

*Unaudited Interim Consolidated Financial Statements of*

**Iteration Energy Ltd.**

*June 30, 2008*

## Iteration Energy Ltd.

### Consolidated Balance Sheets (unaudited)

As at <i>(in thousands of dollars)</i>	June 30, 2008	December 31, 2007
<b>ASSETS (Note 5)</b>		
Current		
Cash	\$39,769	\$1,230
Accounts receivable (Notes 11(e) and 16)	45,703	15,942
Prepays and other current assets	8,840	2,640
	<b>94,312</b>	19,812
Property, plant and equipment (Notes 3 and 4)	<b>900,589</b>	285,354
Goodwill (Note 3)	<b>241,761</b>	33,899
	<b>\$1,236,662</b>	\$339,065
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current		
Bank indebtedness (Note 5)	\$243,000	\$50,370
Accounts payable and accrued liabilities (Note 6)	73,053	30,454
Income taxes payable (Note 9)	458	-
Stock based compensation payable (Note 8(d)and (e))	19,320	7,520
	<b>335,831</b>	88,344
Future income taxes (Notes 3 and 9)	<b>85,938</b>	7,510
Leasehold inducements	<b>270</b>	199
Asset retirement obligation (Note 7)	<b>35,393</b>	18,897
	<b>457,432</b>	114,950
Commitments and contingencies (Notes 10, 11, 12 and 16)		
Shareholders' equity		
Share capital (Note 8)	805,302	238,586
Warrants outstanding (Note 8(e))	-	3,934
Deficit	(26,072)	(18,405)
	<b>779,230</b>	224,115
	<b>\$1,236,662</b>	\$339,065

See accompanying notes to the unaudited interim consolidated financial statements.

# Iteration Energy Ltd.

## Consolidated Statements of Earnings (Loss), Comprehensive Earnings (Loss) and Deficit (unaudited)

<i>(in thousands of dollars, except per share amounts)</i>	Three months ended June 30,		Six months ended June 30,	
	2008	2007	2008	2007
<b>Revenue</b>				
Production revenue	\$127,175	\$26,806	\$182,739	\$50,550
Royalties	(27,199)	(4,601)	(38,878)	(9,419)
	<b>99,976</b>	22,205	<b>143,861</b>	41,131
Other production revenue	629	14	958	(5)
	<b>100,605</b>	22,219	<b>144,819</b>	41,126
<b>Expenses</b>				
Production	20,291	4,910	30,488	9,098
Transportation	1,982	846	3,451	1,577
General and administrative	3,195	1,360	5,472	2,451
Stock based compensation (Note 8(d) and (e))	13,799	708	20,908	5,208
Interest on current debt	3,067	390	4,179	861
Depletion, depreciation and accretion	39,045	14,997	60,600	27,992
	<b>81,381</b>	23,211	<b>125,098</b>	47,187
Income (loss) before the following	<b>19,226</b>	(992)	<b>19,721</b>	(6,061)
Non-cash charge related to warrants (Note 8(e))	(3,546)	-	(3,546)	-
Provision for bankruptcy: SemGroup LP (Note 16)	(9,348)	-	(9,348)	-
Recovery of investment tax credits	-	-	1,820	-
Earnings (loss) before income taxes	<b>6,332</b>	(992)	<b>8,647</b>	(6,061)
Income taxes (Note 9)				
Current income tax expense	171	197	671	197
Future income tax expense (recovery)	5,489	(550)	5,614	(1,950)
	<b>5,660</b>	(353)	<b>6,285</b>	(1,753)
Net earnings (loss) and comprehensive earnings (loss)	<b>672</b>	(639)	<b>2,362</b>	(4,308)
Deficit, beginning of period	<b>(16,716)</b>	(12,632)	<b>(18,405)</b>	(8,963)
Charge on modification of warrant terms (Note 8(e))	<b>(10,029)</b>	-	<b>(10,029)</b>	-
Deficit, end of period	<b>\$(26,072)</b>	\$(13,271)	<b>\$(26,072)</b>	\$(13,271)
Basic and diluted earnings (loss) per common share (Note 8(f))	<b>\$0.00</b>	\$(0.01)	<b>\$0.02</b>	\$(0.07)

See accompanying notes to the unaudited interim consolidated financial statements

# Iteration Energy Ltd.

## Consolidated Statements of Cash Flows (unaudited)

<i>(in thousands of dollars)</i>	Three months ended June 30,		Six months ended June 30,	
	2008	2007	2008	2007
<b>OPERATING ACTIVITIES</b>				
Net earnings (loss)	\$672	\$(639)	\$2,362	\$(4,308)
Add (deduct) non-cash items:				
Depletion, depreciation and accretion	39,045	14,997	60,600	27,992
Recovery of investment tax credits	-	-	(1,820)	0
Future income tax expense (recovery)	5,489	(550)	5,614	(1,950)
Amortization of leasehold inducements	(41)	(33)	(95)	(66)
Stock-based compensation expense (Note 8 (d) and (e))	4,130	708	11,240	5,208
Non-cash charge related to warrants Note 8(e)	3,546	-	3,546	
Asset retirement expenditures	(17)	(19)	(110)	(34)
	52,824	14,464	81,337	26,842
Net change in non-cash operating working capital (Note 13)	(16,114)	(12,453)	(101)	(6,008)
	36,710	2,011	81,236	20,834
<b>INVESTING ACTIVITIES</b>				
Proceeds on sale of property plant and equipment	105		646	
Acquisition of subsidiary	(176)	-	(778)	122
Acquisition of oil and gas properties	(2,858)	(2,019)	(4,414)	(2,373)
Additions to oil and gas properties	(28,479)	(12,948)	(68,635)	(52,951)
Additions to other capital assets	(475)	-	(515)	-
Net change in non-cash investing working capital (Note 13)	(27,286)	(11,973)	(31,650)	(1,738)
	(59,169)	(26,940)	(105,346)	(56,940)
<b>FINANCING ACTIVITIES</b>				
Proceeds from (repayment of) bank indebtedness	78,960	(12,065)	80,630	(6,745)
Common shares issued	2,900	39,403	2,900	40,401
Exercise of warrants	(20,851)	-	(20,851)	-
Share issue costs	(4)	(2,167)	(30)	(2,180)
	61,005	25,171	62,649	31,476
Increase (decrease) in cash	38,546	242	38,539	(4,630)
Cash, beginning of period	1,223	350	1,230	5,222
Cash, end of period	\$39,769	\$592	\$39,769	\$592

See Note 13 for supplemental disclosure

See accompanying notes to the unaudited interim consolidated financial statements

# Iteration Energy Ltd.

## Notes to the Unaudited Interim Consolidated Financial Statements For the Three and Six Months Ended June 30, 2008 and 2007

(Tabular amounts in thousands of dollars, unless otherwise noted)

### 1. NATURE OF OPERATIONS

Iteration Energy Ltd. (“Iteration” or the “Company”) is a public company that trades on the Toronto Stock Exchange and is incorporated under the Business Corporations Act (Alberta). Iteration is engaged in the exploration, development and production of petroleum and natural gas in Canada.

### 2. SIGNIFICANT ACCOUNTING POLICIES

The unaudited interim consolidated financial statements of Iteration Energy Ltd. have been prepared in accordance with Canadian generally accepted accounting principles and are consistent with those policies set out in the audited consolidated financial statements for the year ended December 31, 2007, except as disclosed below. These interim consolidated financial statements do not include all disclosures provided in the December 31 financial statements and should be read in conjunction with those financial statements.

#### Principles of Consolidation

These consolidated financial statements include the accounts of Iteration Energy Ltd., its wholly owned subsidiaries (Cyries Energy Inc, Iteration Energy Inc. and Cyries Wyoming Inc.) and its wholly owned partnerships (Iteration Energy and Iteration Energy Partnership 2007). All inter-company transactions are eliminated on consolidation.

#### Changes in Accounting Policies

The CICA has issued several new accounting standards. 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*. These standards became effective January 1, 2008.

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.

Section 1535 *Capital Disclosures*, establishes standards for disclosing information regarding an entity’s capital and how it is managed. The section specifies the disclosure of i) an entity’s 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. The new disclosures are provided in Note 14.

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.

Sections 3862 *Financial Instruments – Disclosures*, and section 3863 *Financial Instruments – Presentation*, replace section 3861 *Financial Instruments – Disclosure and Presentation*, which revises and enhances financial instruments disclosure requirements and leaves unchanged its presentation requirements. The objective of section 3862 is to provide financial statement disclosure to enable users to evaluate the significance of financial instruments for the Company's financial position and performance. The section also requires increased disclosure on the nature and extent of risks arising from financial instruments that the Company is exposed to during the reporting period and the balance sheet date and how the company is managing those risks. The purpose of section 3863 is to enhance the financial statement users' understanding of the significance of financial instruments to the Company's financial position, performance and cash flows.

#### Future Accounting Policies

The Canadian Accounting Standards Board has now confirmed that the use of International Financial Reporting Standards (“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.

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.

### **3. ACQUISITIONS AND DISPOSITIONS**

#### **Cyries Acquisition**

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. The financial statements for the six month period ended June 30, 2008 incorporate the operations of Iteration Energy Ltd., Iteration Energy Inc., Iteration Energy and Iteration Energy 2007 Partnership for the period from January 1, 2008 to June 30, 2008 and the operations of Cyries Energy Inc. for the period from March 8, 2008 to June 30, 2008.

The acquisition is being accounted for using the purchase method and, after adjustment for deemed uncollectible receivables, aged deposits no longer considered valid and adjustments to the future income tax liability identified during the second quarter of 2008, the purchase price was allocated on a preliminary basis as follows:

	(\$000's)
Furniture and equipment	\$821
Property, plant and equipment	599,448
Goodwill	207,259
Bank Debt	(111,045)
Working capital deficiency	(28,325)
Future income tax liability	(79,563)
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>

#### **Peace River Arch Partnership**

On September 28, 2007, with an effective date of June 1, 2007, the Company purchased 100% of the partnership interests of the Peace River Arch Partnership from an arms length third party for \$50,501,000. The partnership owns producing properties located in the Peace River Arch area of North West Alberta and the Manyberries area in South East Alberta. The results of operations for the Peace River Arch Partnership have been included in the consolidated financial statements from the September 28, 2007 acquisition date.

The acquisition was accounted for by the purchase method and the purchase price was allocated as follows:

	(\$000's)
Property, plant and equipment	\$55,937
Goodwill	13,758
Future income tax liability	(11,863)
Asset retirement obligation	(6,775)
<b>Total purchase price</b>	<b>\$51,057</b>
Consideration was comprised of :	
Cash	\$51,057
<b>Total consideration</b>	<b>\$51,057</b>

#### **4. PROPERTY PLANT AND EQUIPMENT**

	June 30, 2008 (\$000's)	December 31, 2007 (\$000's)
Oil and gas properties	<b>\$ 1,140,539</b>	\$ 467,281
Other	<b>2,309</b>	753
	<b>1,142,848</b>	468,034
Less accumulated depletion and depreciation	<b>242,259</b>	182,680
	<b>\$ 900,589</b>	\$ 285,354

At June 30, 2008, unproved properties and seismic expenditures amounting to \$129,876,000 (June 30, 2007: \$41,332,000) have been excluded from the depletion calculation. Future development costs on proven undeveloped reserves of \$33,695,000 (June 30, 2007: \$6,305,000) are included in the depletion calculation.

For the three and six months ended June 30, 2008, the Company capitalized \$1,020,000 and \$1,790,000 respectively, (three and six months ended June 30, 2007: \$572,500 and \$1,087,500 respectively) of overhead directly related to exploration and development activities.

## 5. BANK INDEBTEDNESS

Bank Indebtedness represents the drawn portion of a syndicated facility, net of any actual cash balances on hand. The syndicated facility provides for maximum borrowings of \$275 million. There are two components to the syndicated facility. The first is a \$260 million term facility which can be used to fund the Company's capital program and matures on April 30, 2009. The maturity date of the facility may be extended for a period of 364 days, if requested by the borrower and accepted by the lender. The second component is a \$15 million working capital revolving facility, which is payable on demand. Under the terms of the term facility, the Company may borrow by way of:

- i) Bankers acceptances in Canadian dollars bearing interest at the bankers acceptance rate plus a margin, ranging from 90 to 150 basis points, depending on the ratio of funded debt to trailing cashflow;
- ii) LIBOR based loans in United States dollars bearing interest at the LIBOR rate plus a margin, ranging from 90 to 150 basis points, depending on the ratio of funded debt to trailing cashflow;
- iii) Prime rate loans in Canadian dollars bearing interest at the Royal Bank of Canada prime rate should the ratio of funded debt to trailing cashflow be less than 2.5 to 1 and at Royal Bank of Canada prime plus 25 basis points should the ratio of funded debt to trailing cashflow be greater than 2.5 to 1; and
- iv) US Base Rate loans in United States dollars bearing interest at the Royal Bank of Canada US base rate should the ratio of funded debt to trailing cashflow be less than 2.5 to 1 and at Royal Bank of Canada prime plus 25 basis points should the ratio of funded debt to trailing cashflow be greater than 2.5 to 1.

The facility is secured by a \$500 million fixed and floating charge debenture.

As at June 30, 2008, \$243 million of indebtedness was in the form of 30 day Bankers acceptances.

## 6. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

The Accounts payable and accrued liabilities consist of the following:

	June 30, 2008 (\$000's)	December 31, 2007 (\$000's)
Trade accounts payable	\$44,811	\$22,023
Joint venture accounts payable	7,609	1,944
Royalties payable	20,633	6,487
<b>Total</b>	<b>\$73,053</b>	<b>\$30,454</b>

## 7. ASSET RETIREMENT OBLIGATION

The total future asset retirement obligations were estimated by management based on the Company's net working interest in all wells and facilities, estimated costs to reclaim and abandon wells and facilities and the estimated timing of the costs to be incurred in future periods. The Company estimates the undiscounted cash flows related to asset retirement obligations, adjusted for inflation, to be incurred over the estimated reserve life of the underlying assets (which is estimated to be from 2008 through 2036) will total approximately \$82,991,000 (December 31, 2007: \$39,2810,000). The estimated fair value of the obligation at June 30, 2008 is \$35,393,000 (December 31, 2007: \$18,897,000) using a discount rate of six and one half percent and an inflation rate of two percent. As at June 30, 2008, no funds have been set aside to settle this obligation.

	June 30, 2008 (\$000's)	December 31, 2007 (\$000's)
Balance, beginning of period	\$18,897	\$9,198
Liabilities incurred on acquisition of properties (note 3)	14,275	6,775
Increase in liabilities from drilling activity	1,407	2,262
Accretion expense	924	833
Settlement of liabilities	(110)	(171)
Balance, end of period	<b>\$35,393</b>	\$18,897

## 8. SHARE CAPITAL

### (a) Authorized

Unlimited number of voting common shares without par value.  
Unlimited number of preferred shares issuable in series

### (b) Common Shares Issued

	Six months ended June 30, 2007		Year ended December 31, 2007	
	Number of Shares	Amount (\$000's)	Number of Shares	Amount (\$000's)
Balance, beginning of period	71,029,780	\$238,586	57,429,847	\$175,195
Shares issued on public offerings	-	-	12,977,400	67,892
Shares issued on corporate acquisition	93,990,607	563,004	-	-
Shares issued on exercise of warrants	1,000,000	3,733	278,333	1,039
Shares issued on exercise of stock options	-	-	344,200	998
Share issue costs, net of tax effect of \$9,000 (2007: \$686,000)	-	(21)	-	(2,795)
Tax benefits renounced on prior year flow through share offering	-	-	-	(3,743)
Balance, end of period	<b>166,020,387</b>	<b>\$ 805,302</b>	71,029,780	\$238,586

**(c) Flow Through Shares**

During 2006, the Company issued common shares on a flow-through basis for gross proceeds of \$12,075,000 to finance certain oil and gas expenditures to be incurred in 2007. The renouncement of these expenditures was made to the purchasers of these shares in 2007 and accordingly, share capital was reduced by the amount of the tax benefits associated with these expenditures (\$3,743,000).

**(d) Stock Options**

The Company has a stock option plan, which was amended with shareholder approval on June 20, 2008 that provides for the issuance of options to its officers, employees and non-employees allowing for the acquisition of up to a fixed maximum of 16,000,000 common shares. This represents less than 10% of the currently issued and outstanding common shares. The dates on which options vest are set by the Board of Directors at the time of grant. The exercise price of an option granted is the closing price of the Company's stock on the last trading date prior to the grant date. The dates on which options expire are also set by the Board of Directors at the time of grant and cannot exceed ten years. Outstanding stock options to acquire common shares through the stock option plan are as follows:

	Six months ended June 30, 2008		Year ended December 31, 2007	
	Number of Options	Weighted average exercise price \$	Number of Options	Weighted average exercise price \$
Outstanding, beginning of period	6,568,789	3.49	5,884,222	3.22
Granted	3,920,665	6.13	1,079,500	4.76
Exercised for shares	-	-	(344,200)	(2.90)
Exercised for cash	(1,642,409)	(2.90)	(667)	(4.90)
Forfeited	(349,000)	(4.49)	(50,066)	(4.49)
Outstanding, end of period	8,498,045	4.72	6,568,789	3.49
Options exercisable, end of period	3,244,133	3.14	3,236,062	3.11

The following table summarizes information about the stock options outstanding at June 30, 2008:

Range of exercise prices	Number outstanding June 30, 2008	Weighted average remaining contractual life (years)	Weighted average exercise price \$	Number exercisable June 30, 2007	Weighted average exercise price \$
\$2.90 to \$4.00	2,729,637	1.68	2.93	2,754,136	2.96
\$4.01 to \$5.00	1,987,867	2.86	4.55	423,322	4.29
\$5.01 to \$9.00	3,780,541	3.65	6.11	66,675	3.21
	8,498,045	2.83	4.72	3,244,133	3.14

The Company's stock option plan provides 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 based on the difference between the option's exercise price and the Company's share price at the time of exercise. For the three and six month periods ended June 30, 2008, stock based compensation expense of \$4,065,000 and \$11,175,000 respectively (2007: \$708,000 and \$5,208,000 respectively), was recognized based on the change in value of the outstanding stock options. 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 options outstanding. Based on the June 30, 2008 share price of \$8.26, had all of the 8,498,045 stock options outstanding been vested, aggregate stock based compensation expense and a corresponding liability of \$30,086,000 (December 31, 2007: \$8,424,300) would have been recognized. Of this amount, \$18,695,000 has been recognized as stock based compensation payable at June 30, 2008 (December 31, 2007: \$7,520,000).

**(e) Warrants**

On March 21, 2005, warrants to purchase 5,000,000 common shares at \$2.90 were issued to Iteration Energy Inc. shareholders. The warrants vested the first day after the common shares of the Company had traded at a weighted average price of not less than \$4.50 per common share for any 45 consecutive calendar days within a 42-month period and expire on September 21, 2008. On May 7, 2005, all of the warrants vested. Warrant capital of \$4.1 million, calculated using the Black –Scholes option pricing methodology, was ascribed to the warrants issued.

During the quarter, 1,000,000 warrants were exercised for common shares of the Company, on the payment by the warrant holder of \$2.90 per warrant exercised. The \$2.9 million of cash received, plus the associated \$883,000 of warrant capital ascribed has been recorded as share capital.

At the Annual General Meeting of the Company held on May 22, 2008, shareholders approved an amendment to the warrants which allowed holders of the then remaining warrants to receive a cash payment in exchange for the surrender of the warrants. The cash payment is equal to the difference between the warrant exercise price and the Company's share price at the time of the exercise. As a result of that change, the Company calculated the cash in lieu amount on the 3,722,000 warrants then outstanding, based on the difference between the fair market value of the Company's common shares at that time of \$7.70 and the exercise price of \$2.90. This amount of \$17.9 million was recorded as stock based compensation payable with an offsetting charge to the deficit. A future income tax benefit associated with the obligation of \$4.7 million, based on the Company's future tax rate of 26.5% was also recorded and warrant capital previously recorded in the financial statements at the time of \$3.1 million was reclassified as a credit to the deficit.

Later in the quarter, 3,605,000 warrants were exercised for cash, which resulted in a cash payment of \$20.9 million. Of this amount, \$3.5 million has been recorded as an expense, representing the difference between the market value of the Company's shares at the date of exercise and the obligation recorded related to the market value of shares on May 22, 2008, as outlined above. The balance has been recorded as a reduction of stock based compensation payable.

Stock based compensation related to the remaining 116,667 warrants in the amount of \$625,000 has been recognized as stock based compensation payable at June 30, 2008.

**(f) Per Share Amounts**

	<b>Three months ended June 30,</b>		<b>Six months ended June 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Weighted average common shares outstanding	<b>165,811,596</b>	<b>62,489,432</b>	<b>129,265,758</b>	<b>60,032,567</b>
Weighted average diluted common shares outstanding	<b>168,412,603</b>	<b>62,489,432</b>	<b>131,241,651</b>	<b>60,032,567</b>

The options and warrants outstanding for the quarter and six months ended June 30, 2007 are not included in the computation of diluted common shares outstanding as the Company realized a net loss during these periods.

## 9. INCOME TAXES

The provision for future income taxes recorded in the financial statements differs from the amount that would be obtained by applying the statutory income tax rate to the earnings (loss) before tax as follows:

(\$000's)	Three months ended June 30,		Six months ended June 30,	
	2008	2007	2008	2007
Earnings (loss) before tax	\$6,332	\$(639)	\$8,647	\$(6,061)
Statutory Canadian corporate tax rate	29.50%	32.12%	29.50%	32.12%
Anticipated tax expense (recovery)	\$1,868	\$(205)	\$2,551	\$(1,947)
Rate adjustment	671	7	590	48
Other	2,950	(352)	2,473	(51)
Future income tax expense (recovery)	\$5,489	\$(550)	\$5,614	\$(1,950)

The Company's future income tax liability at June 30, 2008 and December 31, 2007 is comprised of the following:

(\$000's)	June 30, 2008	December 31, 2007
Income tax rate (%)	26.50	29.50
Property plant and equipment, having different income tax and accounting basis	\$94,080	\$10,228
Deferred partnership income	12,920	13,082
Scientific research pools	-	(5,301)
Non capital loss carry forwards	(2,926)	(730)
Share issue costs	(4,970)	(1,568)
Accrued stock based compensation	(5,120)	(2,218)
Asset retirement obligation	(9,481)	(5,575)
Unamortized leasehold inducements	(72)	(59)
Other	1,507	(349)
Future income tax liability	\$85,938	\$7,510

The current tax expense of \$671,000 for the six months ended June 30, 2008 (June 30, 2007: \$197,000) relates to a provincial part 1 tax assessment.

## 10. OPERATING LEASES

The Company has entered into various operating leases with respect to its premises. The leases have various expiration dates between June 30, 2009 and September 30, 2012 and require the following future minimum lease payments, by calendar year;

	Gross Liability (\$000)	Sublet Recovery (\$000)	Net Liability (\$000)
2008	\$1,420	(\$709)	\$711

2009	\$2,129	(\$1,418)	\$711
2010	\$1,418	(\$1,418)	-
2011	\$1,418	(\$1,418)	-
2012	\$1,063	(\$1,063)	-

The lease costs associated with office space previously occupied by Cyries has been sublet on a full recovery flow through basis commencing June 1, 2008 through until September 30, 2012. As a result of the sublet, starting in June 2008 the Company will recover lease payments of approximately \$1,418,000 per annum.

The existing lease on the Company's office space expires June 30, 2009. The Company is in the process of renegotiating a new lease for office space. However, the lease payments and term of the lease for the period subsequent to June 30, 2009 are not included in the above totals as these are not known at this time.

## 11. FINANCIAL INSTRUMENTS

The Company is exposed to a number of different financial risks arising from normal course business exposures, as well as the Company's use of financial instruments. These risk factors include market risks relating to commodity prices and interest rate risk, as well as liquidity risk and credit risk.

### a) Market Risk

Market risk is the risk or uncertainty arising from possible market price movements and their impact on the future performance of the business. The market price movements that could adversely affect the value of the Company's financial assets, liabilities and expected future cash flows include commodity price risk and interest rate risk.

### b) Commodity Price Risk

The Company's financial performance is closely linked to oil and natural gas prices. A change of \$1.00 Cdn/GJ in natural gas prices at the wellhead would have the effect of changing earnings for the remainder of the year by approximately \$12 million. A \$5.00/bbl change in WTI for oil would have the effect of changing earnings for the remainder of the year by approximately \$2 million.

From time to time, the Company employs the use of various financial instruments to manage these price exposures, and at this time, has entered into the following forward contract for the future physical delivery of crude oil:

Term	Volume (bbl/d)	Contract Price (USD /bbl)	Price Basis
Dec 1, 2008 – Nov 30, 2008	200	\$75.00 floor, \$90.20 ceiling	WTI

The Company considers the contract to be a future sales contract in the normal course of business at prices within a predetermined range with our current oil marketer, which will be satisfied by the future delivery of crude oil. The loss realized during the three months and six months ended June 30, 2008 with respect to this contract was approximately USD \$615,000 and \$756,000 respectively. As at June 30, 2008, the estimated value of the remaining contract was a loss of USD \$1,549,000.

### c) Interest Rate Risk

The Company is exposed to interest rate risk as changes in interest rates may affect future cash flows and the fair value of its financial instruments. The Company's primary debt facility has a floating interest rate that will fluctuate based on prevailing market conditions and the Company's ratio of funded debt to trailing cashflow. Cash flows are sensitive to changes in interest rates on this instrument. Given the amount of debt

employed, the Company's strategy is to manage interest rate risk within the current economic environment framework. If interest rates on the floating instrument were to change by 1.0% for the remainder of the year it is estimated that earnings for the remainder of the year would change by approximately \$1.3 million.

d) Liquidity Risk

Liquidity risk is the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities. The Company believes that it has access to sufficient capital through internally generated cashflows and external equity sources, as well as undrawn committed borrowing facilities to meet current spending forecasts. All of the trade liabilities mature in 2008 and the Company's bank loan is due on demand.

e) Counterparty Credit risk

Counterparty credit risk is the risk that a customer or counterparty will fail to perform an obligation or fail to pay amounts due causing a financial loss. The Company's accounts receivable are with customers and joint venture partners in the oil and gas industry and are subject to normal credit risks. A small portion of the Company's production is currently sold through a joint venture partner to purchasers under normal industry sale and payment terms; the balance is sold to twenty five marketers also under normal industry terms. The Company generally grants unsecured credit but routinely assesses the financial strength of its customers and joint venture partners.

As at June 30, 2008 the Company has an allowance for doubtful accounts of \$10,645,000, (including a provision of \$9.3 million relating to the filing for Company Creditors Arrangement Act protection by two of the Company's marketers of crude oil and natural gas), of trade accounts receivable that in the estimation of the Company may be impaired. (Note 16)

As at June 30, 2008, the aging analysis of trade receivables, net of the allowance for doubtful accounts, is as follows:

	<b>\$ thousands</b>
Current	\$37,854
30 – 60 days	1,013
60 – 90 days	670
Greater than 90 days	6,166
Total	\$45,703

## 12. CONTINGENCIES

The Company is party to various lawsuits as at June 30, 2008. It is management's opinion that, based on the best currently available information, the amount of any potential exposure and the outcome of these law suits is not determinable at this time. As a result, no provisions for these items have been recorded in these financial statements.

Pursuant to a purchase and sale agreement, the Company has indemnified the purchaser of a former subsidiary company for up to \$1,000,000 of income tax and legal expenses incurred with respect to specifically identified income tax returns. The Company accrued this obligation in the first quarter of 2008 and correspondingly increased the purchase price of related property, plant and equipment acquired as part of a series of transactions which occurred in conjunction with the disposition of the former subsidiary.

The Company indemnifies its directors and officers against any and all claims or losses reasonably incurred in the performance of their service to the Company to the extent permitted by law. The Company has acquired and maintains liability insurance for its directors and officers.

### 13. SUPPLEMENTAL DISCLOSURE ON CONSOLIDATED STATEMENTS OF CASH FLOWS

Changes in non-cash working capital were comprised of the following:

(\$000's)	Three months ended June 30,		Six months ended June 30,	
	2008	2007	2008	2007
Accounts receivable	\$15,849	\$(1,780)	\$9,792	\$(1,587)
Prepays and other current assets	(1,748)	(663)	(761)	(448)
Accounts payable and accrued liabilities	(57,671)	(21,983)	(41,240)	(5,711)
Income taxes payable	170	-	458	-
<b>Net change</b>	<b>\$(43,400)</b>	<b>\$(24,426)</b>	<b>\$(31,751)</b>	<b>\$(7,746)</b>

(\$000's)	Three months ended June 30,		Six months ended June 30,	
	2008	2007	2008	2007
Net change by activity:				
Operating	\$(16,114)	\$(12,453)	(\$101)	\$(6,008)
Investing	(27,286)	(11,973)	(31,650)	(1,738)
<b>Net change</b>	<b>\$(43,400)</b>	<b>\$(24,426)</b>	<b>\$(31,751)</b>	<b>\$(7,746)</b>

Additional information:

(\$000's)	Three months ended June 30,		Six months ended June 30,	
	2008	2007	2008	2007
Cash interest paid	\$3,067	\$ 390	\$4,179	\$ 861
Cash taxes paid	170	197	671	197

Included in cash interest paid during three month period ended June 30, 2008 are initial commitment fees of \$448,000 related to the syndicated facility.

### 14. CAPITAL MANAGEMENT

The Company's principal business of the exploration, exploitation and development of oil and gas requires ongoing access to capital in order to allow the Company to successfully implement its growth strategy; and to provide adequate returns for shareholders and benefits for other stakeholders.

The Company defines capital as share capital and bank indebtedness, net of cash and cash equivalents. The consolidated capital structure of the Company is as follows

	As at June 30, 2008		As At December 31, 2007	
	\$ 000	%	\$000	%
Cash	\$ (39,769)	(3.9)	\$(1,230)	(0.4)
Bank indebtedness	243,000	24.1	50,370	17.2
Share capital	805,302	79.8	238,586	81.8
Warrants outstanding	-	-	3,934	1.4
<b>Total</b>	<b>\$1,008,533</b>	<b>100.0</b>	<b>\$291,660</b>	<b>100.0</b>

As at June 30, 2008, the Company had a bank credit facility that contained covenants which limit the amount of debt that can be incurred by the Company. Throughout the periods presented, the Company has met those covenants.

## 15. FINANCIAL INSTRUMENTS

Section 3855 of the CICA Handbook requires the initial measure of all financial instruments at fair value with classification into one of five categories; loans and receivables; assets held to maturity; assets available for sale; other financial liabilities; and held for trading.

The Company has elected to classify its financial instruments as follows:

\$000	June 30, 2008		December 31, 2007	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
<b>Loans and receivables</b>				
Accounts receivable <sup>(1)</sup>	\$45,703	\$45,703	\$15,942	\$15,942
<b>Other financial liabilities</b>				
Bank indebtedness <sup>(1)</sup>	243,000	243,000	50,370	50,370
Accounts payable and accrued liabilities <sup>(1)</sup>	73,053	73,053	30,454	30,454
Income taxes payable <sup>(1)</sup>	458	458	-	-
Stock based compensation payable <sup>(1)</sup>	19,320	19,320	7,520	7,520

(1) Due to the nature and/or short term maturity of these financial instruments, carrying value approximates fair value.

The carrying values of financial instruments included in current assets and current liabilities approximates their fair value, reflecting the short term maturity, normal trade credit terms, and/or the nature of these instruments.

## 16. SUBSEQUENT EVENTS

### SemCAMS ULC and SemCanada Crude Company CCAA Filing

Subsequent to quarter end, SemCanada Crude Company (“SemCanada”) and SemCAMS ULC (SemCAMS) filed for protection under the Company Creditors Arrangement Act (“CCAA”) in association with the filing for Chapter 11 protection in the State of Delaware by their US parent SemGroup, LP (“SemGroup”). The Company has marketing arrangements with SemCAMS for a portion of its natural gas production and with SemCanada for a portion of its crude oil production. As a result of the filing for CCAA protection, producers have been advised that they will not be receiving payment for production supplied for the period from June 1 to July 21, 2008. The Company estimates that the value of this production is approximately \$16 million, of which \$9.3 million represents production for the month of June. The Company has established a provision for bad debts of the entire \$9.3 million amount receivable at June 30, 2008 given the uncertainty with respect to the ultimate timing and collection, if any, of this amount.

