

# MANAGEMENT'S DISCUSSION AND ANALYSIS

May 13, 2008

The following is Management's Discussion and Analysis ("MD&A") of Iteration Energy Ltd. (the "Company" or "Iteration") operating and financial results as at and for the three month period ended March 31, 2008 as well as information and estimates concerning the Company's future outlook based on currently available information. This discussion should be read in conjunction with Iteration's unaudited consolidated financial statements as at and for the three months ended March 31, 2008 and the audited consolidated financial statements as at and for the year ended December 31, 2007, together with accompanying notes. Readers should also refer to Iteration's 2007 Annual Information Form and Management's Discussion and Analysis for the year ended December 31, 2007. All financial information is reported in Canadian dollars, unless noted otherwise, and in accordance with Canadian generally accepted accounting principles ("GAAP").

Certain amounts in prior periods have been reclassified to enable comparison with the current period's presentation.

Natural gas is converted to crude oil equivalent at a ratio of six thousand cubic feet to one barrel. Boes 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.

Additional information about Iteration Energy Ltd. filed with Canadian securities commissions, including periodic quarterly and annual reports and the Annual Information Form (AIF), is available on-line at [www.iterationenergy.com](http://www.iterationenergy.com) and at [www.sedar.com](http://www.sedar.com).

## ITERATION OVERVIEW

Iteration is a Canadian oil and gas company with focus areas in Northeast British Columbia/Northwest Alberta, East Central Alberta and Southern Alberta. The most significant currently producing properties are Boundary Lake and Umbach in Northeast British Columbia and Gold Creek, Knopcik and Rainbow in Alberta.

The Company strives to operate its properties whenever possible and to maintain high working interests. Iteration believes this high level of operatorship can translate to controlling costs, timing of capital outlays and projects as well as providing competitive advantages for future opportunities.

### Acquisition of Cyries Energy Inc.

On March 7, 2008, Iteration acquired Cyries Energy Inc ("Cyries"), by Plan of Arrangement, (the "Arrangement"). Under the Arrangement, Iteration issued 93,990,604 Iteration common shares to acquire the issued and outstanding common shares, warrants and performance shares of Cyries. The value attributed to each Iteration common share was \$5.99 per share, representing the volume weighted average trading price on the Toronto Stock Exchange for an Iteration common share for the period from February 27, 2008 to March 6, 2008. This period includes the three trading days before and after Iteration's announcement on March 3, 2008 of the increase in the exchange ratio.

Upon completion of the Arrangement, Cyries became a wholly owned subsidiary of Iteration with the existing Iteration shareholders, option holders and warrant holders holding approximately 47% of the combined entity. Although Cyries shareholders held 53% of the Iteration Common Shares on a diluted basis following the arrangement, the transaction has been accounted for as an acquisition of Cyries by Iteration, recognizing that Iteration is the surviving legal entity, Iteration paid a premium to acquire Cyries and Iteration's existing management and Board of Directors retained their positions. This MD&A incorporates the operations Iteration Energy Ltd., Iteration Energy Inc., Iteration Energy and Iteration Energy 2007 Partnership for the period from January 1 to March 31, 2008 and the operations of Cyries Energy Inc. for the period from March 8 to March 31, 2008.

The acquisition was accounted for using the purchase method and the purchase equation to record the transaction on a preliminary basis was as follows;

<b>(\$000's)</b>	
Furniture and equipment	\$821
Property, plant and equipment	599,448
Goodwill	196,815
Debt assumed	(111,045)
Working capital deficiency	(20,333)
Future income tax liability	(77,081)
Asset retirement obligation	(14,275)
<b>Total purchase price</b>	<b>\$574,350</b>
Consideration was comprised of :	
Common shares	\$563,004
Transaction costs	\$11,346
<b>Total consideration</b>	<b>\$574,350</b>

## **FINANCIAL AND OPERATIONAL HIGHLIGHTS**

### **The major highlights of the three months ended March 31, 2008 include:**

- Completed the acquisition of Cyries Energy Inc. on March 7, 2008.
- Increased quarter over quarter average production by 36% to approximately 10,900 boed. This represents an 86% increase over the first quarter of 2007.
- Increased quarter end exit production by approximately 150% to 21,300 boed as compared to the December 31, 2007 exit rate.
- Funds from operations of \$28.5 million (\$0.31 per share) increased 155 % over the fourth quarter of 2007 and 130 % compared to the first quarter of 2007.
- Drilled 25.1 net wells with a 93.2 % success record (2.9 oil, 19.5 gas, 1.0 injectors and 1.7 D&A). This includes 5.7 net wells drilled after March 7, 2008 on land acquired from Cyries.
- Prior to its acquisition by Iteration on March 7, 2008, Cyries drilled 12.9 net wells with a 100 % success ratio (9.9 gas and 3.0 oil).
- Increased the Company's land base to approximately 1,030,000 net acres, 722,000 of which were undeveloped. This represents a 170% increase over undeveloped lands held at December 31, 2007 and a 237% increase in undeveloped lands compared to March 31, 2007.

## Financial Highlights

	Three months ended March 31,	
	2008	2007
	Total	Total
<b>Financial</b>		
(\$thousands, except as noted)		
Production revenue before royalties	\$55,564	\$23,744
Funds from operations <sup>(1)</sup>	\$28,511	\$12,379
Per Share (\$) <sup>(2)</sup>		
- basic	\$0.31	\$0.22
- diluted	\$0.30	\$0.22
Net earnings (loss)	\$1,689	\$(3,669)
Per Share (\$) <sup>(2)</sup>		
- basic and diluted	\$0.02	\$(0.06)
Royalties	\$11,679	\$4,857
Production expense	\$10,198	\$4,187
Transportation expense	\$1,469	\$729
General and administrative expense	\$2,277	\$1,091
Stock based compensation expense	\$7,110	\$4,500
Depletion, depreciation and accretion expense	\$21,554	\$12,996
Total assets	\$1,206,693	\$255,654
Capital expenditures:		
Property acquisition, net of dispositions	\$1,618	\$232
Exploration and development	\$40,156	\$40,003
<b>Shares outstanding (thousands)</b>		
Common shares	165,020	57,774
Weighted average – basic <sup>(21)</sup>	90,572	57,548
Weighted average – diluted <sup>(2)</sup>	95,067	57,548
Warrants	4,722	5,000
Stock options	6,560	5,731

- (1) Management uses funds from operations and funds from operations per share (before changes in non-cash working capital and asset retirement expenditures) to analyze operating performance and leverage. Funds from operations and funds from operations per share as presented do not have any standardized meaning prescribed by Canadian GAAP and therefore they may not be comparable with the calculation of similar measures for other entities. Funds from operations as presented is not intended to represent operating cash flow or income from operations for the period nor should it be viewed as an alternative to cash flow from operating activities, net earnings or other measures of financial performance calculated in accordance with

Canadian GAAP. All references to funds from operations and funds from operations per share throughout this Management's Discussion and Analysis are based on cash flow from operating activities before changes in non-cash working capital.

- (2) For periods with a net loss, per share amounts are based on basic common shares outstanding for the period.

## Operating Highlights

	<b>Three months ended March 31,</b>	
	<b>2008</b>	<b>2007</b>
<b>Operating</b>		
Gas Production		
Daily average natural gas (mcf/d)	<b>47,808</b>	32,846
Average price (\$/mcf)	<b>\$8.22</b>	\$7.36
Light Oil Production		
Daily average light oil (bbls/d)	<b>1,609</b>	147
Average price light oil (\$/bbl)	<b>\$94.89</b>	\$61.01
Heavy Oil Production		
Daily average heavy oil (bbls/d)	<b>216</b>	63
Average price heavy oil (\$/bbl)	<b>\$68.11</b>	\$40.28
Natural Gas Liquids (NGLs)		
Daily average NGLs (bbls/d)	<b>1,097</b>	166
Average price NGLs (\$/bbl)	<b>\$46.08</b>	\$67.07
Daily Average Production (boed)	<b>10,890</b>	5,850
<b>Land</b>		
Net undeveloped land holdings (acres)	<b>722,000</b>	215,000
<b>Drilling <sup>(1)</sup></b>		
Wells drilled (net)		
Gas	<b>19.5</b>	16.0
Oil	<b>2.9</b>	-
Injector	<b>1.0</b>	-
Dry	<b>1.7</b>	<u>1.0</u>
Total	<b>25.1</b>	17.0
Success rate (%)	<b>93.1</b>	94.1

- (1) Includes 5.7 net wells from the Cyries program that rig released after the Arrangement was closed on March 7, 2008.

## Quarterly Financial Data

(\$ thousands except per share data)

Quarter ended	2008		2007		2006			
	Mar 31	Dec 31	Sept 30	June 30	Mar 31	Dec 31	Sept 30	June 30
Revenues	\$55,564	\$29,265	\$22,161	\$26,806	\$23,744	\$17,940	\$16,888	\$12,394
Net earnings (loss)	\$1,689	(3,149)	(1,985)	(639)	(3,669)	(3,225)	(2,370)	(1,471)
Net earnings (loss) per common share – basic and diluted (\$)	\$0.02	(0.05)	(0.03)	(0.01)	(0.06)	(0.06)	(0.04)	(0.03)

## OPERATING RESULTS

### Net Earnings (Loss)

Iteration's net income for the three months ended March 31, 2008 was \$1.7 million, as compared to a net loss of \$3.7 million for the three months ended March 31, 2007. Included in the calculation of net income for the quarter is stock based compensation expense of \$7.1 million as compared to stock based compensation expense of \$4.5 million for the quarter ended March 31, 2007. Financial results were positively impacted by 86% higher production on a boe basis, combined with a 22% increase in the realized price per boe.

### Production

Average daily production for the three months ended March 31, 2008 increased by approximately 5,000 boed as compared to the three months ended March 31, 2007. This 86% increase includes production from the Cyries acquisition for the period from March 8 to March 31, 2008, which accounted for approximately 55% of the increase. The production increase in the first quarter of 2008 was also enhanced by a property acquisition which closed in September 2007, and the successful drilling and re-completion of a number of wells in the Company's core areas.

Daily Production <i>Average for the period</i>	Three months ended March 31,		
	2008	2007	% Change
Natural Gas (mcf/d)	47,808	32,846	46
Natural gas liquids (bbls/d)	1,097	166	561
Light oil (bbls/d)	1,609	147	995
Heavy oil (bbls/d)	216	63	243
Total (Boed)	10,890	5,850	86

The Company is projecting a 2008 exit rate of production of between 22,000 and 24,000 boed.

## Commodity Prices

<b>Industry Benchmarks</b> <i>Average for the period</i>	<b>Three months ended March 31,</b>		
	<b>2008</b>	2007	% Change
Natural gas (Alberta Spot- daily) Cdn \$/GJ at AECO	<b>7.30</b>	6.68	9
Natural gas (BC Westcoast Station 2) Cdn \$/GJ	<b>7.24</b>	6.75	7
Average Alberta Spot-daily and BC Westcoast Station 2 Cdn\$/GJ	<b>7.27</b>	6.72	8
Iteration NGL basket Cdn\$/bbl <sup>(1)</sup>	<b>49.37</b>	57.13	(14)
Edmonton Light Crude Cdn\$/bbl	<b>98.16</b>	67.74	45
Hardisty Lloydblend Cdn\$/bbl	<b>76.36</b>	42.50	80

(1) At March 31, 2008, the composition of an Iteration NGL basket was approximately 19% pentane, 20% butane, 24% propane and 37% ethane.

<b>Realized Commodity Prices</b> <i>Average for the period</i>	<b>Three months ended March 31,</b>		
	<b>2008</b>	2007	% Change
Natural Gas (\$/mcf)	<b>8.22</b>	7.37	12
Natural gas liquids (\$/bbl)	<b>46.08</b>	67.07	(31)
Light oil (\$/bbl)	<b>94.89</b>	61.01	56
Heavy oil (\$/bbl)	<b>68.11</b>	40.28	69
Total (\$/boed)	<b>56.08</b>	45.09	24

For purposes of comparing realized prices to benchmark prices, the Company's British Columbia natural gas production is sold at Station 2 pricing (BC Westcoast Station 2) and the majority of the Company's Alberta natural gas production is sold at AECO Spot - daily. Therefore for comparative purposes, the realized price for the commodity should be compared to the benchmark prices for BC Westcoast Station 2 and Alberta Spot - daily at AECO.

For natural gas, the realized price for the first quarter 2008 increased by 12% compared to 2007, which was higher than the 8% change in the average benchmark price during the same period. This increase is due to the positive heating value content associated with the Company's gas production.

For light oil, the realized price for the first quarter of 2008 increased by 56% compared to 2007, which is higher than the 45% change in the benchmark price during the same period. The realized price was positively impacted by the higher API oil acquired through the Cyries production.

For heavy oil, the realized price for the quarter increased by 69% as compared to an 80% increase in the Hardisty Lloydblend benchmark. The lower increase in realized price is a reflection of the heavier API associated with the Company's production.

For natural gas liquids, realized prices for an Iteration NGL basket decreased by 31% for the quarter, as compared to a 14% decrease in the commodity benchmark price. This was due to the commencement of the enhanced extraction of natural gas liquids from all of the Company's British Columbia natural gas

production in the fourth quarter of 2007, which resulted in a change in the composition of the Iteration NGL production basket. Prior to the enhanced extraction, only a nominal component of Iteration's NGL production was ethane. With the enhanced extraction, more than 40% of Iteration's NGL production for the quarter was ethane, which has resulted in a lower realized blended price for the Iteration basket.

For guidance purposes, based on the May 2, 2008 commodity strip, the Company expects an average 2008 natural gas price of \$8.95 Cdn/GJ and a WTI price of \$96.00 Cdn/bbl for oil.

## Revenue

Production revenue was \$55.6 million for the three months ended March 31, 2008, compared with \$23.7 million for the three months ended March 31, 2007. The production revenue increase was due to higher production volumes as well as higher overall commodity prices realized by the Company during the quarter.

<b>Production Revenue before Royalties</b> <i>(\$ thousands)</i>	<b>Three months ended March 31,</b>		
	<b>2008</b>	<b>2007</b>	<b>% Change</b>
Production revenue	<b>55,564</b>	23,744	134

For the three months ended March 31, 2008 natural gas production accounted for 73% of the Company's total production. This compares to 94% for the same period in 2007.

During the first quarter of 2008, the Company had the following fixed price contract in place:

<b>Period</b>	<b>Volume</b>	<b>Type</b>	<b>Pricing</b>	<b>Price</b>
Dec 1, 2007 – Nov 30, 2008	200 bbls/d	Collar	WTI - Nymex	\$75.00 USD floor, \$90.20 USD ceiling

For the quarter ended March 31, 2008, the Company realized a net loss on this contract of approximately USD \$141,000 and as at March 31, 2008, the value of the remaining contract was a loss of approximately USD \$585,000.

## Royalties

Royalty expense was \$11.7 million for the three months ended March 31, 2008, compared with \$4.9 million for the three months ended March 31, 2007. The change in royalty expense is the result of increased production as well as higher overall commodity prices.

The increase in royalty rate per boe in the first quarter of 2008 is a result of the increase in commodity price for the comparative period in 2007.

<b>Royalties</b> <i>(\$ thousands except where noted)</i>	<b>Three months ended March 31,</b>		
	<b>2008</b>	<b>2007</b>	<b>% Change</b>
Royalties	<b>11,679</b>	4,857	140
Per boe (\$/boe)	<b>11.79</b>	9.21	28
Percentage of revenue (%)	<b>21</b>	20	3

For 2008, the Company expects the crown royalty burden to be approximately 21 percent of revenue. On October 25, 2007 the Alberta provincial government announced its changes to the Alberta royalty regime which take effect January 1, 2009. Based on our analysis of the proposed royalty rate changes that have been announced to date, our preliminary assessment of the impact of the changes on the current Alberta based production of the Company indicates, on the assumption that 35% of the combined Company's production is oil and natural gas liquids and 80% of the combined Company's production is Alberta based, at the commodity price used for Company guidance purposes of Cdn \$8.95/GJ for gas and a WTI price of 96.00 /bbl for oil, the combined Company's 2009 total crown royalty burden would increase approximately 10 percentage points above the current crown royalty rate. This would result in the total royalty burden for the Company increasing from 21% to approximately 31%. The actual impact on the Company on January 1, 2009 when the announced changes come into effect cannot be determined at this time as it is dependent on a number of factors, including the proportion of the Company's production that is Alberta based, the production rates of the Alberta wells and commodity prices at that time.

### Production Expenses

Production expenses were \$10.2 million for the three months ended March 31, 2008, compared with \$4.2 million for the three months ended March 31, 2007. The increase in expenses was due to the following:

- 1) An 86 % increase in production for the quarter as compared to the previous year.
- 2) Continued workover and enhancement costs associated with the properties acquired in September 2007. These costs are expensed for financial reporting purposes, even though they result in significant increases in production
- 3) The relative mix in production is now more heavily weighted to oil which typically has higher operating costs on a per boe basis.

<b>Production expenses</b> <i>(\$ thousands)</i>	<b>Three months ended March 31,</b>		
	<b>2008</b>	<b>2007</b>	<b>% Change</b>
Field operating costs	<b>9,943</b>	4,047	146
Allocated general and administrative costs	<b>255</b>	140	82
<b>Total production expense</b>	<b>10,198</b>	4,187	144

<b>Production expenses per boe</b> <i>(\$ per boe)</i>	<b>Three months ended March 31,</b>		
	<b>2008</b>	<b>2007</b>	<b>% Change</b>
Field operating costs	<b>10.03</b>	7.67	31
Allocated general and administrative costs	<b>0.26</b>	0.27	(4)
<b>Total production expense</b>	<b>10.29</b>	7.94	30

The Company had previously published guidance with respect to expected production expenses for the first quarter of 2008 of \$9.75 per boe. The continuation of the workover program and well enhancement program on the assets acquired in September 2007 during the first quarter 2008 has contributed to the increase in production expense per boe. Despite the continuing pressure on costs, the Company still expects operating costs for 2008 to average less than \$10.00 per boe.

### Transportation Expenses

Transportation expense for the quarter was \$1.5 million in 2008 versus \$0.7 million for the three months ended March 31, 2007. Gross transportation expenses increased mainly due to the increase in production as

compared to the prior year. On a per boe basis, transportation costs increased by 7% from \$1.38 per boe to \$1.48 per boe.

<b>Transportation Expenses</b> <i>(\$ thousands except where noted)</i>	<b>Three months ended March 31,</b>		
	<b>2008</b>	2007	% Change
Transportation expenses	<b>1,469</b>	729	102
Per boe (\$/boe)	<b>\$1.48</b>	\$1.38	7

For 2008, the Company expects transportation costs to remain at current levels.

### **Operating Netback**

The operating netback (before general and administrative expenses) realized for the three months ended March 31, 2008 was \$32.52/boe versus \$26.56/boe for the three months ended March 31, 2007. The increase in netback realized was mainly due to the increased average commodity prices.

<b>Operating Netback</b> <i>(\$/boe)</i>	<b>Three months ended March 31,</b>		
	<b>2008</b>	2007	% Change
Production revenue	<b>56.08</b>	45.09	24
Royalties	<b>(11.79)</b>	(9.21)	28
Production costs	<b>(10.29)</b>	(7.94)	30
Transportation costs	<b>(1.48)</b>	(1.38)	7
Operating netback	<b>32.52</b>	26.56	22

The Company had given guidance for a netback of approximately \$25.00/boe for the first quarter. The higher netback occurred as a result of substantially higher than expected commodity prices and due to the positive heating value differential on gas production. For guidance purposes, based on average 2008 commodity prices of \$8.95 Cdn./GJ AECO for natural gas and WTI price of \$96.00 Cdn./bbl for oil, the Company expects an average operating netback (before general and administrative expenses) for 2008 of approximately \$37.00/boe.

### **General and Administrative Expenses**

Expensed general and administrative costs increased by 109% to \$2.3 million for the three months ended March 31, 2008, versus \$1.1 million for the three months ended March 31, 2007, mainly due to increased staffing levels and the assumption of the office space leased by Cyries. On a per boe basis, general and administrative expense increased by 11% in the first quarter of 2008 to \$2.30 per boe compared to \$2.07 per boe for the same period in 2007.

<b>General and Administrative Expenses</b> <i>(\$ thousands except where noted)</i>	<b>Three months ended March 31,</b>		
	<b>2008</b>	2007	% Change
General and administrative costs before the following:			
Overhead recoveries	<b>3,360</b>	1,794	87
Allocation to production expenses	<b>(58)</b>	(48)	21
Capitalized overhead	<b>(255)</b>	(140)	82
General and administrative expense	<b>(770)</b>	(515)	50
General and administrative expense	<b>2,277</b>	1,091	109
Per boe (\$ / boe)	<b>2.30</b>	2.07	11

General and administrative expenses for the quarter were in line with management's expectations. Subsequent to quarter end, the Company was able to sublet all of the Cyries office space on a full recovery flow through basis to an arms length third party. As a result, management expects general and administrative expenses to decline to \$2.00/boe or less for the balance of 2008.

#### **Stock Based Compensation Expense**

The Company's stock option plan was amended by the shareholders effective April 1, 2004 to provide stock option holders the choice, upon exercise, to receive a cash payment in exchange for surrendering the option. The cash payment is equal to the appreciated value of the stock option, as determined by the difference between the option's exercise price and the Company's closing share price the day prior to electing to exercise the option. In July, 2005, the stock option plan was further amended to limit the total number of common shares that may be issued under the stock option plan to 10% of the issued and outstanding Common Shares at that time.

For the three months ended March 31, 2008, a stock based compensation expense of \$7.1 million (2007: \$4.5 million) was recorded based on the increase in value of the outstanding stock options as determined using the March 31, 2008 closing share price, as compared to the closing share price at December 31, 2007. Future fluctuations in the stock based compensation expense or recoveries are dependent on the movement of the Company's share price and the number of vested options outstanding. Based on the March 31, 2008 share price of \$6.02, had all 6,559,923 stock options outstanding been vested, stock based compensation expense and a corresponding liability of \$16.6 million would have been recognized. Of this amount, \$14.6 million has been recognized as a current liability in the March 31, 2008 financial statements.

Subsequent to quarter end,

- 1) the Company issued 3.4 million options at a weighted average exercise price of \$5.94 per option to executive and non-executive employees. The options vest 1/3 per year on the anniversary date of the grant and have a four year term.
- 2) 139,000 options with an average exercise price of \$3.00 per option were exercised for cash.

#### **Interest Expense**

Net interest expense on current debt (the Company had no long term debt) for the three months ended March 31, 2008 was \$1.1 million as compared to interest expense of \$0.5 million for the three months ended December 31, 2007. The increase in interest expense represents the amount of debt utilized during the first quarter of 2008, including the interest on the debt assumed from the Cyries acquisition for the period from March 8 to 31, 2008. The effective interest rate on debt outstanding for the quarter was 5.7% (March 31, 2007: 6%).

<b>Interest expense</b> <i>(\$ thousands except where noted)</i>	<b>Three months ended March 31,</b>		
	<b>2008</b>	2007	% Change
Interest expense	<b>1,112</b>	472	138
Per boe (\$/boe)	<b>1.12</b>	0.89	26

### Depletion, Depreciation and Accretion

Depletion, depreciation and accretion expense was \$21.6 million for the three months ended March 31, 2008 compared to \$13.0 million for the three months ended March 31, 2007. The 66% increase is due to the increase in production in the first quarter of 2008 compared to 2007.

<b>Depletion, Depreciation and Accretion</b> <i>(\$ thousands except where noted)</i>	<b>Three months ended March 31,</b>		
	<b>2008</b>	2007	% Change
Depletion	<b>21,142</b>	12,846	65
Depreciation	<b>45</b>	10	350
Accretion	<b>367</b>	140	162
	<b>21,554</b>	12,996	66
Per boe (\$/boe)	<b>21.75</b>	24.68	(12)

### Capital Expenditures

For three months ended March 31, 2008 exploration and development capital spending was \$41.8 million as compared to \$40.2 million for the comparative period in 2007. The Company's capital expenditures are weighted to the first, third and fourth quarters when surface access for drilling is possible.

<b>Capital Expenditures</b> <i>(\$ thousands)</i>	<b>Three months ended March 31,</b>		
	<b>2008</b>	2007	% Change
Acquisition of oil and gas properties, net of disposition proceeds	<b>1,618</b>	232	597
Exploration and development expenditures	<b>40,156</b>	40,003	-
Total	<b>41,774</b>	40,235	4

### Capital and Liquidity

As an oil and gas company, the Company has a declining asset base and therefore relies on ongoing development and acquisitions to replace production and add additional reserves. Future oil and natural gas production and reserves are highly dependent on success in exploiting the Company's asset base and in acquiring additional reserves. To the extent the Company is successful or unsuccessful in these activities, funds flow could be increased or reduced.

As at March 31, 2008, the Company had a combined credit facility of \$270 million with three Canadian chartered banks. Subsequent to quarter end, this facility was replaced by a combined credit facility of \$275 million with four Canadian Chartered Banks.

As at March 31, 2008, the Company had drawn \$164.0 million of its facility. In addition to this debt, the Company had a working capital deficiency, not including the liability recorded for stock based compensation, of \$53 million, for a total net debt of \$217 million. The ratio of total net debt at March 31, 2008 to annualized funds flow for the quarter ended March 31, 2008 was 1.90:1. However, March 31, 2008 annualized funds flow only includes Cyries production for the period from March 8 to 31, 2008. Had Cyries production been included from January 1, 2008, projected funds flow for the quarter would have been approximately \$54 million. On an annualized basis, this would have resulted in a net debt to annualized funds flow ratio at March 31, 2008 of 1:1.

There is relatively little capital spending in the second quarter due to restricted surface access for drilling, although the Company will continue to pursue land sales aggressively. The debt to annualized funds flow ratio is therefore expected to improve significantly as the year progresses due to the high expected level of funds flow.

The Company continues to anticipate no unusual working capital requirements in 2008. There are currently no capital commitments, other than those associated with the Company's 2008 drilling and exploration program, and no known unusual trends or liquidity issues as at May 13, 2008. The Company expects to be able to meet future obligations associated from ongoing operations with funds flow from operations and draws on the Company's Credit Facility.

Projected funds flow for the first quarter of 2008 was previously forecast to be approximately \$22 million. Actual funds flow for the period was \$28.5 million due to higher than projected realized commodity prices.

For guidance purposes the Company has used projected average prices for 2008 of \$8.95 /GJ AECO for gas and a WTI price of \$96.00/bbl. for Edmonton Light oil. The Company's projected funds flow for 2008 is in the range of \$240 to \$250 million. The impact on the Company's projected 2008 funds flow, of a \$1.00/GJ swing in average AECO price for the remainder of 2008 is approximately \$18 million. The impact of a \$5.00/bbl swing in WTI for oil for the remainder of 2008 is approximately \$5 million.

### **Operating Leases**

The Company has entered into various operating leases with respect to its premises. The leases expire between June 30, 2009, and September 30, 2012, and require the following future minimum lease payments, by calendar year (\$ thousands);

	<b>\$000</b>
2008	1,292
2009	1,354
2010	934
2011	934
2012	700

Included in the above totals are the lease costs associated with the office space, previously occupied by Cyries, which was sublet, subsequent to quarter end, on a full recovery flow through basis for the remainder of the lease term. As a result of the sublet, the Company will recover lease payments of approximately \$934 per annum commencing June, 2008.

### **Related Party Transactions**

For the three months ended March 31, 2008, there were no related party transactions.

### **Outstanding Common Shares**

As at May 13, 2008, there were 166,020,384 common shares, 3,721,667 warrants, and 9,917,088 options outstanding.

### **Critical Accounting Estimates**

In the application of accounting policies, management is often required to make judgments based on underlying estimates and assumptions about future events and their effects. Underlying estimates and assumptions are based on historical experience and other factors that management believes to be reasonable

under the circumstances. These estimates and assumptions are subject to change as new events occur and additional information is obtained. The Company believes the following are the most critical accounting estimates used in determining its financial results.

### **Full Cost Accounting**

The Company follows the full cost method of accounting whereby all costs relating to the acquisition of, exploration for and development of oil and gas reserves are capitalized, whether successful or not. The aggregate of these costs, net of costs of unproved properties and estimated salvage values, and estimated future development costs are depleted and depreciated by the unit of production method based on estimated gross proven reserves as determined by independent engineers. Changes in estimated gross proven reserves, salvage values or future development costs have a direct impact on depletion and depreciation.

### **Ceiling Test**

The Company calculates the ceiling test on reserves based upon estimates of future prices for commodities, production rates, royalty rates, operating costs and inflation rates. Future prices for commodities are based on forward curve amounts. Future production rates, decline rates, royalty rates and operating costs are based on historical amounts. Inflation for commodity prices and operating costs is 2% per annum.

In the calculation of the ceiling test, the carrying value of property and equipment is compared to the sum of undiscounted cash flows expected to result from the future production of proved reserves, salvage value of equipment and the value of seismic over undeveloped land. Cash flows are based on third party quoted forward prices, adjusted for transportation and quality. Should the ceiling test result in an excess of carrying value, the Company would then measure the amount of impairment by comparing the carrying amounts of property, plant and equipment to an amount equal to the estimated net present value of future cash flows from proved plus probable reserves, salvage value of equipment and value of seismic over undeveloped land. A risk-free interest rate of 6% was used to arrive at the net present value of the future cash flows. Any excess is recorded in the statement of earnings.

The carrying value of undeveloped properties (land and seismic data) is reviewed periodically and written down to net realizable value if impairment is determined.

### **Reserve Estimates**

On an annual basis, the Company engages independent petroleum consultants to evaluate 100% of its oil and gas reserves. The estimation of reserves is a subjective process. The accuracy of reserve estimates is a product of the quality and quantity of data available, interpretation and judgment. Reserve estimates are based on engineering and geological data, projected future rates of production, commodity price forecasts and estimated timing of future expenditures, all of which are subject to interpretation and uncertainties.

Reserve estimates are used in the calculation of depletion and depreciation. A change in estimated reserves would result in a higher or lower depletion and depreciation charge to net earnings. Downward revisions to reserve estimates could also result in an impairment write-down of property, plant and equipment under the ceiling test.

### **Asset Retirement Obligations**

The Company recognizes the fair value of a liability for an asset retirement obligation in the period in which it is incurred and records a corresponding increase in the carrying value of the related long-lived asset. The fair value is determined through a review of engineering studies, industry guidelines, and management's estimates on a site by site basis. The liability is subsequently adjusted for the passage of time, and is recognized as an accretion expense in the statement of earnings under asset retirement obligations. The liability is also adjusted due to revisions in either the timing or the amount of the original estimated cash flows associated with the liability. Estimates of the asset retirement costs are subject to uncertainty associated with the method, timing and extent of future retirement activities.

The Company calculates the asset retirement obligation based on estimates of the date of abandonment, abandonment costs, and inflation. During the year, the estimates used for abandonment and reclamation

costs were increased to reflect the increased percentage of the Company's wells that are oil, and the deeper gas wells that were acquired through the acquisition of the Peace River Arch partnership. These amounts are then discounted to a present value amount. The rate used to estimate the risk free borrowing rate was increased from 6% to 6.5% in 2007 to reflect the upward pressure experienced on interest rates. The changes in estimates were applied retroactively to January 1, 2007. The impact of the change in estimated abandonment costs and the estimated risk free borrowing rate effectively offset each other. The estimates used are as follows:

Abandonment and reclamation costs:

Well bore and surface reclamation	
Less than 1,750 meters	\$18,972 per well
More than 1,750 meters	\$26,622 per well
Surface reclamation	
Natural gas wells	\$19,482 per well
Oil wells	\$26,622 per well
Pipelines	\$10,200 per pipeline segment
Roads	\$15,300 per km
Batteries	\$15,300 per battery
Compressors	\$204,000 per compressor
Inflation	2 % per annum
Discount rate	6.5% per annum

### Income Taxes

The Company records future tax assets and liabilities to account for the expected future tax consequences of events that have been recorded in its consolidated financial statements and its tax returns. These amounts are estimates; the actual tax consequences may differ from the estimates due to changing tax rates and regimes, as well as changing estimates of cash flows and capital expenditures in current and future periods. The Company periodically assesses the realizability of its future tax assets. A valuation allowance is recorded to the extent that there is uncertainty regarding utilization of future tax assets.

### Impact of New Accounting Pronouncements

On January 1, 2008, the Company adopted five new accounting standards that were issued by the Canadian Institute of Chartered Accountants: Section 1400 *General Standards of Financial Statement Presentation*, Section 1535 *Capital Disclosures*, Section 3031 *Inventories*, Section 3862 *Financial Instruments – Disclosures*, and Section 3863 *Financial Instruments – Presentation*. The adoption of these standards has had no material impact on the Company's equity, net income or cash flows. The other effects of the implementation of the new standards are discussed below.

#### General Standards of Financial Statement Presentation

CICA 1400 *General Standards of Financial Statement Presentation* was amended to include requirements to assess and disclose an entity's ability to continue as a going concern. The adoption of this standard did not have an impact on the Company's financial statements.

#### Capital Disclosures

Section 1535 *Capital Disclosures*, establishes standards for disclosing information regarding an entities capital and how it is managed. The section specifies the disclosure of i) an entities objectives, policies, and processes for managing capital; ii) quantitative data about what the entity regards as capital; iii) whether the entity has complied with any capital requirements; and iv) if it has not complied, the consequences of such non-compliance.

## Inventories

Section 3031 *Inventories*, requires inventories to be measured at the lower of cost or net realizable value; disallows the use of a last-in first-out inventory-costing methodology; and requires that, when circumstances which previously caused inventories to be written down below cost or net realizable value no longer exist, the amount of the write-down is to be reversed. This section is the Canadian Equivalent to International Reporting Standards IAS-2, *Inventories*. The adoption of this standard had no material impact on the Company's consolidated financial statements.

## Financial Instruments – Disclosures and Presentation

As of January 1, 2008, the Company adopted two new CICA standards. Handbook Section 3862, *Financial Instruments – Disclosures* and Handbook Section 3863, *Financial Instruments – Presentation*. These Handbook Sections replaced existing Handbook Section 3861, *Financial Instruments – Presentation and Disclosure*. The new disclosure standards increase the emphasis on the risks associated with both recognized and unrecognized financial instruments and how those risks are managed. The new presentation standard carries forward the former presentation requirements.

In addition, the Company has assessed new and revised accounting pronouncements that have been issued that are not yet effective and determined that the following may have a significant impact on the Company.

## Goodwill and Intangible Assets

Effective January 1, 2009, the Company will be adopting the new CICA Handbook Section 3064, *Goodwill and Intangible Assets*, which converges Canadian GAAP for goodwill and intangible assets with IFRS. The new standard provides more comprehensive guidance on intangible assets, particularly for internally developed intangible assets. The Company is still assessing the financial reporting impact of this standard.

## International Financial Reporting Standards (“IFRS”)

The Canadian Accounting Standards Board has now confirmed that the use of IFRS will be required in 2011 for publicly accountable, profit-oriented enterprises. IFRS will replace current Canadian GAAP followed by the Company. The Company will be required to begin reporting under IFRS effective January 1, 2011 and will be required to provide information following IFRS for the comparative period. The Company is currently evaluating the impact of adopting IFRS.

## **Disclosure Controls and Procedures**

The Company has implemented disclosure controls and procedures to ensure that information required to be disclosed by the Company is accumulated and communicated to the Company's management, as appropriate, to allow timely decisions regarding required disclosures. The Company's Chief Executive Officer and Chief Financial Officer, together with management, have concluded, based on their evaluation as of the year-end, the Company's disclosure controls and procedures are effective to provide reasonable assurance that material information related to the issuer is made known to them by others.

It should be noted that while the Company's Chief Executive Officer and Chief Financial Officer believe that the Company's disclosure controls and procedures provide a reasonable level of assurance that they are effective, they do not expect that the disclosure controls and procedures will necessarily prevent all errors and fraud. A control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met.

## **Internal Controls over Financial Reporting**

Under the supervision of, and with the participation of the Company's management, including the Chief Executive Officer and the Chief Financial Officer, internal control over financial reporting has been designed and maintained in order to provide reasonable assurance regarding the reliability of financial

reporting, as of the end of the period covered by the filings. During the quarter ended March 31, 2008, there have been no material changes in internal control over financial reporting. In common with many small companies, with limited accounting support staff, segregation of duties is difficult; however management is satisfied that compensating controls are in place including key management authorizations and reviews.

### Outlook for 2008

The acquisition of Cyries Energy Inc. closed on March 7, 2008, and has transformed the Company into an intermediate producer. The exit rate of production at March 31, 2008 was approximately 21,000 boed. Average production for the month of April 2008 was lower, at approximately 20,000 boed, as a result of traditional plant turnarounds and normal production declines which cannot be mitigated due to surface access restrictions. Production rates will rebound once surface access restrictions are lifted and the Company can continue its planned drilling program in June. In addition, substantially all of the Company's British Columbia production will be shut in for three weeks in June, due to the scheduled turnaround of the McMahan gas plant.

The Company has a large inventory of drilling prospects on its current land base which is expected to drive future growth. For 2008, the largest focus areas for the Company will be in the Deep Basin and Peace River Arch areas of Western Alberta and North East British Columbia. These two areas currently account for approximately two thirds of the Company's production and are prospective for liquids rich gas and light oil. Production from these areas will be complemented by exploration and exploitation opportunities for dry gas and heavy oil in Eastern Alberta, as well as additional light oil prospects in North West and South East Alberta. The range of prospects provides a mixture of summer and winter access opportunities and allows the Company flexibility to focus its activity in those areas which will provide maximum return under prevailing commodity prices and conditions. The following guidance reflects the currently planned program and does not include capital for any acquisitions we may pursue beyond that for minor partner interest buy-ups.

Expected 2008 Program	Iteration <sup>(1)</sup>
Average 2008 production (boed)	17,500
Year end 2008 exit production (boed)	22,000 to 24,000
Capital program (\$ million)	212
Funds from operations (\$ million) <sup>(2)</sup>	243
Year end net debt (\$ million)	187
Ratio of Debt to annualized 2008 Q4 funds flow	0.6
Net wells	115

(1) Includes results of operations of Iteration Energy Inc. for the period from January 1 to December 31, 2008 and Cyries Energy Inc. for the period from March 8 to December 31, 2008.

(2) Includes the net cost of approximately \$16 million for the Company to repurchase in September 2008 the remaining 3.7 million outstanding warrants for the amount market value exceeds exercise price, calculated assuming a market value of \$7.25 per common share. The repurchase of the warrants is subject to approval by the Company's shareholders at the 2008 Annual General Meeting of amendments to the terms of the warrants. The proposed amendments are more fully described in the Company's Information Circular regarding the Annual General Meeting.

The 2008 program is expected to include a number of multi frac horizontal wells which will allow for the evaluation of production and reserve uplift potential that may be realized in several Cretaceous and Triassic reservoirs which are present on the Company's lands.

The recent rise in commodity prices coupled with increased production from operations has led to a significant increase in the projected funds from operations for the balance of the year. However, both commodity prices and costs of services can change rapidly so we are prepared to adjusted capital spending

appropriately. The Company's very strong balance sheet will allow us to pursue accretive acquisitions should they arise to further enhance production growth.

### **Directors, Officers and Auditors**

Current Officers and Directors of the Company are as follows;

#### Officers

Brian Illing	President and CEO
Mark Ariss	VP Exploration East
Sean Johnson	CFO
Jane Mactaggart	VP Exploitation
Carmen McKay-Illing	VP Corporate Affairs
Myron Rak	VP Production
Kevin Stromquist	VP Exploration West

#### Directors

Don Archibald (Chairman)	Independent Businessman (former Chairman & CEO – Cyries)
Pat Breen P. Eng.	President- Foremost Income Fund
Howard Crone P. Eng.	Independent Businessman (former director – Cyries)
Dallas Droppo Q.C.	Partner- Blake, Cassels and Graydon LLP
Jim Grenon	President- TOM Capital Associates
Michael Hibberd	President- MJH Services Inc.
Brian Illing P. Geol	President and CEO- Iteration Energy Ltd.
Robert Waters CA	Senior VP and CFO- Enerplus Resources Fund

Gary Peddle (former VP Corporate Affairs of Cyries) is expected to join Board of Directors following the Annual and Special meeting to be held on May 22, 2008.

#### Corporate Secretary

Tony Grenon	Managing Director- TOM Capital Associates
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#### Auditors

Ernst & Young LLP

#### Corporate Council

Bennett Jones LLP

### **Advisory – Forward-Looking Information**

This MD&A was prepared on May 13, 2008 and is management's assessment of Iteration's historical financial and operating results. The reader should be aware that historical results are not necessarily indicative of future performance. This MD&A contains forward-looking statements relating to future events or future performance. In some cases, forward-looking statements can be identified by terminology such as "may", "will", "should", "expects", "projects", "plans", "anticipates" and similar expressions. Forward-looking statements and information are based on the Company's current beliefs as well as assumptions made by, and information currently available to, the Company concerning anticipated financial performance, business prospects, strategies, regulatory developments, future natural gas commodity prices, future natural gas production levels, the ability to obtain equipment in a timely manner to carry out development activities, the ability to market natural gas successfully to current and new customers, the impact of increasing competition, the ability to obtain financing on acceptable terms, and the ability to add production and reserves through development and exploration activities. Although management considers these assumptions to be reasonable based on information currently available to it, they may prove to be incorrect.

Undue reliance should not be placed on these forward-looking statements which are based upon management's assumptions and are subject to known and unknown risks and uncertainties, including the business risks discussed below, which may cause actual performance and financial results in future periods to differ materially from any projections of future performance or results expressed or implied by such forward-looking statements. Accordingly, readers are cautioned that events or circumstances could cause results to differ materially from those predicted. The Company undertakes no obligation, except as required by applicable securities legislation, to update publicly or to revise any of the included forward looking statements, whether as a result of new information, future events or otherwise.

The forward looking statements contained herein are expressly qualified by this cautionary statement. Readers are cautioned that the following list of risk factors is not exhaustive.

In particular, this discussion contains forward-looking statements and information pertaining to the following:

- The quantity and recoverability of our reserves;
- The timing and amount of future production;
- Prices for natural gas produced;
- Operating and other costs;
- Business strategies and plans of management;
- Supply and demand of natural gas;
- Expectations regarding our ability to raise capital and to add to our reserves through acquisitions as well as exploration and development;
- The focus of capital expenditures on development activity rather than exploration;
- The sale, farming in, farming out or development of certain exploration properties using third party resources;
- The use of development activity and acquisitions to replace and add to reserves;
- The impact of changes in natural gas prices on cash flow after hedging;
- Drilling plans;
- The existence, operation and strategy of the commodity price risk management program;
- The approximate and maximum amount of forward sales and hedging to be employed;
- The Company's acquisition strategy, and the criteria to be considered and the benefits to be derived;
- The impact of Canadian federal and provincial governmental regulation on the Company relative to other issuers of similar size;
- Our treatment under governmental regulatory regimes;
- The goal to sustain or grow production and reserves through prudent management and acquisition;
- The emergence of accretive growth opportunities; and
- The Company's ability to benefit from the combination of growth opportunities and the means to grow through the capital markets.

Iteration's actual results could differ materially from those anticipated in our forward-looking statements as a result of the risk factors set forth below and noted elsewhere in this MD&A which include but are not limited to:

- Volatility in market prices for natural gas;
- Risks inherent in our operations;
- Uncertainties associated with estimating reserves;
- Competition for, among other things: capital, acquisitions of reserves, undeveloped lands and skilled personnel;
- Incorrect assessments of the value of acquisitions;
- Geological, technical, drilling and process problems;
- General economic conditions including fluctuations in the price of natural gas;
- Royalties payable in respect of Iteration's production;

- Governmental regulation of the oil and gas industry, including environmental regulation;
- Fluctuation in foreign exchange or interest rates;
- Unanticipated operational events that can reduce production or cause production to be shut-in or delayed;
- Stock market volatility and market valuations;
- The need to obtain required approvals from regulatory authorities;
- Environmental risks;
- Insurance limitations risks;
- Risks inherent in replacing reserves;
- Reliance on operators and key employees;
- Access to funding and issuance of debt;
- Aboriginal claims; and
- Availability of drilling equipment, access restrictions and cost inflation.

**Additional Information on the Company**

Other information about the Company, including the Unaudited Interim Consolidated Financial Statements for the three months ended March 31, 2008, and the Audited Consolidated Financial Statements, Management's Discussion and Analysis and the Annual Information Form for the year ended December 31, 2007, is available through the internet on the Company's website at [www.iterationenergy.com](http://www.iterationenergy.com) and on the Company's SEDAR profile at [www.sedar.com](http://www.sedar.com).