

# Ithaca Energy Inc.

## Consolidated Balance Sheets (unaudited)

	March 31, 2008 US\$	December 31, 2007 US\$
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	\$ 58,635,137	\$ 96,214,707
Accounts receivable	1,597,949	3,048,284
Deposits, prepaid expenses and other	11,337,222	9,915,663
	71,570,308	109,178,654
Property, plant and equipment (note 3)	150,947,311	116,963,890
	\$ 222,517,619	\$ 226,142,544
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities		
Accounts payable and accrued liabilities	\$ 15,000,142	\$ 17,949,326
Asset retirement obligation	8,182,871	4,716,475
	23,183,013	22,665,801
Shareholders' Equity		
Share capital (note 4)	\$ 210,479,768	\$ 209,551,869
Contributed surplus	2,195,231	1,765,333
Deficit	(13,340,393)	(7,840,459)
	199,334,606	203,476,743
	\$ 222,517,619	\$ 226,142,544

Commitments (note 6)  
"Approved on behalf of the Board"

**"John P. Summers"**

Director

**"Michael B. A. Nobbs"**

Director

# Ithaca Energy Inc.

## Consolidated Statements of Comprehensive Loss and Deficit (unaudited) 3 months ended

	March 31, 2008 US\$	March 31, 2007 US\$
<b>INTEREST INCOME</b>	\$ 379,350	\$ 348,604
<b>COSTS AND EXPENSES</b>		
General and administrative	1,675,593	722,685
Depreciation and accretion	206,540	58,898
Loss (gain) on foreign exchange	3,997,151	(309,798)
<b>Comprehensive Loss</b>	\$ 5,499,934	\$ 123,181
<b>Net loss and comprehensive loss per share (basic &amp; diluted)</b>	\$ 0.05	\$ 0.00

Nature of operations (note 1)

## Consolidated Statements of Shareholders' Equity (unaudited)

	Share Capital	Contributed Surplus	Deficit	2008 Total	2007 Total
Balance, January 1	\$ 209,551,869	\$1,765,333	\$(7,840,459)	\$203,476,743	\$106,154,177
Shares Issued for cash	-	-	-	-	101,837,132
Options Exercised	927,899	(168,300)	-	759,599	1,783,203
Share Issue Costs	-	-	-	-	(5,078,594)
Stock based compensation	-	598,198	-	598,198	1,109,396
Loss for the period	-	-	(5,499,934)	(5,499,934)	(2,328,571))
<b>Balance, March 31</b>	<b>\$210,479,768</b>	<b>\$2,195,231</b>	<b>\$(13,340,393)</b>	<b>\$199,334,606</b>	<b>\$203,476,743</b>

# Ithaca Energy Inc.

## Consolidated Statements of Cash Flows (unaudited) 3 months ended

	March 31, 2008 US\$	March 31, 2007 US\$
<b>CASH PROVIDED BY (USED IN):</b>		
<b>OPERATING ACTIVITIES:</b>		
Net loss	\$ (5,499,934)	\$ (123,180)
Items not affecting cash		
Depreciation and accretion	206,539	58,898
Stock based compensation (note 5)	598,198	269,586
	(4,695,197)	205,304
Changes in Non-Cash Working Capital	(62,687)	708,461
	(4,757,884)	913,765
<b>FINANCING ACTIVITIES:</b>		
Proceeds from issuance of shares	759,599	-
Share issue costs		-
	759,599	-
<b>INVESTING ACTIVITIES:</b>		
Oil and natural gas property additions	(30,588,199)	(1,415,733)
Office furniture and equipment additions	(135,366)	
	(30,723,565)	(1,415,733)
Changes in Non-Cash Working Capital relating to investing activities	(2,595,468)	(9,300,014)
	(33,319,033)	(10,715,747)
Unrealised gain on foreign exchange	(262,252)	-
<b>(DECREASE)/INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>\$ (37,579,570)</b>	<b>\$ (9,801,982)</b>
<b>Cash and cash equivalents, beginning of period</b>	<b>\$ 96,214,707</b>	<b>\$ 51,371,607</b>
<b>Cash and cash equivalents, end of period</b>	<b>\$ 58,635,137</b>	<b>\$ 41,569,625</b>

# **Ithaca Energy Inc.**

## **NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

Unaudited three months ended March 31, 2008

**All figures are in US Dollars, except where otherwise stated.**

### **1. NATURE OF OPERATIONS**

Ithaca Energy Inc. (the "Corporation"), incorporated in Alberta, and its wholly-owned subsidiary, Ithaca Energy (UK) Limited, incorporated in Scotland, are companies involved in the exploration and development of oil and gas in the North Sea. The Corporation's shares are listed on the TSX Venture Exchange in Canada and the London Stock Exchange's AIM in the United Kingdom.

Since May 2004, the Corporation has been evaluating the resource potential of certain oil and natural gas exploration properties and is considered to be in its development stage of operations. The recoverability of amounts shown for oil and natural gas properties is dependent upon the determination of economically recoverable reserves.

The Corporation requires additional financing in order to fund its ongoing exploration and development programs. Management intends to raise the required financing through a combination of equity issues, bank financing, asset rationalizations, farm outs or by other means.

### **2. SIGNIFICANT ACCOUNTING POLICIES**

#### **Principles of consolidation**

The unaudited interim consolidated financial statements of the Corporation include the accounts of Ithaca Energy Inc. and its wholly-owned subsidiary Ithaca Energy (UK) Limited. The interim consolidated statements have been prepared following the same accounting policies and methods of computation as the consolidated financial statements for the fiscal year ended December 31, 2007, except as noted below. The notes to these unaudited interim consolidated financial statements do not conform in all respects to the note disclosure requirements of Canadian generally accepted accounting principles ("GAAP") for annual financial statements. Accordingly, these unaudited interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements as at and for the year ended December 31, 2007.

#### **Change in Accounting Policies**

##### **a) Financial Instruments Disclosure and Presentation**

In December 2006, the CICA approved Handbook Section 3862 "Financial Instruments - Disclosures", and Handbook Section 3863 "Financial Instruments Presentation". The objective of Section 3862 is to require entities to provide disclosures in their financial statements that enable users to evaluate both the significance of financial instruments for the entity's financial position and performance and the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the balance sheet date, and how the entity manages those risks. The purpose of Section 3863 is to enhance financial statement users' understanding of the significance of financial instruments to an entity's financial position, performance and cash flows. These sections apply to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007. The Corporation has adopted the new disclosure requirements in the first quarter of 2008. The two sections result in the additional disclosures set out below. There have been no significant changes from the previous year to the Corporation on

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## **NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

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its exposure to risks and management's objectives, policies and process to manage the market risks outlined below.

The Corporation has identified that it is exposed principally to these areas of market risk.

### *i) Commodity Risk*

Commodity price risk related to crude oil prices is one of the Corporation's most significant market risk exposures. Crude oil prices and quality differentials are influenced by worldwide factors such as OPEC actions, political events and supply and demand fundamentals. To a lesser extent the Corporation is also exposed to natural gas price movements. Natural gas prices are generally influenced by oil prices, European supply and demand and local market conditions. The Corporation's expenditures are subject to the effects of inflation and prices received for the product sold are not readily adjustable to cover any increase in expenses from inflation. The Corporation may periodically use different types of derivative instruments to manage its exposure to price volatility, thus mitigating fluctuations in commodity-related cash flows. The Corporation currently has no production.

Fluctuations in oil price may impact the economic recoverability of reserves. This is part of the impairment test conducted at year end and following any significant event.

### *ii) Interest Risk*

The Corporation will use floating rate debt to finance its developments and operations, fixed as required by the banking facility terms.

The Corporation is exposed to interest rate risk to the extent that LIBOR may fluctuate. The Corporation's debt will be denominated in U.S. dollars ("USD"). Since December 31, 2007 US based LIBOR rates have been decreasing.

The Corporation any will evaluate its annual forward cash flow requirements on a rolling monthly basis. Accordingly, individual facility amounts utilized and related interest terms will vary.

### *iii) Foreign Exchange Rate Risk*

The Corporation is exposed to foreign exchange risks to the extent it transacts in various currencies, while measuring and reporting its results in USD. The exposure to foreign exchange risk is partly mitigated since debt financing is mostly in USD. Since time passes between the recording of a receivable or payable transaction and its collection or payment, the Corporation is exposed to gains or losses on non USD amounts and on balance sheet translation of monetary accounts denominated in non USD amounts upon spot rate fluctuations from quarter to quarter.

The Corporation believes that its foreign exchange risk is mitigated in that revenues and interest expense and a portion of its operating and exploration costs are largely transacted in USD. In addition, additions to plant property and equipment are recorded and translated at historical cost.

### *iv) Credit Risk*

The Corporation's accounts receivable with customers in the oil and gas industry are subject to normal industry credit risks and are unsecured. Currently the Corporation has no production and therefore there are no customers at the moment. In the future a substantial portion of

# Ithaca Energy Inc.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Unaudited three months ended March 31, 2008

Corporation's revenues are expected to be derived from large reputable multi-national corporations.

The Corporation assesses partners' credit worthiness before entering into farm-in or joint venture agreements. In the past, the Corporation has not experienced credit loss in the collection of accounts receivable. As the Corporation's exploration, drilling and development activities expand with existing and new joint venture partners, the Corporation will assess and continuously update its management of associated credit risk and related procedures.

The Corporation regularly monitors all customer receivable balances outstanding in excess of 90 days. As at March 31, 2008 substantially all accounts receivables are current, defined as less than 90 days. Accordingly, there is no allowance for doubtful accounts on accounts receivable.

### *v) Liquidity Risk*

Liquidity risk includes the risk that as a result of its operational liquidity requirements the Corporation will not have sufficient funds to settle a transaction on the due date. The Corporation manages liquidity risk by maintaining adequate cash reserves, banking facilities, and by considering medium and future requirements by continuously monitoring forecast and actual cash flows. The Corporation considers the maturity profiles of its financial assets and liabilities. As at March 31, 2008, substantially all accounts payable are current.

### **b) Inventory**

Effective January 1, 2008 the Corporation prospectively adopted Section 3031, "Inventories" which stipulates that major spare parts and standby equipment that are not in use should be included in property plant and equipment, and also provides more guidance on the measurement and disclosure requirements for inventory that is at the lower of cost and net realizable value. There has been no impact on the Corporation's financial statements as a result of adopting this policy.

### **c) Capital Disclosures**

Effective January 1, 2008 the Corporation has adopted Handbook Section 1535, "Capital Disclosures" which requires entities to disclose their objectives, policies and processes for managing capital, and in addition, whether the entity has complied with any externally imposed capital requirements.

The Corporation's objectives when managing capital are:

- to safeguard the Corporation's ability to continue as a going concern;
- to maintain balance sheet strength and optimal capital structure, while ensuring the Corporation's strategic objectives are met; and
- to provide an appropriate return to shareholders relative to the risk of the Corporation's underlying assets

In the management of capital, the Corporation includes shareholders' equity, and interest bearing debt and capital lease obligations. Shareholders' equity includes share capital, contributed surplus, retained earnings or deficit and other comprehensive income.

# Ithaca Energy Inc.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Unaudited three months ended March 31, 2008

The Corporation maintains and adjusts its capital structure based on changes in economic conditions and the Corporation's planned requirements. The Board of Directors reviews the Corporation's capital structure and monitors requirements. The Corporation may adjust its capital structure by issuing new equity and/or debt, selling and/or acquiring assets, and controlling capital expenditures program.

The Board sets guidelines for the management of the Corporation's capital. The Corporation monitors its capital structure using the debt-to-equity ratio and other benchmark measures at the consolidated group level.

As at March 31, 2008, there were no externally imposed debt covenants with respect to the Corporation's capital structure.

There have been no significant changes from the previous year to management's objectives, policies and processes to manage capital or to the components defined as capital.

### 3. PROPERTY, PLANT AND EQUIPMENT

	March 31, 2008	December 31, 2007
Oil and natural gas properties	\$ 150,569,981	\$ 116,675,835
Office furniture and equipment	613,188	477,822
Less accumulated depreciation and amortization	(235,858)	(189,767)
Total property, plant and equipment	\$ 150,947,311	\$ 116,963,890

As the Corporation had no production at either March 31, 2008 or 2007, there was no depletion charge for either period. At March 31, 2008, oil and natural gas properties included \$101.7 million (2007 - \$19.0 million) relating to proved properties and \$48.9 million (2007 \$22.6 million) unproved properties. During 2008, the Corporation capitalized \$1.3 million (2007 - \$0.7 million) of overhead directly related to exploration and appraisal activities.

### 4. SHARE CAPITAL

#### (a) Issued

The issued share capital is as follows:

Issued	Number	Amount
Balance December 31, 2007	111,931,975	\$ 209,551,869
Issued for cash – options exercised	330,000	759,599
Transfer from Contributed Surplus on options exercised		168,300
Balance March 31, 2008	112,261,975	\$ 210,479,768

# Ithaca Energy Inc.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Unaudited three months ended March 31, 2008

### (b) Stock Options

On February 15, 2008 the Corporation's Board granted 2,670,000 options at an exercise price of C\$3.65 to directors and employees. At March 31, 2008 6,670,000 stock options to purchase common shares were outstanding, having an exercise price range of \$0.90 (C\$1.06) and \$2.07 to \$3.70 (C\$2.32 to C\$3.65) per share.

Changes to the Corporation's stock options are summarized as follows:

	2008	
	Number of Options	Wt. Avg. Exercise Price *
Balance, December 31, 2007	4,330,000	\$ 2.01
Granted	2,670,000	3.70
Exercised	(330,000)	2.07
Balance, March 31, 2008	6,670,000	\$ 2.37
Exercisable, March 31, 2008	2,405,000	\$ 1.80

\*The weighted average exercise price has been converted into U.S. dollars based on the foreign exchange rate in effect at the date of issuance.

### (c) Stock-Based Compensation

Options granted are accounted for using the fair value method. The compensation cost charged against earnings for stock options granted in 2008 was \$598,198 (2007 \$269,586) The fair value of each stock option grant was estimated at the date of grant, using the Black-Scholes option pricing model with the following assumptions:

	2008
Risk free interest rate	3.12
Expected dividend yield	0%
Expected stock volatility	77%
Expected life of options	4 years

## 5. PER SHARE AMOUNTS

The weighted average number of shares outstanding during 2008 was basic 112,153,184 (2007: 82,904,475) and diluted 118,068,239 (2007: 87,306,975). The difference relates to outstanding stock options.

# Ithaca Energy Inc.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Unaudited three months ended March 31, 2008

### 6. COMMITMENTS

The Corporation has the following financial commitments:

	2008	2009	2010
Office sublease	\$ 320,000	\$ 320,000	\$ 320,000
Exploration license fees	\$ 384,700	\$ 245,400	\$ 245,400
Jacket Fabrication	\$ 15,000,000	\$ -	\$ -
Rig Commitment	\$ 33,600,000	\$ -	\$ -

### 7. RELATED PARTY TRANSACTIONS

Jay Zammit, a Director of the Corporation is a partner in Burstall Winger LLP who acts as counsel for the Corporation. The amount of fees, on an arms length basis, paid to Burstall Winger LLP in 2008 were \$23,786 (2007 - \$134,778)

### 8. SUBSEQUENT EVENTS

#### Royal Bank of Scotland \$60 million Pre-Development Facility

On April 4, 2008, a \$60 million secured pre-development credit facility was signed with the Royal Bank of Scotland to assist in the funding of expenditure for the Athena and Jacky assets. The Corporation intends to replace this facility post approval of the respective field development plans with a borrowing base facility that will also incorporate the Barbara field and its Beatrice acquisition.

#### Stella Acquisition

On May 1, 2008 the Corporation announced that it had acquired a 66.67% working interest in the Stella and Harrier Shallow discoveries which lie in UKCS Block 30/6 Rest of Block (Chalk Layers and Younger) for an initial consideration of US\$15 million. A further payment of US\$15 million will become payable at the time of time of Field Development Plan approval and proceeds from production will be subject to a 5% over-riding royalty. The acquisition is expected to close before the end of the second quarter 2008 and is subject to the usual government and partner consents.