

*Unaudited Interim Consolidated Financial Statements of*

**Iteration Energy Ltd.**

*March 31, 2009 and 2008*

## Iteration Energy Ltd.

### Consolidated Balance Sheets (unaudited)

As at <i>(in thousands of dollars)</i>	March 31, 2009	December 31, 2008
<b>ASSETS</b> (Notes 5 and 14)		
Current		
Cash	\$278	\$6,832
Accounts receivable (Note 10(d))	38,911	43,996
Prepays and other current assets	9,887	10,846
	<b>49,076</b>	61,674
Property, plant and equipment (Note 4)	973,421	973,529
	<b>\$1,022,497</b>	\$1,035,203
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current		
Bank indebtedness (Notes 5 and 14)	\$285,545	\$266,800
Accounts payable and accrued liabilities (Note 6)	60,257	71,004
	<b>345,802</b>	337,804
Future income taxes (Note 9)	86,589	92,539
Leasehold inducements	160	193
Asset retirement obligation (Note 7)	42,877	43,323
	<b>475,428</b>	473,859
Commitments and contingencies (Note 11)		
Shareholders' equity		
Share capital (Note 8)	805,301	805,301
Deficit	(258,232)	(243,957)
	<b>547,069</b>	561,344
	<b>\$1,022,497</b>	\$1,035,203

Subsequent events (Note 14)

See accompanying notes to the unaudited interim consolidated financial statements.

# Iteration Energy Ltd.

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

	Three months ended March 31	
<i>(in thousands of dollars, except per share amounts)</i>	<b>2009</b>	2008
Revenue		
Production revenue	<b>\$58,693</b>	\$55,564
Royalties	<b>(12,142)</b>	(11,679)
	<b>46,551</b>	43,885
Other production revenue	-	329
	<b>46,551</b>	44,214
Expenses		
Production	<b>24,881</b>	10,198
Transportation	<b>1,434</b>	1,469
General and administrative	<b>3,131</b>	2,277
Stock based compensation expense (Note 8(c))	-	7,110
Interest on current debt	<b>1,618</b>	1,112
Depletion, depreciation and accretion	<b>35,700</b>	21,554
Recovery of investment tax credits	-	(1,820)
	<b>66,764</b>	41,900
Income (loss) before income taxes	<b>(20,213)</b>	2,314
Income taxes (Note 9)		
Current income tax expense	<b>12</b>	500
Future income tax expense (recovery)	<b>(5,950)</b>	125
	<b>(5,938)</b>	625
Net income (loss) and comprehensive income (loss)	<b>(14,275)</b>	1,689
Deficit, beginning of period	<b>(243,957)</b>	(18,405)
Deficit, end of period	<b>\$(258,232)</b>	\$(16,716)
Basic and diluted income (loss) per common share (Note 8(d))	<b>\$(0.09)</b>	\$0.02

See accompanying notes to the unaudited interim consolidated financial statements

# Iteration Energy Ltd.

## Consolidated Statements of Cash Flows (unaudited)

	Three months ended March 31	
<i>(in thousands of dollars)</i>	2009	2008
<b>OPERATING ACTIVITIES</b>		
Net income (loss)	<b>\$(14,275)</b>	\$1,689
Add (deduct) non-cash items:		
Depletion, depreciation and accretion	<b>35,700</b>	21,554
Recovery of investment tax credits	-	(1,820)
Future income tax expense (recovery)	<b>(5,950)</b>	125
Amortization of leasehold inducements	<b>(33)</b>	(54)
Stock-based compensation expense	-	7,110
Asset retirement expenditures (note 7)	<b>(542)</b>	(93)
	<b>14,900</b>	28,511
Net change in non-cash operating working capital (Note 12)	<b>5,909</b>	15,135
	<b>20,809</b>	43,646
<b>INVESTING ACTIVITIES</b>		
Proceeds on sale of property, plant and equipment	<b>227</b>	(62)
Acquisition of oil and gas properties	-	(1,556)
Additions to oil and gas properties	<b>(35,587)</b>	(40,156)
Additions to other capital assets	<b>(135)</b>	(40)
Net change in non-cash investing working capital (Note 12)	<b>(10,621)</b>	(3,483)
	<b>(46,116)</b>	(45,297)
<b>FINANCING ACTIVITIES</b>		
Proceeds from bank indebtedness	<b>18,745</b>	1,670
Share issue costs (Note 8(b))	-	(26)
Net change in non-cash financing working capital (Note 12)	<b>8</b>	-
	<b>18,753</b>	1,644
Decrease in cash	<b>(6,554)</b>	(7)
Cash, beginning of period	<b>6,832</b>	1,230
Cash, end of period	<b>\$278</b>	\$1,223

See Note 12 for supplemental disclosure

See accompanying notes to the unaudited interim consolidated financial statements

# **Iteration Energy Ltd.**

## **Notes to the Unaudited Interim Consolidated Financial Statements Period ended March 31, 2009 and 2008**

(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. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The unaudited interim consolidated financial statements of Iteration have been prepared in accordance with Canadian generally accepted accounting principles (“GAAP”) and are consistent with those policies set out in the audited consolidated financial statements of the Company for the year ended December 31, 2008, except as disclosed below. These unaudited interim consolidated financial statements do not include all the disclosures provided in the December 31, 2008 financial statements and should be read in conjunction with those financial statements. The timely preparation of financial statements requires that management make estimates and assumptions, and use judgment regarding assets, liabilities, revenues and expenses. Such estimates primarily relate to unsettled transactions and events as of the date of the financial statements. Accordingly, actual results may differ from estimated amounts. In the quarter ended March 31, 2009 the Company recorded additional production expenses for 2008 as costs accrued at year-end 2008 did not reflect late invoices from vendors and higher than expected recent charges from partners relating to 2008. In the opinion of management, these unaudited interim consolidated financial statements have been properly prepared within reasonable limits of materiality and within the framework of the significant accounting policies summarized below.

#### **Basis of Consolidation**

These unaudited interim 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**

Effective January 1, 2009, the Company adopted 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. This new standard has no impact on the Company’s financial reporting.

#### **Future Accounting Policies**

In January 2009, the CICA issued three new accounting standards, Section 1582 *Business Combinations*, Section 1601 *Consolidated Financial Statements* and Section 1602 *Non-controlling interests*, each of which are effective for fiscal years beginning on or after January 1, 2011 and further align Canadian GAAP with International Financial Reporting Standards (“IFRS”). Earlier adoption of these recommendations is permitted.

The Canadian Accounting Standards Board (“AcSB”) 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 developing a changeover plan to complete the transition to IFRS by January 1, 2011, including the preparation of required comparative information. The key elements of the plan include:

- determine appropriate changes to accounting policies and required amendments to financial disclosures;
- identify and implement changes in associated processes and information systems;
- comply with internal control requirements;
- educate and train internal and external stakeholders.

At March 31, 2009, the Company had completed a diagnostic study of the anticipated impact of the transition to IFRS. The Company is currently analyzing the accounting policy alternatives and identifying implementation options for the corresponding process changes. As IFRS is expected to change prior to 2011, the impact of IFRS on the Company’s consolidated financial statements is not reasonably determinable at this time. The Company will continue to monitor standards development as issued by the International Accounting Standards Board (“IASB”) and AcSB as well as regulatory developments as issued by the Canadian Security Administrators, which may affect the timing, nature or disclosure of its adoption of IFRS.

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

#### **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 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 an increase in the exchange ratio for the acquisition.

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 period ending March 31, 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 March 31, 2008 and the operations of Cyries and its subsidiaries for the period from March 8, 2008 to March 31, 2008.

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

<b>(\$000's)</b>	
Furniture and equipment	\$969
Property, plant and equipment	599,448
Goodwill	205,208
Bank debt	(111,223)
Working capital deficiency	(29,827)
Future income tax liability	(75,950)
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>

Note: Goodwill was written off at December 31, 2008.

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

	<b>March 31, 2009</b>	December 31, 2008
	<b>(\$000's)</b>	(\$000's)
Oil and gas properties	<b>\$1,324,995</b>	\$1,290,246
Other	<b>3,060</b>	2,925
	<b>1,328,055</b>	1,293,171
<b>Less accumulated depletion and depreciation</b>	<b>354,634</b>	319,642
	<b>\$973,421</b>	\$973,529

At March 31, 2009, unproved properties and seismic expenditures amounting to \$139,936,000 (March 31, 2008: \$111,475,000) have been excluded from the depletion calculation. Future development costs on proven undeveloped reserves of \$75,142,000 (March 31, 2008: \$35,540,000) are included in the depletion calculation.

For the three months ended March 31, 2009, the Company capitalized \$1,135,000 (three months ended March 31, 2008: \$770,000) of overhead directly related to exploration and development activities.

#### **5. BANK INDEBTEDNESS (see also note 14)**

Bank indebtedness represents the drawn portion of a syndicated facility. As at March 31, 2009, the syndicated facility provided for maximum borrowings of \$300 million. There were three components to the syndicated facility. The first was a \$260 million term facility which could be used to fund the Company's capital program. The second component was a \$15 million working capital revolving facility, which was payable on demand. The third component was a supplemental facility for \$25 million which matured on April 30, 2009.

Under the terms of the first two components of the facility, the Company borrowed primarily by either Bankers' Acceptances which carried a margin of 165 to 275 basis points or by prime rate loans which carried a margin of 65 to 175 basis points, each depending on the ratio of funded debt to trailing cash flow.

Under the terms of the \$25 million supplemental facility, the Company borrowed primarily by either Bankers' Acceptances which carried a margin of 275 to 400 basis points or by prime rate loans which carried a margin of 175 to 300 basis points each, depending on the ratio of funded debt to trailing cash flow.

On May 14, 2009 the Company entered into a new bank agreement. See note 14 for details.

## 6. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

The accounts payable and accrued liabilities consist of the following:

	March 31, 2009 (\$000's)	December 31, 2008 (\$000's)
Trade accounts payable	\$47,647	\$57,474
Joint venture accounts payable	4,281	3,790
Royalties payable	8,329	9,740
<b>Total</b>	<b>\$60,257</b>	<b>\$71,004</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 (from 2009 through 2036) will total approximately \$97,736,000 (December 31, 2008: \$98,079,000). The book value of the obligation at March 31, 2009 is \$42,877,000 (December 31, 2008: \$43,323,000) using a discount rate of eight and one half percent for obligations incurred subsequent to September 30, 2008 (six and one half percent prior thereto) and an inflation rate of two per cent. As at March 31, 2009, no funds have been set aside to settle this obligation.

	Three months ended March 31, 2009 (\$000's)	Year ended December 31, 2008 (\$000's)
Balance, beginning of period	\$43,323	\$18,897
Liabilities incurred on acquisition of properties	-	19,854
Change in estimate	(712)	-
Increase in liabilities from drilling activity	100	2,848
Accretion expense	708	2,271
Settlement of liabilities	(542)	(547)
<b>Balance, end of period</b>	<b>\$42,877</b>	<b>\$43,323</b>

The Company calculates the asset retirement obligation based on estimates of the date of abandonment, abandonment costs, and inflation. These amounts are then discounted to a present value amount.

## 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**

	Three months ended March 31, 2009		Year ended December 31, 2008	
	Number of Shares	Amount (\$000's)	Number of Shares	Amount (\$000's)
Balance, beginning of period	<b>166,020,384</b>	<b>\$805,301</b>	71,029,780	\$238,586
Shares issued on corporate acquisition (note 3)	-	-	93,990,604	563,004
Shares issued on exercise of warrants	-	-	1,000,000	3,733
Share issue costs, net of tax effect of \$nil, (2008: \$9)	-	-	-	(22)
<b>Balance, end of period</b>	<b>166,020,384</b>	<b>\$805,301</b>	166,020,384	\$805,301

See note 14 with respect to equity issued subsequent to the quarter on May 6, 2009.

**(c) Stock Options**

The Company has a stock option plan which that provides for the issuance of options to its officers, employees and consultants allowing for the acquisition of up to a fixed maximum of 16,000,000 common shares. The dates on which options vest are set by the Compensation Committee of 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 Compensation Committee of 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:

	Three months ended March 31, 2009		Year ended December 31, 2008	
	Number of Options	Weighted average exercise price \$	Number of Options	Weighted average exercise price \$
Outstanding, beginning of period	<b>9,782,445</b>	<b>\$4.55</b>	6,568,789	\$3.49
Granted	<b>955,591</b>	<b>0.95</b>	5,343,065	5.47
Exercised for cash	-	-	(1,642,409)	(2.94)
Forfeited	<b>(602,661)</b>	<b>(4.77)</b>	(487,000)	(5.70)
<b>Outstanding, end of period</b>	<b>10,135,375</b>	<b>\$4.20</b>	9,782,445	\$4.55
<b>Options exercisable, end of period</b>	<b>3,846,754</b>	<b>\$3.39</b>	3,759,285	\$3.36

The following table summarizes information about the stock options outstanding at March 31, 2009:

Range of exercise prices	Number outstanding March 31, 2009	Weighted average remaining contractual life (years)	Weighted average exercise price \$	Number exercisable March 31, 2009	Weighted average exercise price \$
\$0.70 to \$2.89	1,210,132	3.97	\$1.23	-	\$-
\$2.90 to \$4.00	3,549,037	1.95	3.12	2,779,636	2.97
\$4.01 to \$5.00	1,869,598	2.49	4.54	955,377	4.40
\$5.01 to \$9.00	3,506,608	3.25	6.14	111,741	5.16
	<b>10,135,375</b>	<b>2.74</b>	<b>\$4.20</b>	<b>3,846,754</b>	<b>\$3.39</b>

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 period ended March 31, 2009, stock based compensation expense of \$nil (March 31, 2008: \$7,110,000), was recognized based on the change in value of the outstanding stock options. The current period amounts were determined using the March 31, 2009 closing share price, as compared to the closing share price at December 31, 2008. 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 March 31, 2009 closing share price of \$0.98, had all of the outstanding stock options to acquire 10,135,375 common shares been vested, there would be no aggregate stock based compensation expense or corresponding liability recognized (December 31, 2008: \$nil). At March 31, 2009 and December 31, 2008, there has been no amount recognized as stock based compensation payable. Subsequent to quarter end, 450,000 options with a weighted average exercise price of \$0.98 were issued to new employees of the Company and 71,833 options with a weighted average price of \$5.13 were forfeited due to resignations.

**(d) Per Share Amounts**

	<b>Three months ended</b>	
	<b>March 31,</b>	
	<b>2009</b>	<b>2008</b>
Weighted average common shares outstanding	<b>166,020,387</b>	90,572,381
Weighted average diluted common shares outstanding	<b>166,020,387</b>	95,066,572

**9. INCOME TAXES**

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

<b>(\$000's)</b>	<b>Three months ended</b>	
	<b>March 31,</b>	
	<b>2009</b>	<b>2008</b>
Income (loss) before tax	<b>\$(20,213)</b>	\$2,314
Statutory Canadian corporate tax rate	<b>29.20%</b>	29.50%
Anticipated tax expense (recovery)	<b>\$(5,900)</b>	\$683
Rate adjustment	<b>(220)</b>	(81)
Other	<b>182</b>	23
Income tax expense (recovery)	<b>\$(5,938)</b>	\$625

The Company's future income tax liability at March 31, 2009 and December 31, 2008 is comprised of the following:

(\$000's)	March 31, 2009	December 31, 2008
Income tax rate (%)	26.50	26.70
Property, plant and equipment, having different income tax and accounting basis	\$98,575	\$72,392
Deferred partnership income	2,736	46,449
Non-capital loss carry forwards	-	(13,136)
Share issue costs	(3,767)	(4,162)
Asset retirement obligation	(11,362)	(11,567)
Unamortized leasehold inducements	(42)	(52)
Other	449	2,615
<b>Future income tax liability</b>	<b>\$86,589</b>	<b>\$92,539</b>

## 10. 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.

- Commodity Price Risk

The Company's financial performance is closely linked to oil and natural gas prices. A change of \$1.00 Cdn/mcf in natural gas prices at the wellhead would have the effect of changing net loss for the quarter by approximately \$4.3 million. A US \$5.00/bbl change in WTI for oil would have the effect of changing net loss for the quarter by approximately \$1.2 million.

- 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 cash flow. 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 quarter, it is estimated that net loss for the quarter would change by approximately \$0.2 million.

### b) 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 currently has access to sufficient capital through internally generated cash flows and external equity sources, as well as undrawn committed borrowing facilities to meet current spending forecasts. All of the trade liabilities mature in 2009 and the Company's bank loan is due on April 30, 2010. See subsequent events note 14.

Scheduled reviews of the credit facility focus on the borrowing base supporting lending limits and are influenced by the lenders willingness to lend in general, commodity price forecasts used to determine the lending base, lenders interest in particular business sectors, such as energy and the relative strength of the borrower. Given these constraints, there is no assurance that Iteration will be able to sustain its current borrowing base and may be required to reduce its outstanding loans. Should there be a requirement of the Company to reduce its outstanding loans, there are a number of options available including, but not limited to:

- a) Issuance of additional equity;
- b) Negotiation of incremental borrowings with subordinated lenders;
- c) Divestiture of assets; and
- d) Dedication of funds from operations.

c) Foreign Exchange Risk

Foreign exchange risk is the risk that the fair value of the future cash flows will fluctuate because of changes in foreign exchange rates. The benchmark pricing for most natural gas and crude oil is based on US Dollars. Changes in the exchange rate of the Canadian dollar relative to the US dollar will indirectly impact the Canadian dollar commodity price realized by the Company and, as a result, cash flow. If foreign exchange rates were to change by 1% over the course of the quarter, it is estimated that net loss for the quarter would change by approximately \$0.3 million.

d) 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 four marketers also under normal industry terms. Of these twenty four marketers, sales to four account for approximately 80% of the Company's production revenue.

As at March 31, 2009, the Company had an allowance for doubtful accounts of \$15.7 million (December 31, 2008 \$15.4 million, including a provision of \$13.9 million relating to the filing for CCAA protection by SemCanada and SemCAMS), on trade accounts receivable that in the estimation of the Company may be impaired.

As at March 31, 2009, the aging analysis of trade receivables is as follows:

	(\$000's)
Current	24,144
30 – 60 days	4,135
60 – 90 days	2,712
Greater than 90 days	23,595
Total	54,586
Less allowance for doubtful accounts	(15,675)
Total	38,911

Note: Greater than 90 days includes amounts receivable from for SemCanada and SemCAMS.

e) Fair Value of Financial Instruments

Section 3855 of the CICA Handbook requires the initial measurement 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's)	March 31, 2009		December 31, 2008	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
<b>Loans and receivables</b>				
Accounts receivable	\$38,911	\$38,911	\$43,996	\$43,996
<b>Other financial liabilities</b>				
Bank indebtedness	285,545	285,545	266,800	266,800
Accounts payable and accrued liabilities	60,257	60,257	71,004	71,004

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

## 11. CONTINGENCIES

The Company is party to various lawsuits as at March 31, 2009. It is management's opinion that, based on the best currently available information, the amount of any potential exposure and the outcome of these lawsuits 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.

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

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

(\$000's)	Three months ended March 31,	
	2009	2008
Accounts receivable	\$5,561	\$(5,993)
Prepays and other current assets	470	986
Accounts payable and accrued liabilities	(10,735)	16,659
Net change	\$(4,704)	\$11,652

(\$000's)	Three months ended March 31,	
	2009	2008
Net change by activity:		
Operating	\$5,909	\$15,135
Investing	(10,621)	(3,483)
Financing	8	-
Net change	\$(4,704)	\$11,652

Additional information:

(\$000's)	Three months ended	
	2009	March 31, 2008
Cash interest paid	\$1,618	\$1,112
Cash taxes paid	\$12	\$500

### 13. 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 business 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. The consolidated capital structure of the Company is as follows:

	As at March 31, 2009		As at December 31, 2008	
	(\$000's)	%	(\$000's)	%
Bank indebtedness (net of cash)	285,267	26.2	259,968	24.4
Share capital	805,301	73.8	805,301	75.6
Total	\$1,090,568	100.0	\$1,065,629	100.0

As at March 31, 2009, the Company had a borrowing base 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.

The Company actively manages its capital structure with the objective of maintaining sufficient flexibility to allow it to execute on its capital investment program, including investing in oil and gas acquisitions, exploration and development, which may or may not be successful. For this objective to be achieved, the Company continually strives to balance the proportion of debt to equity in its capital structure to take into account the level of risk being incurred through capital expenditures.

In order to maintain or adjust the capital structure, the Company considers various factors including, but not limited to:

- a) projected debt to projected funds from operations ratio while attempting to finance an acceptable investment program, including incremental investment and acquisition opportunities;
- b) the current level of bank credit available from the banking syndicate;
- c) the level of bank credit that may be available from the banking syndicate as a result of anticipated changes in reserves;
- d) the availability of other sources of debt with different characteristics from the existing bank debt;
- e) the sale of assets;
- f) limiting the size of the investment or capital program; and
- g) issuing new common equity if available on favorable terms.

### 14. SUBSEQUENT EVENTS

The following events occurred subsequent to quarter end;

- 1) On April 30, 2009 the Company extended its credit facility with its syndicate of lenders to May 29, 2009. The borrowing base was established at \$260 million and proceeds from the Company's announced equity financing (see Note 14 (2) below) were used to repay any borrowing base shortfall.

On April 30, 2009, the Company also extended the maturity date of the supplemental facility to May 29, 2009. Proceeds from the Company's announced equity financing (see Note 14 (2) below) were used to repay this facility and the facility was cancelled.

- 2) On May 6, 2009 the Company closed a bought deal equity financing of 39,100,000 common shares plus an over-allotment option of 5,865,000 common shares all at \$1.28 per common share for gross proceeds of \$57.5 million (net proceeds of approximately \$54.4 million). The proceeds of the financing were applied to reduce the Company's credit facility and repay the Company's supplemental facility, which was then cancelled.
- 3) On May 14, 2009 the Company entered into a new credit facility with a syndicate of lenders, consisting of Canadian Imperial Bank of Commerce, Bank of Nova Scotia, Bank of Montreal and Alberta Treasury Branch, to replace the existing credit facility described in Notes 5 and 14 (1) above. The borrowing base on this new facility was established at \$265 million and consists of a \$12.5 million operating facility and a \$252.5 million extendible revolving term facility. This facility is secured by a \$500 million floating charge demand debenture. This facility will mature April 30, 2010, and, at the Company's request, such Credit Facilities may be renewed for a period of not more than 364 days on agreement of the lenders. The pricing on this facility is as follows:
  - a) For Canadian prime based loans or US base rate loans, at applicable prime plus a margin ranging from 175 to 325 basis points, depending on the ratio of consolidated debt to annualized earnings before interest, taxes and depletion/depreciation/accretion for the preceding four quarters;
  - b) For borrowings by way of Bankers' Acceptances or LIBOR loans, at the Bankers' Acceptance or LIBOR rate plus a stamping fee ranging from 275 to 425 basis points, depending on the ratio of consolidated debt to annualized earnings before interest, taxes and depletion/depreciation/accretion for the preceding four quarters, and
  - c) A standby fee on the unutilized portion of the facility of between 82.5 and 127.5 basis points depending on the ratio of consolidated debt to annualized earnings before interest, taxes and depletion/depreciation/accretion for the preceding four quarters.