

Unaudited Interim Consolidated Financial Statements of

Iteration Energy Ltd.

June 30, 2009

Iteration Energy Ltd.
Consolidated Balance Sheets (unaudited)

As at <i>(in thousands of dollars)</i>	June 30, 2009	December 31, 2008
ASSETS		
Current		
Cash	\$ 139	\$ 6,832
Accounts receivable (Note 9(f))	32,422	43,996
Prepays and other current assets	12,100	10,846
	44,661	61,674
Property, plant and equipment (Note 4)	941,760	973,529
	\$ 986,421	\$ 1,035,203
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current		
Bank indebtedness (Note 5)	\$ 246,000	\$ 266,800
Accounts payable and accrued liabilities (Note 6)	39,997	71,004
Stock based compensation payable (Note 8(c))	35	-
	286,032	337,804
Future income taxes	77,395	92,539
Leasehold inducements	127	193
Asset retirement obligation (Note 7)	43,532	43,323
	407,086	473,859
Commitments and contingencies (Note 10)		
Shareholders' equity		
Share capital (Note 8 (b))	860,545	805,301
Deficit	(281,210)	(243,957)
	579,335	561,344
	\$ 986,421	\$ 1,035,203

See accompanying notes to the unaudited interim consolidated financial statements.

Iteration Energy Ltd.

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

	Three months ended June 30,		Six months ended June 30,	
<i>(in thousands of dollars, except per share amounts)</i>	2009	2008	2009	2008
Revenue				
Production revenue	\$ 44,936	\$ 127,175	\$ 103,629	\$ 182,739
Royalties	(6,517)	(27,199)	(18,659)	(38,878)
Other production revenue	222	629	217	958
	38,641	100,605	85,187	144,819
Expenses				
Production	23,752	20,291	48,633	30,488
Transportation	1,301	1,982	2,735	3,451
General and administrative	3,063	3,195	6,189	5,472
Stock based compensation (Note 8(c))	35	13,799	35	20,908
Interest on debt	3,215	3,067	4,833	4,179
Depletion, depreciation and accretion	36,800	39,045	72,500	60,600
	68,166	81,379	134,925	125,098
Income (loss) before the following	(29,525)	19,226	(49,738)	19,721
Non-cash charge related to warrants	-	(3,546)	-	(3,546)
Provision for bankruptcy: SemGroup LP (Note 9 (f))	(1,812)	(9,348)	(1,812)	(9,348)
Recovery of investment tax credits	-	-	-	1,820
Earnings (loss) before income taxes	(31,337)	6,332	(51,550)	8,647
Income taxes				
Current income tax expense	1	171	13	671
Future income tax expense (recovery)	(8,360)	5,489	(14,310)	5,614
	(8,359)	5,660	(14,297)	6,285
Net earnings (loss) and comprehensive earnings (loss)	(22,978)	672	(37,253)	2,362
Deficit, beginning of period	\$ (258,232)	\$ (16,716)	\$ (243,957)	\$ (18,406)
Charge on modification of warrant terms	-	(10,029)	-	(10,029)
Deficit, end of period	\$ (281,210)	\$ (26,073)	\$ (281,210)	\$ (26,073)
Basic and diluted earnings (loss) per common share (Note	\$ (0.12)	\$ -	\$ (0.21)	\$ 0.02

See accompanying notes to the unaudited interim consolidated financial statements

Iteration Energy Ltd.

Consolidated Statements of Cash Flows (unaudited)

	Three months ended		Six months ended	
	June 30,		June 30,	
<i>(in thousands of dollars)</i>	2009	2008	2009	2008
OPERATING ACTIVITIES				
Net earnings (loss)	\$ (22,978)	\$ 672	\$ (37,253)	\$ 2,362
Add (deduct) non-cash items:				
Depletion, depreciation and accretion	36,800	39,045	72,500	60,600
Recovery of investment tax credits	-	-	-	(1,820)
Future income tax expense (recovery)	(8,360)	5,489	(14,310)	5,614
Amortization of leasehold inducements	(33)	(41)	(66)	(95)
Stock-based compensation expense (Note 8 (c))	35	4,130	35	11,240
Non-cash charge related to warrants	-	3,546	-	3,546
Asset retirement expenditures	(86)	(17)	(628)	(110)
	5,378	52,824	20,278	81,337
Net change in non-cash operating working capital (Note 11)	3,286	(16,114)	9,195	(101)
	8,664	36,710	29,473	81,236
INVESTING ACTIVITIES				
Proceeds on sale of property plant and equipment	2,151	105	2,378	646
Acquisition of subsidiary	-	(176)	-	(778)
Acquisition of oil and gas properties	-	(2,858)	-	(4,414)
Additions to oil and gas properties	(6,347)	(28,479)	(41,934)	(68,635)
Additions to other capital assets	(200)	(475)	(335)	(515)
Net change in non-cash investing working capital (Note 11)	(19,125)	(27,286)	(29,746)	(31,650)
	(23,521)	(59,169)	(69,637)	(105,346)
FINANCING ACTIVITIES				
Proceeds from (repayment of) bank indebtedness	(39,545)	78,960	(20,800)	80,630
Common shares issued	57,555	2,900	57,555	2,900
Exercise of warrants	-	(20,851)	-	(20,851)
Share issue costs	(3,146)	(4)	(3,146)	(30)
Net change in non-cash financing working capital (Note 11)	(146)	-	(138)	-
	14,718	61,005	33,471	62,649
Increase (decrease) in cash	(139)	38,546	(6,693)	38,539
Cash, beginning of period	278	1,223	6,832	1,230
Cash, end of period	139	39,769	139	39,769

See Note 11 for supplemental disclosure

See accompanying notes to the unaudited interim consolidated financial statements

Iteration Energy Ltd.

Notes to the Unaudited Interim Consolidated Financial Statements As at and for the Three and Six Months Ended June 30, 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. 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, 2008, except as disclosed below. These interim consolidated financial statements do not include all 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 three and six months ended June 30, 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 International Financial Reporting Standards (“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 current financial reporting.

Future Accounting Policies

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 June 30, 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. Until this analysis is complete and 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 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, the purchase price was allocated as follows:

	(\$000's)
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)
Total purchase price	\$574,350
Consideration was comprised of :	
Common shares	\$563,004
Transaction costs	11,346
Total consideration	\$574,350

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

4. PROPERTY PLANT AND EQUIPMENT

	June 30, 2009	December 31, 2008
	(\$000's)	(\$000's)
Oil and gas properties	\$ 1,329,193	\$ 1,290,246
Other	3,260	2,925
	1,332,453	1,293,171
Less accumulated depletion and depreciation	390,693	319,642
	\$ 941,760	\$ 973,529

At June 30, 2009, unproved properties and seismic expenditures amounting to \$122,032,000 (June 30, 2008: \$129,876,000) have been excluded from the depletion calculation. Future development costs on proven undeveloped reserves of \$84,800,000 (June 30, 2008: \$33,695,000) are included in the depletion calculation.

For the three and six months ended June 30, 2009, the Company capitalized \$1,047,000 and \$2,182,000 (three and six months ended June 30, 2008: \$1,020,000 and \$1,790,000) 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 credit facility is with a syndicate of lenders, consisting of Canadian Imperial Bank of Commerce, Bank of Nova Scotia, Bank of Montreal and Alberta Treasury Branch. The borrowing base on this facility was established at \$265 million and consists of a \$12.5 million operating facility and a \$252.5 million extendible revolving term facility. Subsequent to June 30 the Company sold properties and the borrowing base was reduced by \$12.5 million (See Note 13 for details). 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.

As at June 30, 2009, bank indebtedness was \$246 million. The effective interest rate for the six month period ended June 30, 2009 is 3.6%.

6. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

The accounts payable and accrued liabilities consist of the following:

	June 30, 2009	December 31, 2008
	(\$000's)	(\$000's)
Trade accounts payable	\$ 32,329	\$ 57,474
Joint venture accounts payable	3,892	3,790
Royalties payable	3,776	9,740
Total	\$ 39,997	\$ 71,004

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 2009 through 2036) will total approximately \$97,073,000 (December 31, 2008: \$98,079,000). The book value of the obligation at June 30, 2009 is 43,532,000 (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 percent. As at June 30, 2009, no funds have been set aside to settle this obligation.

	June 30, 2009	December 31, 2008
	(\$000's)	(\$000's)
Balance, beginning of period	\$ 43,323	\$ 18,897
Liabilities incurred on acquisition of properties (note 3)	-	19,854
Change in estimate	(712)	-
Increase in liabilities from drilling activity	100	2,848
Accretion expense	1,449	2,271
Settlement of liabilities	(628)	(547)
Balance, end of period	\$ 43,532	\$ 43,323

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		Year ended	
	June 30, 2009		December 31, 2008	
	Number of Shares	Amount (\$000's)	Number of Shares	Amount (\$000's)
Balance, beginning of period	166,020,384	\$ 805,301	71,029,780	\$ 238,586
Shares issued on public offerings	44,965,000	57,555	-	-
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 \$834 (2008: \$9)	-	(2,311)	-	(22)
Balance, end of period	210,985,384	\$ 860,545	166,020,384	\$ 805,301

(c) Stock Options

The Company has a stock option plan which 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:

	Six months ended		Year ended	
	June 30, 2009		December 31, 2008	
	Number of Options	Weighted average exercise price \$	Number of Options	Weighted average exercise price \$
Outstanding, beginning of period	9,782,445	\$4.55	6,568,789	\$3.49
Granted	3,126,291	1.19	5,343,065	5.47
Granted in conjunction with surrender	1,306,707	1.40	-	-
Exercised for cash	-	-	(1,642,409)	(2.94)
Forfeited or cancelled	(4,367,735)	(4.00)	(487,000)	(5.70)
Outstanding, end of period	9,847,708	\$2.82	9,782,445	\$4.55
Options exercisable, end of period	3,487,430	\$3.56	3,759,285	\$3.36

In June of 2009 the Company provided employees (excluding officers and directors) the option to surrender options they held with a strike price above \$3.50 per share and in turn receive 40% of their surrendered number of options with a strike price at the then prevailing share price of \$1.40. As a result 3.4 million options were surrendered and 1.3 million options were issued

The following table summarizes information about the stock options outstanding at June 30, 2009:

Range of exercise prices	Number outstanding June 30, 2009	Weighted average remaining contractual life (years)	Weighted average exercise price \$	Number exercisable June 30, 2009	Weighted average exercise price \$
\$0.70 to \$2.89	4,650,277	3.80	1.31	-	-
\$2.90 to \$4.00	2,977,638	1.02	2.99	2,728,637	2.96
\$4.01 to \$5.00	422,334	1.88	4.68	141,445	4.57
\$5.01 to \$9.00	1,797,459	2.74	6.02	617,348	5.99
	9,847,708	2.68	2.82	3,487,430	3.56

The Company's stock option plan provides stock option holders the right to request, upon exercise, to receive a cash payment in exchange for surrendering the option provided the request is accepted by the Company. 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, 2009, stock based compensation expense of \$35,000 (2008: \$4,065,000 and \$11,175,000 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 vested and outstanding. Based on the June 30, 2008 share price of \$1.17, had all of the 9,847,708 stock options outstanding been vested, aggregate stock-based compensation expense and a corresponding liability of \$276,000 (December 31, 2008: \$nil) would have been recognized. Of this amount, \$35,000 has been recognized as stock-based compensation payable at June 30, 2009 (December 31, 2008: \$nil).

(d) Per Share Amounts

	Three months ended June 30,		Six months ended June 30,	
	2009	2008	2009	2008
Weighted average common shares outstanding	193,197,035	165,811,596	179,683,785	129,265,758
Weighted average diluted common shares outstanding	193,197,035	168,412,603	179,683,785	131,241,651

The options outstanding for the quarter and six months ended June 30, 2009 are not included in the computation of diluted common shares outstanding as the Company realized a net loss during these periods.

9. 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/mcf in natural gas prices at the wellhead would have changed the net loss for the six months ended June 30, 2009 by approximately \$8.2 million. A \$5.00/bbl change in WTI for oil would have the effect of changing the net loss for the six months ended June 30, 2009 by approximately \$1.8 million.

From time to time, the Company employs the use of various financial instruments to manage these price exposures, and at this time, has not entered into any financial instruments.

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 earnings before interest, taxes, and depletion/depreciation/accretion. 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% it is estimated that net loss for the six months ended June 30, 2009 would change by approximately \$0.8 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 2009 and the Company's bank loan is due on April 30, 2010.

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.

e) 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 \$0.6 million.

f) 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. Of these twenty five marketers, sales to four account for approximately 80% of the Company's production revenue.

As at June 30, 2009, the Company had an allowance for doubtful accounts of \$17.3 million (December 31, 2008 \$15.4 million) including a provision of \$15.7 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 June 30, 2009, the aging analysis of trade receivables, net of the allowance for doubtful accounts, is as follows:

	<u>(\$000's)</u>
Current	\$ 18,690
30 – 60 days	2,579
60 – 90 days	797
Greater than 90 days	<u>27,687</u>
Total	49,753
Less allowance for doubtful accounts	<u>(17,331)</u>
Total	<u>\$ 32,422</u>

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

g) 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)	June 30, 2009		December 31, 2008	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Loans and receivables				
Accounts receivable	32,422	32,422	43,996	43,996
Other financial liabilities				
Bank indebtedness	246,000	246,000	266,800	266,800
Accounts payable and accrued liabilities	39,997	39,997	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.

10. CONTINGENCIES

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.

11. SUPPLEMENTAL DISCLOSURE ON CONSOLIDATED STATEMENTS OF CASH FLOWS

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

(\$000's)	Three months ended		Six months ended	
	June 30,		June 30,	
	2009	2008	2009	2008
Accounts receivable	\$ 6,488	\$ 15,849	\$ 11,553	\$ 9,792
Prepays and other current assets	(2,213)	(1,748)	(1,245)	(761)
Accounts payable and accrued liabilities	(20,260)	(57,671)	(30,996)	(41,240)
Income taxes payable	-	170	-	458
Net change	\$ (15,985)	\$ (43,400)	\$ (20,688)	\$ (31,751)

(\$000's)	Three months ended		Six months ended	
	June 30,		June 30,	
	2009	2008	2009	2008
Net change by activity:				
Operating	\$ 3,286	\$ (16,114)	\$ 9,195	\$ (101)
Investing	(19,125)	(27,286)	(29,746)	(31,650)
Financing	(146)	-	(138)	-
Net change	\$ (15,985)	\$ (43,400)	\$ (20,690)	\$ (31,751)

Additional information:

(\$000's)	Three months ended		Six months ended	
	June 30,		June 30,	
	2009	2008	2009	2008
Cash interest paid	\$3,215	\$3,067	\$4,833	\$4,179
Cash taxes paid	1	171	13	671

Included in cash interest paid during the three month period ended June 30, 2009 are initial commitment fees of \$347,000 related to the syndicated facility.

12. 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, 2009		As At December 31, 2008	
	(\$000's)	%	(\$000's)	%
Bank indebtedness	\$ 245,861	22.2	259,968	24.4
Share capital	860,545	77.8	805,301	75.6
Total	<u>\$ 1,106,406</u>	<u>100.0</u>	<u>\$1,065,269</u>	<u>100.0</u>

As at June 30, 2009, 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.

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.

13. SUBSEQUENT EVENTS

In July 2009, the Company disposed of oil and gas properties for proceeds of \$39.8 million, prior to closing adjustments. These proceeds were applied against bank debt. Accordingly, the bank borrowing base was decreased by \$12.5 million to \$252.5 million.