in northwest Ethiopia. Terms of the PSA include an initial three-year exploration period that includes a minimum financial commitment of \$3.0 million to drill one exploratory well and to acquire a minimum of 200 kilometers of 2D seismic. In the event the Corporation makes a commercial discovery, the initial percentage split of profit oil and/or gas will be 80% for the Corporation and 20% for the Ministry.

RESULTS OF OPERATIONS

The following discussion encompasses the Corporation's revenues and costs of operations. Unless noted otherwise, the discussion pertains to the Corporation's Appalachian basin segment in the United States, as all other identified geographical operating segments were essentially in the start-up phase during the presented years and had minimal reportable revenues or operating costs during the presented years.

Total revenues

	2010	2009
<i>(in thousands of dollars, except per unit and production values)</i>		
Total Revenues	\$ 14,753	\$ 5,439
Net natural gas production (Mcf)	3,011,003	1,080,777
Average natural gas price (\$/Mcf)	\$ 4.89	\$ 5.02
End of period net production exit rate (Mcf/d)	6,416	6,357
Net oil production (bbls)	386	81
Average oil price (\$/bbl)	\$ 79.62	\$ 120.64

Three months ended December 31, 2010 and 2009

Total revenues increased by \$1.8 million compared to fourth quarter of 2009 due to an increase in gas production of 334,089 Mcf as a result of three additional Pennsylvania wells operating at the end of December 2010 compared to December 2009.

Twelve months ended December 31, 2010 and 2009

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Total revenues increased by \$9.3 million compared to the twelve months ended December 31, 2010 due to an increase in gas production of 1,930,226 Mcf as a result of three additional Pennsylvania wells operating at the end of December 2010 compared to December 2009. Furthermore, 50% of the Corporation's pro-rata production was subject to physical delivery fixed prices, in effect to June 30, 2010, with higher than market gas prices. In 2009, these contracts were in effect to the end of April and following their expiry the natural gas production was sold at spot market rate at substantially lower natural gas prices.

Project Operating Costs

<i>(in thousands of dollars)</i>	Twelve Months Ended December 31,	
	2010	2009
Project operating costs	1,485	1,340

Project operating costs consist of lease operating expenses necessary to extract gas and oil, including transporting it to a sales point and production taxes assessed by the state in which production occurs. These expenses vary directly with the level of oil and natural gas production and related expenses.

Three months ended December 31, 2010 and 2009

The project operating costs for the 4th quarter of 2010 increased \$0.2 million compared to the same period in 2009 due to an increase in production in 2010.

Twelve months ended December 31, 2010 and 2009

The project operating costs for 2010 increased as compared to 2009 due to an increase in production in 2010 but the costs per Mcf have declined from \$1.24 in 2009 to \$0.49 in 2010 due to the farmout agreement with Chesapeake which carries Epsilon's share of lease operating expenses. In 2010, there was a further reduction in production taxes that are included in project operating costs due to the sale of the West Virginia interests. There are no production taxes in Pennsylvania or New York.

Impairment of unproved properties

<i>(in thousands of dollars)</i>	Twelve Months Ended December 31,	
	2010	2009
Impairment of unproved properties	296	18,784

Three and twelve months ended December 31, 2010 and 2009

In 2010, the Corporation recorded an unproved property impairment on interests in Uruguay, Syria and Iraq. During 2009 the Corporation recorded an unproved property impairment of \$17,861 pertaining to Block 41 in Yemen, writing down the value of the assets to the fair market value of \$100, and recorded an unproved property impairment of \$923 pertaining to Oman.

Depletion, depreciation, and accretion ("DD&A")

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<i>(in thousands of dollars)</i>	Twelve Months Ended	
	December 31,	
	2010	2009
Depletion, depreciation and accretion	4,920	3,458

In line with the Full Cost Accounting principle, the Corporation capitalizes all costs related to the exploration for and development of natural gas and crude oil reserves. The capitalized costs and future development costs are depleted on the unit-of-production method based on estimated proved reserves. Costs of significant unproved properties, net of impairments, are excluded from the depletion, depreciation and accretion calculation. See section “*Full Cost Accounting*” below.

Substantially all depreciation expense amounts pertained to the Corporation’s office furniture and fixtures, computer hardware and software, while all accretion expense amounts pertain to the amortization of the Corporation’s asset retirement obligations.

Three and twelve months ended December 31, 2010 and 2009

The Depletion, Depreciation and Accretion (“**DD&A**”) expense increased during the three and twelve month periods ended December 31, 2010 compared to the same periods ended December 31, 2009 due to the increase in proved reserves from 72.7 Bcf as of December 31, 2009 to 86.6 Bcf as of December 31, 2010.

General and administrative

<i>(in thousands of dollars)</i>	Twelve Months Ended	
	December 31,	
	2010	2009
General and administrative	4,078	4,611

General and Administrative (“**G&A**”) consists of general corporate expenses such as compensation, legal, accounting and professional fees, consulting services, travel and other related corporate costs such as stock options granted.

Three months ended December 31, 2010 and 2009

The G&A expense were consistent in the three months ended December 31, 2010 compared to the three months ended December 31, 2009.

Twelve months ended December 31, 2010 and 2009

The G&A expense decreased by approximately \$0.5 million in 2010 compared to 2009 as a result of continuation of cost containment measures, reversal of unvested stock options on forfeitures and the reversal of the Ontario capital tax discontinued in 2010.

In the first quarter of 2010, the Corporation incurred a one-time \$1.0 million transaction fee on the closing of the joint venture agreement with Chesapeake. Excluding the impact of this expenditure, general and administrative expenses decreased by \$1.5 million.

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Other income (expense)

<i>(in thousands of dollars)</i>	Twelve Months Ended	
	December 31,	
	2010	2009
Other income (expense)	88	(225)

Other income (expense) mainly consists of interest income or expense and purchase discounts.

Three and twelve months ended December 31, 2010 and 2009

In 2010, Epsilon had higher interest income compared to 2009 since the Corporation had higher cash balance and no debt.

Gain (loss) on sale of assets

<i>(in thousands of dollars)</i>	Twelve Months Ended	
	December 31,	
	2010	2009
Gain (loss) on sale of assets	(35)	2,751

Three and twelve months ended December 31, 2010 and 2009

In 2010, the corporation recorded a loss on disposal of furniture and equipment related to the closure of an office in Abu Dhabi, the United Arab Emirates.

During 2009, the Corporation recorded a net gain of \$2,751 reflecting \$7,142 loss (net of tax) from the sale of its oil and natural gas property interests in West Virginia offset by a gain of \$9,893 from the sale of non-core acres located in eastern Pennsylvania.

Income taxes

In 2010, Epsilon had sufficient losses carried forward to offset taxable income for the year. The Corporation did not have taxable income in 2009.

Net income (loss)

<i>(in thousands of dollars except per share amounts)</i>	Twelve Months Ended	
	December 31,	
	2010	2009
Net income (loss)	4,027	(20,229)
Net income (loss) per share, basic	0.08	(0.40)
Net income (loss) per share, diluted	0.08	(0.40)

Three months ended December 31, 2010 and 2009

The net income for the fourth quarter ended December 31, 2010 of approximately \$2.0 million (\$0.04 net income per share) as compared to a net loss of \$5.7 million (\$0.40 net loss per share) for the same period in 2009 was primarily attributable to a combination of the following factors, all of which were discussed earlier:

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- \$1.8 million attributable to higher revenue
- \$16.0 million reduction in property impairment
- \$12.5 million reduction in gain on sale of assets

Twelve months ended December 31, 2010 and 2009

The net income in 2010 of approximately \$4.0 million (\$0.08 net income per share) as compared to a net loss of \$20.2 million (\$0.40 net loss per share) for the same period in 2009 was primarily attributable to a combination of the following factors, all of which were discussed earlier:

- \$9.3 million attributable to higher revenue
- \$18.5 million reduction in impairment of unproved properties
- \$1.5 million increase in depletion, depreciation and accretion
- \$2.7 million reduction in gain on sale of assets

FOURTH QUARTER

During the fourth quarter of 2010, Epsilon generated net income of \$2.0 million compared to a net loss of \$5.7 million in the fourth quarter of 2009. The increase is due to an increase in gas production from 523,354 Mcf to 857,452 Mcf primarily related to Highway 706 project in Pennsylvania.

The project operating costs for the 4th quarter of 2010 increased \$0.2 million compared to the same period in 2009 due to an increase in production in 2010.

During the fourth quarter of 2009 the Corporation recorded unproved property impairment of \$16.0 million pertaining to Yemen and Oman. There was no impairment expense recorded in the fourth quarter of 2010.

The general and administrative expenses during the fourth quarter of 2010 were consistent with those in the fourth quarter of 2009.

During the fourth quarter of 2010, Epsilon generated cash of \$2.2 million from operating activities compares \$0.1 million in the fourth quarter of 2009.

SUMMARY OF QUARTERLY RESULTS

Summary quarterly information is presented in the table below. All amounts rounded to thousands of dollars, except for the number of shares and per share amounts.

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(in thousands of dollars, except shares outstanding and per share amounts)	Mar 31, 2009 \$	Jun 30, 2009 \$	Sep 30, 2009 \$	Dec 31, 2009 \$	Mar 31, 2010 \$	June 30, 2010 \$	Sep 30, 2010 \$	Dec 31, 2010 \$
Revenues:								
Gas	1,650	665	607	2,374	3,983	3,864	2,685	4,191
Oil	(15)	6	-	19	13	6	5	7
Gathering fees, net	72	61	-	-	-	-	-	-
Total revenues	1,707	732	607	2,393	3,996	3,870	2,690	4,198
Operating costs	467	385	188	300	427	441	75	543
Impairment of unproved properties	-	2,172	581	16,031	33	-	263	-
DD&A	697	612	1,212	937	1,544	1,356	1,153	868
G&A	1,306	1,166	1,369	770	1,960	1,105	243	769
Cost of operations	2,470	4,335	3,350	18,038	3,964	2,902	1,734	2,180
Operating income (loss)	(763)	(3,603)	(2,743)	(15,645)	32	968	956	2,018
Gain (loss) on sale of assets	-	(9,728)	(14)	12,493	-	-	3	(38)
Other income (loss)	(72)	(114)	(55)	16	18	22	25	23
Net income (loss) before income taxes	(835)	(13,445)	(2,812)	(3,136)	50	990	984	2,003
Income tax expense (recovery)	-	-	-	-	-	-	-	-
Net income (loss)	(835)	(13,445)	(2,812)	(3,136)	50	990	984	2,003
Weighted average number of shares								
outstanding, basic	51,315,323	51,315,323	51,315,323	50,325,998	50,550,998	49,840,185	49,722,672	49,725,179
outstanding, diluted	51,315,323	51,315,323	51,315,323	50,325,998	50,550,998	51,175,431	50,719,276	49,800,170
Net income (loss) per share, basic	(0.02)	(0.27)	(0.05)	(0.06)	0.00	0.02	0.02	0.04
Net income (loss) per share, diluted	(0.02)	(0.27)	(0.05)	(0.06)	0.00	0.02	0.02	0.04

LIQUIDITY AND CAPITAL RESOURCES

Working Capital

At December 31, 2010, the Corporation had a working capital surplus (inclusive of restricted cash) of \$20.3 million, as compared to \$14.2 million of surplus working capital (inclusive of restricted cash) at December 31, 2009. The \$6.1 million increase in working capital at December 31, 2010, as compared to December 31, 2009 is primarily attributable to \$1.3 million increase in accounts receivable due to higher gas revenues and a \$1.3 million decrease in accounts payable as a result of paying off outstanding balances more promptly. There has also been an increase in cash from higher revenues and lower operating costs pursuant to the farmout agreement, and to an increase in restricted cash due to a road bond with the Department of Environmental Protection.

As of December 31, 2010, Epsilon is debt free. It is expected that cash on hand and cash flow from the sale of natural gas as part of the farmout agreement with Chesapeake should be more than sufficient to fund the Corporation's exploration plans, particularly in the Marcellus shale project and other projects in the US, Canada and Africa.

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Cash Flow from Operations

Three months ended December 31, 2010 and 2009

During the fourth quarter of 2010, \$2.2 million was provided by the Corporation's operating activities, an increase of \$2.1 million compared to the fourth quarter of 2009 due to net income of \$2.0 million for the three months ended December 31, 2010 compared to a net loss of \$5.7 for the same period in 2009. The increase in cash from operating activities was offset by higher non-cash addbacks in 2009.

Twelve months ended December 31, 2010 and 2009

In 2010, \$9.1 million was provided by the Corporation's operating activities, an increase of \$20.7 million as compared to 2009. This is mainly attributable to the net income of \$4.0 million generated in 2010 compared to a net loss of \$20.2 million in 2009. The increase in cash from operating activities was offset by higher non-cash addbacks in 2009.

Outstanding Share Capital

The following table summarizes the development of share capital from December 31, 2008 to December 30, 2010:

(in thousands of dollars, except for the number of shares)

	Number of Shares Issued	Amount
Balance at December 31, 2008	50,315,323	\$ 138,259
Issuance costs for Bought Deal	-	-
Exercise of stock options	10,675	13
Balance at December 31, 2009	50,325,998	\$ 138,272
Buy back of shares	(1,125,000)	(3,068)
Exercise of stock options	515,254	797
Balance at December 31, 2010	<u>49,716,252</u>	<u>\$ 136,001</u>

Stock options

The weighted average fair value of options granted during the period ended December 31, 2010 was \$2.84 per option calculated using a risk-free rate of 4.3%, dividend yield of 0%, volatility factor of 84%, and expected life of 5 years. The value of the options was recorded as stock based compensation expense, with an offsetting amount to contributed surplus based on the vesting terms.

Property and Equipment

<i>(in thousands of dollars)</i>	Years ended December 31,	
	2010	2009
Property and equipment	<u>\$63,309</u>	<u>\$66,691</u>

Total property and equipment decreased by \$3.4 million from December 31, 2009 primarily due to:

- A reduction in the property and equipment balance of \$5.0 million as a result of the \$5.0 million consideration received on the closing of the farmout agreement that was applied against the agreed-upon carry amount.

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- An increase as a result of drilling activities in New York, capital expenditures in Pennsylvania, completion costs of the first well in the Bakken shale and exploratory costs in Ethiopia, offset by the DD&A costs.

Reportable Geographical Operating Segments

As at December 31, 2010, the Corporation's operations by geographical area included the United States, Canada, Yemen and Ethiopia. See Note 3 "Property and Equipment". Summarized reportable geographical segment data follows:

(in thousands of dollars)

Reportable Segments:	2010	2009
United States:		
Revenues	\$ 14,726	\$ 5,421
Operating costs	1,478	1,329
Capital expenditures	4,062	20,441
Canada:		
Revenues	27	18
Operating costs	7	11
Capital expenditures	2,446	2,712
Yemen:		
Revenues	-	-
Operating costs	-	-
Capital expenditures	-	2,785
Ethiopia:		
Revenues	-	-
Operating costs	-	-
Capital expenditures	294	243
Other International:		
Revenues	-	-
Operating costs	-	-
Capital expenditures	16	747
Total Reportable Segments		
Revenues	\$ 14,753	\$ 5,439
Operating costs	\$ 1,485	\$ 1,340
Capital expenditures	\$ 6,818	\$ 26,928

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COMMITMENTS AND CONTINGENCIES

Saskatchewan - Bakken Shale Drilling Commitment

The Corporation entered into an agreement with an unrelated public Canadian company on August 28, 2008, whereby the Corporation agreed to pay 100% of the costs to drill a minimum of two horizontal wells in the Bakken shale in order to earn a 50% working interest in acreage controlled by the unrelated public company. As of December 31, 2010, the Corporation paid \$2,180,126 (2009: \$2,213,680) for the cost to drill and complete the first of the two aforementioned earning wells. The second well obligation of \$2.4 million has been partially substituted for a 3D seismic program, which resulted in expenditures to the Corporation of \$1.365 million. The remaining balance after the completion of 3D seismic program will be committed to the next well that is expected to be drilled in 2011.

New York - Trenton-Black River Well Units

During 2006, the Department of Environmental Conservation (“**DEC**”) classified the Corporation’s interest in several wells drilled prior to a statute change as an integrated non-participating owner. As a result, the Corporation was charged a non-consent penalty (300% of 100% of the total drilling and completion costs) on its pro-rata share of costs to drill and complete various wells by Talisman Energy Inc. (formerly Fortuna Energy Inc.), the operator. Epsilon believes its interest in the subject wells should have been classified as an integrated participating owner upon payment of its pro-rata share of costs, effectively negating the non-consent penalty the operator could charge prior to disbursing the Corporation’s pro-rata share of profits. The Corporation formally appealed the DEC’s ruling, and, if successful, will require the non-consent penalty withheld by the operator to be disbursed to the Corporation. As a result, there is no anticipated effect on the Corporation’s established working interest. As a non-operator, the Corporation is not liable to make any non-consent payments.

Due to this contingency, there were no amounts initially recorded on the Corporation’s consolidated financial statements prior to payout. In the case where payout has occurred, the Corporation recorded its share of costs and revenues on a prospective basis beginning with the month that each well had been determined to have achieved payout. As at December 31, 2010, the Corporation was classified as an integrated non-participating owner in 7 gross (0.10 net) wells, including 3 gross (0.06 net) for which the non-consent penalty had been paid out. In 2009 the Corporation had received a favorable decision on its F. Andrews well appeal from the New York DEC commissioner. The decision was not appealed by Talisman Energy Inc. (formerly Fortuna Energy Inc.) and the Corporation is currently awaiting final settlement numbers. This decision will result in reimbursement of the non-consent penalty charged to the Corporation for that well. There has been no decision issued for the remaining wells that the Corporation has appealed.

Mississippi

On October 1, 2010, the Corporation signed Participation Agreement (the “**Agreement**”) with a large US-based private land owner (“**land owner**”) to explore for and produce oil and gas. Under the principal terms of the Agreement, Epsilon is committed to drill a minimum of two horizontal wells within one year from the effective date of the agreement at an estimated cost of \$10 million and, in turn, Epsilon will earn 60% of the land owner’s available mineral interests in the approximate 15,800 gross/13,600 net acres it owns or controls. Should the Corporation fail to drill the two wells within the time period specified, the Corporation will pay a sum of \$1.0 million within ten days after the end of that year. On November 1, 2010, the Corporation entered into a joint venture agreement with Rockefeller Hughes (USA), LLC (“**RHC**”), a party related by common directorship, pursuant to which the Corporation agreed to assign 9% of its 60% working interest in the land owner’s available mineral interests to RHC.

Ethiopia

On May 14, 2009, the Corporation announced that it had signed a Production Sharing Agreement (“**PSA**”) with the Ministry of Mines and Energy in Democratic Republic of Ethiopia (the “**Ministry**”). Terms of the PSA comprise of an initial three-year exploration period that includes a commitment to drill one exploratory well and to acquire a minimum of 200 kilometers of 2D seismic. The Corporation is also

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committed to make three annual payments \$40,000 each for training and community development, three annual payments of \$82,500 for land rentals and one lump-sum payment of \$3,000,000 by the end of the PSA term.

In the event the Corporation makes a commercial discovery, the initial percentage split of profit oil and/or gas will be 80% for the Corporation and 20% for the Ministry. To December 31, 2010, the Corporation had incurred \$2,388,561 (2009: \$2,094,038) under the terms of this agreement mainly for a high resolution airborne gravity and magnetic survey.

The Corporation's future commitments are summarized in the following table:

(in thousands of dollars)

	Payments Due by Period			
	Total	Less than 1 Year	1 – 3 Years	4 Years and After
Future Commitments:				
Accounts payable and accrued liabilities	\$ 2,197	\$ 2,196	\$ 1	\$ -
Operating leases	228	76	152	-
Purchase obligations - Canada	10,798	10,798	-	-
Purchase obligations - US	10,000	10,000	-	-
Other long-term obligations - International	3,201	201	3,000	-
Total future commitments	\$ 26,424	\$ 23,271	\$ 3,153	\$ -

Litigation

The Corporation is involved in litigation and claims arising in the normal course of operations. Management is of the opinion that any pending litigation is without merit and would not have a material impact on the Corporation's financial position or results of operations.

CRITICAL ACCOUNTING ESTIMATES

Epsilon's financial and operating results incorporate certain estimates including:

- Estimated revenues, royalties and operating costs on production as at a specific reporting date but for which actual revenues and costs have not yet been received;
- Estimated capital expenditures on projects that are in progress;
- Estimated depletion, depreciation and accretion that are based on estimates of oil and gas reserves that the Corporation expects to recover in the future;
- Estimated value of asset retirement obligations that are dependent upon estimates of future costs and timing of expenditures;
- Estimated future recoverable value of property, plant and equipment.
- Estimated future income tax assets and liabilities for estimated tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis; and
- Estimated valuation allowance to reduce income tax assets, if it is more likely than not that all or some portions of such tax assets will not be realized.

Below are bullet points of significant critical accounting estimates. Also see Note 2 – “*Significant Accounting Policies*” within the annual consolidated financial statements for the years ended December 31, 2010 and 2009 for more details.

- *Full Cost Accounting*

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- *Crude Oil and Natural Gas Reserves*
- *Asset Retirement Obligations ("ARO")*
- *Stock-Based Compensation*
- *Income Taxes*

CHANGES IN ACCOUNTING POLICIES

International Financial Reporting Standards ("IFRS")

In October 2009, the Accounting Standards Board issued a third and final IFRS Omnibus Exposure Draft confirming that publicly accountable enterprises will be required to apply IFRS, in full and without modification, for financial periods beginning on January 1, 2011. The adoption date of January 1, 2011 will require the restatement, for comparative purposes, of amounts reported by the Corporation for the year ended December 31, 2010, including the opening balance sheet as at January 1, 2010.

The Corporation is continually assessing the impact of the convergence of Canadian GAAP with IFRS on the Corporation's results of operations, financial position and disclosures. Under the direction and oversight of the Board of Directors and Audit Committee, the Corporation's management has commenced the transition and is working to ensure successful implementation within the required time frame.

The Corporation's IFRS transition project consists of three key phases:

- (i) **Scope and Plan** - This phase involves performing a high level impact analysis to identify areas that may be affected by the transition to IFRS. The results of this analysis are priority ranked according to complexity and the amount of time required to assess the impact of changes in transitioning to IFRS.
- (ii) **Impact Analysis and Evaluation** - During this phase, items identified in the scope and planning phase are addressed according to the priority levels assigned to them. This phase involves analysis of policy choices allowed under IFRS and their impact on the financial statements. The conclusion of the impact analysis and evaluation phase might potentially require the audit committee of the Board of Directors to review and approve all accounting policy choices as proposed by management.
- (iii) **Implementation and Review** - involves implementation of all changes approved in the impact analysis phase and might include changes to information systems, business processes, modification of agreements and training of all staff who are impacted by the conversion.

Epsilon has completed all three phases of the conversion plan and has finalized the opening balance sheet as at January 1, 2010.

The Corporation has considered the following key issues that were expected to have the most significant impact on the Corporation's results of operations, financial position and disclosures:

- IFRS 1 – First-time adoption of International Financial Reporting Standards
- IFRS 6 – Exploration and evaluation of mineral resources
- IAS 16 – Property, plant and equipment
- IAS 36 – Impairment of assets
- IAS 37 – Provisions, contingent liabilities and contingent assets

First-Time Adoption of IFRS

IFRS 1, "First-Time Adoption of International Financial Reporting Standards" ("**IFRS 1**"), provides entities adopting IFRS for the first time with a number of optional exemptions and mandatory exceptions in certain areas to the general requirement for full retrospective application of IFRS. Management has considered the following optional exemptions:

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- Business Combinations – IFRS 1 would allow the Corporation to use the IFRS rules for business combinations on a prospective basis rather than re-stating all business combinations. The IFRS business combination rules converge with the new CICA Handbook section 1582 that is also effective for the Corporation on January 1, 2011; however, early adoption is permitted. This election had no impact on the Corporation's opening balance sheet
- Property, Plant and Equipment (“**PP&E**”) – IFRS 1 provides the option to value the PP&E assets at their deemed cost being the Canadian GAAP net book value assigned to these assets as at the date of transition, January 1, 2010. This amendment is permissible for entities, such as the Corporation, who currently follow the full cost accounting guideline under Canadian GAAP that accumulates all oil and gas assets into one cost centre. The Corporation has elected to carry the PP&E forward at net book value on the date of transition. Further, under IFRS, the Corporation's PP&E assets must be divided into smaller cost centers. The net book value of the assets on the date of transition has been allocated to the new cost centers on the basis of the Corporation's reserve volumes or values at that point in time.
- Share-Based Payments – IFRS 1 allows the Corporation an exemption on IFRS 2, “Share-Based Payments” to equity instruments which vested before the Corporation's transition date to IFRS. There will be no impact on the Corporation on the adoption of IFRS 2 because the Corporation has been using the graded vesting method from inception.
- The Effects of Changes in Foreign Exchange Rates – IAS 21 allows an entity to deem all cumulative translation differences related to investments in foreign operations to zero at the transition date to avoid retrospective application. Epsilon will use this election at transition date.

The transition from Canadian GAAP to IFRS is a significant undertaking that may materially affect our reported financial position and results of operations. At this time, the Corporation has identified key differences that will impact the financial statements as follows:

- Re-classification of Exploration and Evaluation (“**E&E**”) expenditures from PP&E – Upon transition to IFRS, the Corporation re-classified all E&E expenditures that are currently included in the PP&E balance on the Consolidated Balance Sheet. This will consist of the book value for the Corporation's undeveloped land that relates to exploration properties. E&E assets will not be depleted and must be assessed for impairment when indicators suggest the possibility of impairment.
- Impairment of PP&E assets – Under IFRS, impairment of PP&E must be calculated at a more granular level than what is currently required under Canadian GAAP. Impairment calculations have been performed at the cash generating unit level and no material impairment was determined to exist on transition date.
- Calculation of depletion expense for PP&E assets – Upon transition to IFRS, the Corporation has the option to calculate depletion using a reserve base of proved reserves or both proved and probable reserves, as compared to the Canadian GAAP method of calculating depletion using only proved reserves. The Corporation will continue to calculate depletion using proved reserves.
- The Effects of Changes in Foreign Exchange Rates – a cumulative translation adjustment related to investments in foreign operations totaling \$6.9 million was deemed nil by netting it against the deficit. This reclassification resulted in a nil adjustment to shareholders' equity on transition date.

In addition to accounting policy differences, Epsilon's transition to IFRS will impact the internal controls over financial reporting, the disclosure controls and procedures, Epsilon's business activities and IT systems as follows:

- Internal Controls over Financial Reporting (“**ICFR**”) – This has been an ongoing process through 2010 to ensure that all changes in accounting policies include the appropriate additional controls and procedures for future IFRS reporting requirements.

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- Disclosure controls and procedures – Throughout the transition process, Epsilon has assessed stakeholders' information requirements and will ensure that adequate and timely information is provided so that all stakeholders are kept apprised. Management anticipates delivering investor presentations during the fourth quarter of 2011 to explain the differences between the historical Canadian GAAP statements and the IFRS statements.
- Business activities – Based on the expected changes to Epsilon's accounting policies at this time, there are no foreseen issues as a result of the conversion to IFRS.
- IT systems – The modifications are not expected to be significant

Disclosure Controls and Procedures and Internal Controls over Financial Reporting

Management is responsible for establishing and maintaining adequate ICFR. ICFR means a process designed by or under the supervision of the Chief Executive Officer and Chief Financial Officer, and effected by the Board of Directors, management and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of consolidated financial statements for external purposes in accordance with GAAP.

Disclosure controls and procedures are designed to provide reasonable assurance that material information is gathered and reported to senior management, including the Chief Executive Officer and Chief Financial Officer, as appropriate to permit timely decisions regarding public disclosure. The Corporation has evaluated the effectiveness of its disclosure controls and procedures and has concluded based on this evaluation that the disclosure controls and procedures are effective for the year ended December 31, 2010.

Management completed an assessment of the design of ICFR. The Corporation used the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") framework and guidance for smaller public companies for the design of the Corporation's ICFR. All internal control systems have inherent limitations and therefore our ICFR can only provide reasonable assurance and may not prevent or detect misstatements due to error or fraud.

As of March 31, 2010, the corporation had identified a material weakness in ICFR. In the second and third quarters of 2010, the Corporation has made substantial improvements in its ICFR framework. Specifically, a CFO with over 12 years of experience in financial reporting and internal controls has been appointed. An Approval Authority Matrix was adopted which outlines authority for entering into transactions for all major cycles of the Corporation.

The Chief Financial Officer, having designed ICFR to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial reporting in accordance with GAAP, has been closely monitoring the effectiveness of the Corporation's internal controls during the second, third and fourth quarters of 2010 and noted that they have been operating effectively. The CFO also noted that, as at December 31, 2010, there is sufficient history of effective functioning of internal controls to remove the deficiency disclosure.

Environmental Issues

Compliance with Environmental and Safety Regulations

All phases of the oil and natural gas business present environmental risks and hazards and are subject to environmental regulation pursuant to a variety of federal, provincial and local laws and regulations. Environmental legislation provides for, among other things, restrictions and prohibitions on spills and releases or emissions of various substances produced in association with oil and natural gas operations. The legislation also requires that wells and facility sites be operated, maintained, abandoned and reclaimed to the satisfaction of applicable regulatory authorities. Compliance with such legislation can require significant expenditures and a breach may result in the imposition of fines and penalties, some of which may be material. Environmental legislation is evolving in a manner expected to result in stricter standards

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and enforcement, larger fines and liabilities, and potentially increased capital expenditures and operating costs. The discharge of oil, natural gas or other pollutants into the air, soil or water may give rise to liabilities to governments and third parties and may require the Corporation to incur costs to remedy such discharge. Although the Corporation believes that it is in material compliance with current applicable environmental regulations, no assurance can be given that environmental laws will not result in a curtailment of production or a material increase in the costs of production, development or exploration activities or otherwise adversely affect the Corporation's financial condition, results of operations or prospects. The Corporation must also conduct its operations in accordance with various laws and regulations concerning occupational safety and health. Currently, the Corporation does not foresee expending material amounts to comply with occupational safety and health laws and regulations. However, since such laws and regulations are frequently changed, the Corporation is unable to predict the future effect of these laws and regulations.

The Corporation's activities are subject to numerous federal, provincial and state laws and regulations concerning the storage, use and discharge of materials into the environment, the remediation of environmental impacts and other matters relating to environmental protection, all of which may adversely affect the Corporation's operations and the costs of doing business. Federal, provincial and state regulatory authorities also have established rules and regulations requiring permits for drilling, drilling bonds and reports concerning drilling and producing activities. Such regulations also cover the location of wells, the method of drilling and casing wells, the surface use and restoration of well locations, the plugging and abandoning of wells, and other matters. There can be no assurance that future legislation or administrative regulations or interpretations will not impose stricter requirements that could have an adverse impact on the operating costs of the Corporation and the oil and natural gas industry in general. The Corporation believes it is in material compliance with existing environmental laws and regulations and does not currently believe that it will be required to expend material amounts to comply with existing environmental laws and regulations in the future.

OFF-BALANCE SHEET ARRANGEMENTS

The Corporation has no off-balance sheet arrangements.

TRANSACTIONS WITH RELATED PARTIES

The Corporation reports its related party transactions on an exchange amount basis in equivalent US dollars. A summary of such transactions follows:

Executive Chairman

The Corporation utilizes administrative services provided by 706147 Ontario, Inc., a company owned by the Executive Chairman's spouse. The Corporation utilizes consultation services provided by Capital Z Corporation, a company owned by the Executive Chairman and the Corporation shares office space with Capital Z Corporation at no charge. The Executive Chairman is the Chairman and CEO of Rockefeller Hughes, a company that rents office space from the Corporation. The following general and administrative transactions arose in the normal course of business and have been accounted for at the exchange amount being the amount agreed to by the related parties, which approximates the arms length equivalent value:

(in thousands of dollars)

	Years ended December 31,	
	2010	2009
706147 Ontario, Inc.	\$ 42	\$ 49
Capital Z Corporation	46	2
Rockefeller Hughes	(18)	-

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The following balances are included in accounts payable and accrued liabilities and are unsecured, non-interest bearing and due on demand:

(in thousands of dollars)

	Years ended December 31,	
	2010	2009
706147 Ontario, Inc.	\$ -	\$ 4
Capital Z Corporation	-	2

Director

On February 7, 2007, the Corporation obtained a 25% undivided participating interest in Gastem Inc.'s undeveloped oil and natural gas interests covering approximately 1,184,000 acres (249,000 net) in the St. Lawrence Lowlands and in the Gaspé Peninsula of Quebec. Under terms of the agreement, the Corporation may elect to participate on a well-by-well basis with a 25% working interest in any current or future oil and natural gas property Gastem Inc. may acquire in Quebec. In return, the Corporation granted Gastem Inc. the right to participate for 25% of the Corporation's interest in certain future wells to be drilled in the Corporation's Amber Bank project in West Virginia by spending up to \$1.05 million. The Corporation's carrying value of the portion of its Amber Bank project's leasehold attributable to Gastem Inc.'s participation was nominal. The agreement was consummated with the expectation that Raymond Savoie, Gastem Inc.'s President, would become a director of the Corporation. Mr. Savoie became a director of the Corporation on July 16, 2007. On June 16, 2009, the Corporation, along with Gastem Inc., sold all of its oil and natural gas property interests in West Virginia to an unrelated third party for a gross amount of \$14,000,000 (\$779,802 net to Gastem Inc.). Related party transactions with Gastem Inc. were conducted in US dollars. A summary of Gastem's joint venture share of related party transactions between the Corporation and Gastem Inc. follows:

(in thousands of dollars)

	Years ended December 31,	
	2010	2009
Gastem Inc.		
Joint venture costs	\$ 114	\$ 341
Joint venture revenues	-	112
Accounts payable	151	297
Proceeds from sale of assets	-	780

These transactions arose in the normal course of business and have been accounted for at the exchange amount being the amount agreed to by the related parties, which approximates the arms length equivalent. The balances are unsecured, non-interest bearing and due on demand.

Former Director and former President and CEO

Austin Exploration LLC, a company owned by a former Director (resigned January 2010) who is also the former President and CEO of the Corporation, is a participant in the Corporation's Empire project. Western Land Services Inc., a company owned by the same person, used to provide oil and natural gas lease

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brokerage services to the Corporation in accordance with a Project Services Agreement between Western Land Services and the Corporation. The agreement with Western Land Services was terminated during second quarter of 2010.

(in thousands of dollars)

	Nine months September 30, 2010	Year ended December 31, 2009
Austin Exploration LLC:		
Accounts receivable	\$ -	\$ 37
Joint venture costs	-	409
Joint venture revenues	-	564
Western Land Services:		
Lease brokerage services	\$ -	440
Accounts payable	-	86

SUBSEQUENT EVENT

Letter of Credit

In March 2011, the Corporation established a letter of credit with the Amegy Bank in favour of the Mississippi State Oil and Gas Board in the amount of \$100,000 for the plugging and abandonment of the Corporation's Mississippi wells. Epsilon has provided a certificate of deposit in the amount of \$100,000 as collateral for the letter of credit. The certificate of deposit is held as restricted cash.

OUTLOOK

In 2010, Epsilon had another strong year. In February, the Corporation signed a farmout agreement with Chesapeake Energy Corp. related to its Pennsylvania interests. The leasehold acquisition, drilling, completing, equipping and gathering activities are expected to continue as stipulated in the agreement. The gas production has more than doubled over 2009 and the Corporation generated net income of \$4.0 million and EBITA of \$8.9 million.

In October 2010, the Corporation signed a Participation Agreement with a US-based private land owner to drill two oil wells in Mississippi to better balance its oil and gas interests. The acreage subject to the proposed joint operating agreement is in the immediate proximity of an existing producing oil fairway.

Macroeconomic conditions in 2010 were considerably better than they were in 2009. The price of crude oil rose as did the price of natural gas. The resumption of economic growth – particularly in Asia – has set energy demand on its upward course again. The increasing populations of developing countries will impart further momentum to the trend. To meet that surging demand, energy of all sorts will be needed.

In the October 13, 2010 Short-term Energy Outlook, the Energy Information Administration (“EIA”) revised its 2010 world oil consumption growth to 2.1% over consumption in 2009 in response to higher demand in China and developing countries. The EIA forecasts that world oil consumption will increase in 2011 by 3.7% compared with 2009.

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In the EIA's October Short-term Energy Outlook, demand for natural gas in the United States markets is expected to increase in 2011 compared with 2009. The industrial and electrical generation sectors are expected to account for 89% of the increase in natural gas consumption between 2009 and 2011.

All of these economic indicators portend well for the future of the Corporation.

Additional Information:

Additional information relating to the Corporation can be found on SEDAR at www.sedar.com

Zoran Arandjelovic
President and CEO
Epsilon Energy Ltd.
150 Jardin Drive, Suite 9
Concord, ON, Canada L4K 3P9
(905) 738-7877
www.epsilonenergyltd.com