

## A MESSAGE FROM THE CHAIRMAN

This message should be read in conjunction with the Corporation's unaudited consolidated financial statements as at March 31, 2009 and 2008 for each of the three month periods then ended, and with the Corporation's audited consolidated financial statements as at December 31, 2008, together with the accompanying notes, and the December 31, 2008 MD&A and Annual Information Form. These documents and additional information about Ithaca Energy Inc. are available on SEDAR at [www.sedar.com](http://www.sedar.com)

Certain statements contained in this letter, including estimates of reserves, estimates of future cash flows and estimates of future production as well as other statements about anticipated future events or results, are forwarding-looking statements. Forward-looking statements are often but not always identified by the use of words such as "seek", "anticipate", "believe", "plan", "estimate", "expect", "targeting" and "intend" and statements that an event or result "may", "will", "should", "could" or "might" occur or be achieved and other similar expressions. The forward-looking statements that are contained in this letter involve a number of risks and uncertainties. As a consequence, actual results might differ materially from results forecast or suggested in these forward-looking statements. Accordingly, readers are cautioned that events or circumstances could cause results to differ materially from those predicted.

The information with respect to net present values of future net revenues from reserves presented throughout this letter, whether calculated without discount or using a discount rate, are estimated values and do not represent fair market value. It should not be assumed that the net present values of future net revenues from reserves contained in this letter are representative of the fair market value of the reserves. There is no assurance that the price and cost assumptions will be attained and variances could be material.

Barrel of oil equivalent (Boe) volumes are reported at 6:1 with 6 MCF = 1 Boe. All figures are in United States Dollars unless otherwise noted.

### **To the Shareholders of Ithaca Energy Inc**

The year 2008 was unusual to say the least. What started out to be a good year for the industry ended in a meltdown. All oil companies suffered the collapse of world finance and of crude oil prices and Ithaca was no exception. The Company has, however, survived and while not unscathed, has continued to grow and is well equipped to take advantage of future opportunities.

By the beginning of the year 2008, the banking crisis was evident and rapidly gaining momentum. Notwithstanding, this did not seem to radically affect our industry; banks were continuing to lend and make offers to an industry which was experiencing the highest commodity prices for some years. On July 14<sup>th</sup> crude oil prices reached US\$147 per barrel, up from US\$100 on January 1<sup>st</sup>. The next day, prices embarked on a slide that persisted all the way down to US\$34. The industry had lost 75% of the price of its product. Not surprisingly, the oil industry as a whole haemorrhaged, particularly small companies reliant upon capital markets to fund their growth. The depreciation of asset values, the devastating erosion of cash flow and the complete evaporation of credit and equity facilities

created a drastic reduction of discretionary capital expenditures and a commensurate cessation of growth across the industry.

Our business is a business of depletion, destined to disappear into obscurity without the discovery of new reserves accomplished only with capital commitment. Companies that cannot generate capital from cash flow or other sources, cannot grow, and eventually will deplete themselves out of business.

With some degree of creativity and good fortune borne of hard work, Ithaca has survived and grown. The raising of new capital to finance the Company's development and acquisition projects was essential. On August 11<sup>th</sup>, 2008 Ithaca raised C\$75 million through the issue of 50 million new shares at C\$1.50 per share; a very contentious event at the time, later to be vindicated by the market. Ithaca also sold its 20% interest in the Barbara discovery to Dyas UK Limited (Dyas), a privately owned Dutch company. This property was sold because it was non-core and the timing of its development was uncertain. Much of the activity of the Company was also financed by others through farmout arrangements.

The most significant event however, was the sale on October 31<sup>st</sup>, 2008 of 25.5% of the Company's assets at the time, for US\$65.5 million to Dyas. In so doing, Ithaca realized a price of US\$6.69 per barrel equivalent when the share price of the Company reflected a value of approximately C\$2.00 per boe. At the same time, Dyas replaced the Company's loan of US\$62 million from the Royal Bank of Scotland on favourable terms for two years. This loan is convertible into an incremental 15.15% working interest in the properties held by Ithaca at October 31<sup>st</sup>, 2008, and if exercised, will leave the Company debt free.

The Dyas transaction provided the funds to continue the Company's capital program including the Company's commitment to acquire a 66.67% interest (49.9% after the Dyas transaction) in the Stella Gas/condensate discovery for an initial US\$15 million, a 5% royalty on its share of production and a further US\$15 million on receipt of Field Development Approval. This is a gas/condensate discovery which has, in the Company's opinion, significant upside which will be tested in the third quarter of 2009. On November 10<sup>th</sup>, 2008, Ithaca purchased a lease of a 100% interest (75% after the Dyas transaction) in the Beatrice oilfield in the Inner Moray Firth for the consideration of £10 million (approximately US\$16.5 million). This provided Ithaca with its first production, approximately 1,350 barrels per day net to the Company. Ithaca is in the process of reducing operating costs on this project and believes that it can increase production significantly. The responsibility of decommissioning costs remains with the Lessor.

In the Beatrice area, new reserves were discovered at Polly (near Beatrice) and on November 10<sup>th</sup>, 2008, Ithaca received Field Development Approval for the previously discovered Jacky accumulation (67.3% after the Dyas transaction). As Operator, Ithaca finished the installation of production facilities and placed the field on production within five

months at an initial rate of approximately 8,000 barrels per day (5,400) net to the Company.

The Dyas transaction also provided the Company with the ability to continue with a limited but highly focussed exploration program which resulted in a significant gas discovery (Carna) in the Southern North Sea and as well, had the effect of reducing Ithaca's future capital requirements while maintaining the Company's majority position. As a consequence, Ithaca has grown from an exploration company with no production in November, 2008 to a producer of in excess of 6,000 barrels per day, net to the Company, by April 2009.

So, rather than going top ground during the financial holocaust, Ithaca found a way, not only to survive, but to grow.

Significant to the Company's future were the appointments of Iain McKendrick as Chief Operating Officer on January 24<sup>th</sup>, 2008 and Steven Turner as Chief Financial Officer on March 25<sup>th</sup>, 2008. It is to these and the other members of the Ithaca staff which the credit of survival and growth are due.

The Company was also fortunate to acquire the services on the Board of Directors of Jack C Lee, R Bradley Hurtubise and Alexander Berger, the latter of which was accomplished in the Dyas transaction. Michael Nobbs, who has served diligently as a non-executive Director for four years, elected not to let his name stand for re-election for the ensuing year. The Company is thankful for his significant contribution to the growth of the Company. John Summers, one of our original Directors who served so well as Chairman has remained as non-executive Director. His contribution as Chairman has been enormous over the past five years, and we look forward to his continuing involvement.

On December 1<sup>st</sup>, 2008, Iain McKendrick assumed the position of Chief Executive Officer and I, that of Chairman. I am proud and privileged to have been associated with this company since inception and I look forward to my new role.

Under the stewardship of Iain McKendrick and with the support and contribution of all who work and have worked for the Company, Ithaca Energy is in good hands.

Sincerely,

*"Lawrence H Payne"*

Lawrence H Payne

Chairman

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF OPERATING RESULTS AND FINANCIAL CONDITION

The following is management's discussion and analysis ("MD&A") of the operating and financial results of the Ithaca Energy Inc. group of companies (the "Corporation" or "Ithaca Energy") for the year ended December 31, 2008. The information is provided as of March 26, 2009. The 2008 results have been compared to the results of 2007. All figures and the comparative figures contained herein are expressed in US dollars unless otherwise stated.

This discussion and analysis should be read in conjunction with the Corporation's audited consolidated financial statements as at December 31, 2008 and 2007 and for each of the years in the two year period ended December 31, 2008, together with the accompanying notes, and the December 31, 2008 Annual Information Form. These documents and additional information about Ithaca Energy Inc. are available on SEDAR at [www.sedar.com](http://www.sedar.com).

This MD&A and any documents incorporated by reference herein contain certain forward-looking statements and forward-looking information which are based on the Corporation's internal expectations, estimates, projections, assumptions and beliefs as at the date of such statements or information, including, among other things, assumptions with respect to production, future capital expenditures and cash flow. The reader is cautioned that assumptions used in the preparation of such information may prove to be incorrect. The use of any of the words "anticipate", "continue", "estimate", "expect", "may", "will", "project", "plan", "should", "believe" and similar expressions are intended to identify forward-looking statements and forward-looking information. These statements are not guarantees of future performance and involve known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in such forward-looking statements or information. The Corporation believes that the expectations reflected in those forward-looking statements and information are reasonable but no assurance can be given that these expectations, or the assumptions underlying these expectations, will prove to be correct and such forward-looking statements and information included in this MD&A and any documents incorporated by reference herein should not be unduly relied upon. Such forward-looking statements and information speak only as of the date of this MD&A and any documents incorporated by reference herein, as the case may be, and the Corporation does not undertake any obligation to publicly update or revise any forward-looking statements or information, except as required by applicable laws.

In particular, this MD&A and any documents incorporated by reference herein, contains specific forward-looking statements and information pertaining to the following:

- the quality of and future net revenues from the Corporation's reserves;
- oil, natural gas liquids ("NGLs") and natural gas production levels;
- commodity prices, foreign currency exchange rates and interest rates;
- capital expenditure programs and other expenditures;
- supply and demand for oil, NGLs and natural gas;
- the Corporation's ability to raise capital;
- the Corporation's ability to continually add to reserves;
- schedules and timing of certain projects and the Corporation's strategy for growth;
- the Corporation's future operating and financial results;
- treatment under governmental and other regulatory regimes and tax, environmental and other laws; and

- the start up of production at the Jacky field.

With respect to forward-looking statements contained in this MD&A and any documents incorporated by reference herein, the Corporation has made assumptions regarding, among other things:

- Ithaca's ability to obtain additional drilling rigs and other equipment in a timely manner, as required;
- future oil and natural gas production levels from Ithaca's properties and the prices obtained from the sales of such production;
- the level of future capital expenditure required to exploit and develop reserves;
- Ithaca's ability to obtain financing on acceptable terms; and
- the state of the debt and equity markets in the current economic environment.

The Corporation's actual results could differ materially from those anticipated in these forward-looking statements and information as a result of assumptions proving inaccurate and of both known and unknown risks, including the risk factors set forth in this MD&A and under the heading "Risk Factors" in the Corporation's Annual Information Form for the year ended December 31, 2008 (the "AIF") and the documents incorporated by reference herein and those set forth below:

- risks associated with the exploration for and development of oil and natural gas reserves;
- operational risks and liabilities that are not covered by insurance;
- volatility in market prices for oil, NGLs and natural gas;
- the ability of the Corporation to fund its substantial capital requirements and operations;
- risks associated with ensuring title to the Corporation's properties;
- changes in environmental or other legislation applicable to the Corporation's operations, and the Corporation's ability to comply with current and future environmental and other laws;
- the accuracy of oil and gas reserve estimates and estimated production levels as they are affected by the Corporation's exploration and development drilling and estimated decline rates, in particular the production rates of the Jacky field;
- the Corporation's success at acquisition, exploration, exploitation and development of reserves;
- the Corporation's reliance on key operational and management personnel;
- the ability of the Corporation to obtain and maintain all of its required permits and licenses;
- competition for, among other things, capital, drilling equipment, acquisitions of reserves, undeveloped lands and skilled personnel;
- changes in general economic, market and business conditions in Canada, North America, the United Kingdom, Europe and worldwide, specifically being the closing of the debt and equity markets to the Corporation during the current economic crisis;
- actions by governmental or regulatory authorities including changes in income tax laws or changes in tax laws, royalty rates and incentive programs relating to the oil and gas industry;
- adverse regulatory rulings, orders and decisions; and
- risks associated with the nature of the Common Shares.

Statements relating to "resources" are deemed to be forward-looking statements, as they involve the implied assessment, based on certain estimates and assumptions, that the reserves described can be profitably produced in the future. Many of these risk factors, other specific

risks, uncertainties and material assumptions are discussed in further detail throughout the AIF and in the MD&A. Readers are specifically referred to the risk factors described in the AIF under "Risk Factors" and in other documents the Corporation files from time to time with securities regulatory authorities. Copies of these documents are available without charge from Ithaca or electronically on the internet on Ithaca's SEDAR profile at [www.sedar.com](http://www.sedar.com).

The information with respect to net present values of future net revenues from reserves presented throughout this discussion and analysis, whether calculated without discount or using a discount rate, are estimated values and do not represent fair market value. It should not be assumed that the net present values of future net revenues from reserves contained in this discussion and analysis are representative of the fair market value of the reserves. There is no assurance that the price and cost assumptions will be attained and variances could be material.

Barrel of oil equivalent (Boe) volumes are reported at 6:1 with 6 MCF = 1 Boe. All figures are in United States dollars unless otherwise noted.

## **BUSINESS OF THE CORPORATION**

Ithaca Energy is an oil and gas exploration, development and production corporation active in the United Kingdom's Continental Shelf ("UKCS"). Exploration and development activities are focused on the Inner and Outer Moray Firth and the Central and Southern Gas Basin areas of the UKCS. The goal of Ithaca Energy, in the near term, is to achieve oil production from the development of existing discoveries on licences held by the Corporation, to originate and participate in exploration on licences held by the Corporation that has the potential of making significant contributions to future production, and to consider other opportunities for growth as they are presented to the Corporation. The Corporation is targeting first oil production from its 67.3% owned Jacky field to commence at or around the end of March, 2009. Production from its 66.7% owned Stella field is expected to commence in 2011, whilst development of its 52.3% owned Athena field is currently on hold pending a recovery in the oil price and the Corporation sees a price correction in the oil services sector.

The Corporation's common shares are listed for trading on the TSX Venture Exchange and the London Alternative Investment Market under the symbol "IAE"

## **OVERALL PERFORMANCE**

2008 has been a year of exceptional market turbulence with volatile oil prices and the closing of both debt and equity markets for the smaller oil companies such as Ithaca Energy. The Corporation commenced the year seeking to close out the previously announced transaction to lease the Beatrice field from Talisman Energy (UK) Limited and Talisman North Sea Limited ("Talisman"), tie in the Jacky development and materially advance the development of the Athena field. The Corporation planned to fund this program through accessing both the equity and the debt markets. A new borrowing base debt facility through a syndicate of banks was intended to replace the existing Royal Bank of Scotland \$60 million Pre Development Facility agreed in November 2007 (the "RBS Facility").

As a direct result of the market conditions, the Corporation altered its development program, prioritising the Jacky development. During 2008, the Corporation succeeded in:

- Drilling four wells, compared with two wells in 2007. There was one well drilled in 2006 and no drilling activity in 2005 or 2004. In January 2008 Ithaca drilled the Polly prospect and then in February 2008 the Manuel prospect, both located in the Beatrice area. On March and April 2008 the Corporation drilled the Athena 14/18-17 well and in June and July, 2008 drilled the 14/18b well also located in the Athena field;
- Raising C\$75 million in equity through a public offering in August 2008;
- Completing the acquisition of an interest in the Stella and Harrier fields in August 2008;
- Substantially strengthening the balance sheet through a transaction with Dyas (UK) Limited in October 2008, whereby 25.25% of the Corporation's portfolio was sold for a consideration of £40 million and the RBS Facility was replaced with a US\$61.2 million two year convertible facility (the "Dyas Transaction"). In addition to supplying finance to achieve the Corporation's objectives, this transaction provided Ithaca Energy with a well financed strategic partner across the Corporation's portfolio and strengthened the Board of the Corporation with the appointment of the Managing Director of Dyas BV;
- Closing the Beatrice acquisition in November 2008 and subsequently reducing operating costs whilst sustaining higher rates of production;
- Obtaining Field Development Plan approval for the Jacky development in November 2008 with production targeted for the end of March, 2009; and
- Completing the sale of the Corporation's interest in the non core Barbara field in November 2008 for consideration of \$8.25 million.

Ithaca Energy exited 2008 in good financial condition. The Corporation had free cash balances of \$26.9 million at year end as a result of the recently completed Dyas Transaction and from an issue of 50 million common shares, which closed in August 2008 and raised net proceeds of approximately \$67 million. Total cash including funds posted as collateral in support of certain cash backed bank letters of credit was \$39.2 million. It is anticipated that these restricted funds will be released by the bank in mid 2009.

The table presented below reviews the actual application of proceeds raised from the previous four share issues as compared to the forecast application of proceeds at the time of each of the equity issues.

Nature of Expense \$M	Equity funds raised from May 2006 to Nov 2007	Equity issued Aug 11 2008	Total Equity raised	Application of proceeds	Variance
Barbara Project Development	6,800	-	6,800	6,600	200
Athena Project Appraisal and first and second phase of Field Development Plan	82,196	16,991	99,188	95,066	4,122
Beatrice Alpha North (Jacky) Project appraisal and first phase of Field	11,892	-	11,892	26,000	(14,108)

Development Plan					
Acquisition of Beatrice and Stella	-	42,951	42,951	28,803	14,147
Exploration Program	35,315	-	35,315	53,079	(17,764)
Geological and Geophysical, General and administrative expenses, and general corporate purposes	4,401	-	4,401	10,084	(5,683)
Undesignated expenditure and working capital requirements	51,928	6,608	58,536	68,253	(9,717)
TOTAL	\$192,532	\$66,550	\$259,082	\$259,082	

The under-spend on the Athena field reflects the Corporation's decision to suspend the development of the Athena project. With respect to the Beatrice acquisition, an agreement was reached with Talisman to defer the payment of the consideration until such time as the Jacky field enters into production. The consideration is then to be paid in four equal monthly instalments from the date of commencement of the Jacky production. The additional funds arising from these positive variances have been applied to completing the Jacky development. It was anticipated at the time that these equity funds were raised that the remaining Jacky development costs would have been met from new bank borrowing. The negative variance on the exploration program is due to the decision to drill the Manuel prospect in order to take advantage of favourable rig contractual terms following the drilling of the budgeted Polly prospect.

Property, plant and equipment increased from \$117.0 million at December 31, 2007, to \$296.5 million at December 31, 2008, as analyzed below:

Area \$M	2008	2007
Inner Moray Firth	152,375	34,949
Outer Moray Firth	119,642	68,737
Central North Sea	19,079	8,885
NW Core	2,117	2,541
SE Core	2,527	1,564
Office Equipment	783	288
Total	\$ 296,523	\$ 116,964

The material increase in the Inner Moray Firth and Outer Moray Firth relates to the four wells drilled in 2008, two in each of the Beatrice Area and Athena field.

Current liabilities increased from \$17.9 million at December 31, 2008, to \$41.1 million at December 31, 2008, which was comprised entirely of accounts payable and accrued liabilities. This increase is a reflection of the level of activity underway at the year end associated with the Jacky field development and the drilling of the Carna exploration well. These amounts have largely been settled post year end with the balance being the Beatrice deferred lease premium and the proportionate proceeds from the first oil sale post the Beatrice transaction due to Talisman relating to oil produced prior to the closing of the Beatrice transaction, payable in the second and third quarters of 2009. The Corporation had secured debt of \$61.2 million as at December 31, 2008 and no debt in 2007. Working capital was lower at December 31, 2008 at approximately \$19.7 million versus \$91.3 million at December 31, 2007, with the high balance at the 2007 year end being due to a C\$100m equity issuance that had closed in the month of

November. The increase in share capital, shareholders equity and common shares outstanding reflects the equity financing that closed in August 2008.

The 2008 net loss before income taxes increased to \$30.1 million from \$2.3 million in 2007. The increase in net loss is primarily due to: the amortization of the fees associated with the RBS Facility that was repaid during the year; operating costs of the Beatrice facility; loss on foreign exchange being largely the devaluation of British Pound cash balances held during the year against a strengthening US Dollar; loss on a US Dollar/Euro forward contract as a result of the strengthening US Dollar; and increased expenses relating to stock based compensation awarded during the year.

Cash flow from operations was negative in 2008, as in 2007. Negative cash flow from operations resulted from the Corporation's activity levels in the North Sea, including the operations of the Beatrice facility, and the commensurate overheads related to these activities. Oil production from Jacky is anticipated to commence on or around the end of March 2009 and is therefore expected to reverse this trend. Management has actively looked to reduce Beatrice operating costs since taking over the facilities. Material changes have included: improved terms for equipment storage and supply vessels; reduction in non operational manning on Beatrice facilities; and the renegotiation of electricity supply contracts amounting to an annual cost savings of approximately \$3.9 million.

Sproule International Limited (Sproule) prepared an independent engineering evaluation, at December 31, 2008, which adheres to the NI 51-101 standards for reserve volumes and values. Total Proved plus Probable plus Possible reserves, net to the Corporation's interest, were 54.97MMBoe at December 31, 2008 (2007: 39.36MMBoe) representing a 40% increase year on year representing the additions of the Beatrice and Stella fields as adjusted for the Barbara disposal (transacted at \$10.17/boe based on a Sproule report effective 31 May 2008) and the Dyas Transaction (transacted at \$6.56/boe based on a Sproule report dated 31 May 2008).

Total Proved reserves, net to the Corporation's interest and relating entirely to the Beatrice and Jacky developments were 2.2MMBoe at 31 December, 2008 (2007:12.60MMBoe) and included 0.69MMBoe of developed producing (2007: Nil) and 0.96MMBoe of developed non-producing (2007: Nil). A further 7.69MMBoe of Proved reserves were attributed to the Athena field and 4.61MMBoe to the Stella field. Total Probable reserves, net to the Corporation's interest, at December 31, 2008 were 14.22MMBoe compared to 13.66MMBoe at December 31, 2007, Total Proved and Probable reserves net to the Corporation's interest at December 31, 2008 were 28.74MMBoe compared to 26.26MMBoe at December 31, 2007 being an increase year on year of 9.5%.

Possible reserves net to the Corporation's interest, at December 31, 2008, were evaluated by Sproule to be 26.22MMBoe (2007: 13.09MMBoe) largely being the addition of the Stella field.

Sproule evaluated the commerciality of the pools at December 31, 2008 and calculated net present value of the Corporation's reserves net to Ithaca's interest, discounted at 10% per annum. All values were computed using forecast prices and costs.

US\$MM NPV <sub>10</sub>	Proved		Probable		Possible	
	2008	2007	2008	2007	2008	2007
Before tax	150.09	110.27	399.66	327.44	784.61	353.8
After tax	145.16	63.31	212.54	163.84	394.83	179.5

Complete disclosure of the Corporation's reserves as reported under the guidelines of NI 51-101 can be found on SEDAR at [www.sedar.com](http://www.sedar.com).

Ithaca Energy's primary focus in 2009 will be the bringing on-stream of its 67.3% owned Jacky field, the appraisal of its 49.8% Stella field, and maximising the production and efficiency of its 74.8% Beatrice facility all within the means of the Corporation's current capital structure. In addition, the Corporation has continued its UK North Sea exploration program, having drilled its 29.9% owned Carna prospect in the first quarter of 2009. The Corporation has set a capital budget of \$60.2 million to complete its 2009 development, appraisal, and exploration program which include the drilling of two wells (one exploration and one appraisal) on the Corporation's prospects, the completion of the Jacky development and the tie in of the Beatrice Bravo platform.

Ithaca Energy has been able to execute its business plan for the UK North Sea in large part by its ability to access capital through the issuance of equity and through the successful divestment of assets:

- On April 4, 2008, the Corporation signed a \$60 million Senior Secured Credit Facility with the Royal Bank of Scotland in support of the Jacky and Athena developments. This was fully drawn over the year and refinanced on 31 October 31, 2008 by the Dyas Transaction (described below).
- On August 11, 2008 the Corporation successfully marketed, 50,000,000 common shares at a price of CAD\$1.50 per common share for gross proceeds of CAD\$75 million. Shortly thereafter the equity markets effectively closed to oil companies comparable to the Corporation.
- On October 31, 2008 Ithaca entered into a Sale and Purchase Agreement (the "Dyas Transaction") with Dyas UK Limited ("Dyas") for the sale of a portion of its interests in all of its oil and gas licences and the provision of a convertible loan facility. The Dyas Transaction provided that Dyas would purchase 25.25% of Ithaca's interests in all assets owned by the Corporation for the consideration of £40 million cash (approximately US\$65.6 million) with an effective date of November 1, 2008. Dyas advanced this sum to Ithaca as a loan until closing of the transaction at which time the consideration would be repaid and the loan would become immediately repayable.

In addition, Dyas provided Ithaca with a senior secured loan (the "Dyas Facility") with which to redeem in full the fully drawn Royal Bank of Scotland US\$60 million Predevelopment Facility. The Dyas Facility has a margin over US Dollar Libor of 4.5% and an initial term of two years. The loan is extendable by Dyas in two one-year tranches should the oil price average less than US\$60 per barrel in the previous year, giving Ithaca an extended credit facility.

Dyas UK Limited has the option at any time during the subsequent two years (or up to the end of the extended period is applicable) to acquire an additional 15.15% of the Corporation's portfolio held as at the effective date, for a consideration of \$61.2 million, adjusted for working capital movements in the intervening period. In the event that the option is exercised, then the \$61.2 million outstanding loan facility would become immediately due and payable, and the consideration would then be applied to meet this obligation in full.

On December 17, 2008 the Dyas Transaction partially completed with all the interests other than that relating to the Stella field having been transferred. As a consequence the consideration paid on the partial completion was adjusted to £35 million with the balance of £5 million payable upon the transfer of the Stella interest. The drawn amounts on the £40 million tranche of the Dyas Facility were repaid and the amount available to be drawn under this portion of the loan was reduced to £5 million. The transfer of the interest in the Stella property is expected to complete in late March or early April 2009.

- The 20% (6.7% expected unitization) interest in the Barbara gas field was disposed of for \$8.25 million on November 14, 2008 as it was considered to be non core to Ithaca (the “Barbara Disposal”).

Significant capital will be required to further the Corporation’s anticipated development activities in 2009 and 2010 and these are expected to be met through a combination of existing cash resources, production from the Beatrice and Jacky fields and selective farm-outs. The Corporation has budgeted for its future capital spending plans assuming no new funds from equity or debt markets.

#### *Non Binding Proposed Offer from Endeavour*

On June 20, 2008 Ithaca confirmed that it had received an unsolicited non-binding proposed offer (the “Non-Binding Proposed Offer”) from Endeavour International Corporation (“Endeavour”) to acquire the entire issued share capital of Ithaca for a combination of cash and shares at an indicative price of US\$3.25 per Ithaca share. On July 7, 2008 the Corporation announced that the Board had unanimously decided that the unsolicited Non-Binding Proposed Offer was not in the best interest of shareholders. On July 7, 2008 Endeavour withdrew its Non-Binding Proposed Offer.

#### *25th Round Awards*

Ithaca UK was offered six new license areas in the 25th licensing round. The offers of awards covered: Northern North Sea blocks 3/3b, 211/11b, 211/16b (all Ithaca UK as operator at 35% and, under a bidding agreement paying 50% of all work up to and including the end of the first well in each of the two areas and increasing to 42.5% working interest after this obligation is met); Central North Sea blocks 29/4b and 29/5e (Ithaca UK 100% and operator); block 29/10b (Ithaca UK 50% and operated by Maersk Oil and Gas); Southern North Sea blocks 43/28 and 43/29 (Ithaca 30% and operated by Venture). Ithaca will discuss these offers with its potential partners and DECC prior to accepting any of the offers in 2009. Upon acceptance, the discrete licenses would then be awarded by DECC.

## **SELECTED ANNUAL INFORMATION**

The consolidated financial statements of the Corporation and the financial data contained in the MD&A are prepared in accordance with Canadian Generally Accepted Accounting Principles (“GAAP”). The consolidated financial statements include the accounts of Ithaca Energy Inc. and its wholly-owned subsidiary Ithaca Energy (UK) Limited. All inter-company transactions and balances have been eliminated on consolidation. A significant portion of the Corporation’s North Sea oil and gas activities are carried out jointly with others. The consolidated financial statements reflect only the Corporation’s proportionate interest in such activities.

The Corporation's reporting currency is US dollars ("\$"); unless indicated otherwise, all amounts are presented in US dollars. The accounting records of Ithaca Energy (UK) Limited are likewise maintained in US dollars.

US \$	2008	2007	2006
Trading Revenue	2,472,106	-	-
Net loss	30,446,967	2,328,571	4,306,335
Net loss per share	0.23	0.02	0.09
Net loss per share diluted basis	0.23	0.02	0.09
Total assets	357,670,361	226,142,544	114,934,154
Total long-term liabilities	72,744,703	4,716,475	1,513,000

## SUMMARY OF QUARTERLY

### RESULTS OF OPERATIONS

The Corporation generated its first operational revenue following the acquisition of the Beatrice facilities, completed on November 11, 2008. During the period to year end production averaged 1,152 boepd (58,720 boe) and at an average realised price of \$42.10 per barrel.

#### Ithaca Energy Quarterly Results

	31-Dec-08	30-Sep-08	30-Jun-08	31-Mar-08	31-Dec-07	30-Sep-07	30-Jun-07	31-Mar-07
<b>REVENUE</b>	\$	\$	\$	\$	\$	\$	\$	\$
Oil Sales	2,472,106							
Interest income	143,441	160,635	126,137	379,350	455,865	355,920	177,232	348,604
<b>COSTS AND EXPENSES</b>								
General and administrative	3,287,190	1,954,388	1,680,204	1,675,593	2,795,777	989,702	1,527,583	722,685
Loan Fee Amortization	1,194,497	2,339,082	135,312	-	-	-	-	-
Loss on Financial	1,777,181							
Operating	4,587,834	-	-	-				
Depreciation and accretion	2,076,311	249,794	278,838	206,540	261,560	84,211	51,156	58,898
(Gain) Loss on foreign exchange	7,739,985	648,805	(447,527)	3,997,151	(230,551)	(296,583)	(1,988,448)	(309,798)
<b>NET PROFIT / (LOSS)</b>	(18,047,451)	(5,031,434)	(1,520,690)	(5,499,934)	(2,370,921)	(421,410)	586,941	(123,181)
<b>TAXES</b>	347,458	-	-	-	-	-	-	-
<b>NET PROFIT / (LOSS) AFTER TAX</b>	(18,394,909)	(5,031,434)	(1,520,690)	(5,499,934)	(2,370,921)	(421,410)	586,941	(123,181)
<b>NET PROFIT / (LOSS) PER SHARE</b>	(0.14)	(0.04)	(0.01)	(0.05)	(0.02)	(0.00)	0.01	0.00
<b>Deficit, beginning of period</b>	(19,892,517)	(14,861,083)	(13,340,393)	(7,840,459)	(5,469,538)	(5,048,128)	(5,635,069)	(5,511,888)
<b>Deficit, end of period</b>	(38,287,426)	(19,892,517)	(14,861,083)	(13,340,393)	(7,840,459)	(5,469,538)	(5,048,128)	(5,635,069)

The Corporation had a net loss before taxes of \$30,099,509 for the year ended December 31, 2008 as compared to a net loss of \$2,328,571 for the year ended December 31, 2007. This increase in net loss was driven by: the accelerated amortisation of the fees for the RBS Facility of \$3,668,891; foreign exchange losses in the year of \$11,938,414 being largely unrealised losses arising from the conversion of the Canadian Dollar proceeds from the August equity issuance being converted to British Pounds, and the British Pounds consideration for the Dyas Transaction during a period of substantial strengthening of the US Dollar; and increased stock based compensation expenses totalling \$3,529,252. Additionally the acquisition of the producing Beatrice facility led to operating costs of \$4,587,834 and depletion expenses of \$2,811,483. General and administrative fees and bank interest were in line with the previous year.

Interest income in the periods under review resulted from interest on bank accounts and short-term deposits, as the Corporation had high cash balances from the equity offerings and the Dyas Transaction. The proceeds from the November 2007 equity issue was held in Canadian Dollar bank accounts and as a result of the strengthening US Dollar the Corporation realised a foreign exchange loss in the second quarter as these funds were converted to meet US Dollar expenses. In March 2008, the Corporation's Board approved a hedging policy to manage foreign exchange risks. Subsequently the Corporation entered in to a forward US Dollar to Euro exchange rate contract with the Royal Bank of Scotland to mitigate exchange rate movements associated with the Jacky platform costs. This contract was hedged through a forward contract at a weighted average rate of 1.568:1 and expired in December 2008. In March 2009, a further exchange rate contract was entered in to with the Bank of Scotland to hedge over 90% of its known British Pound expenditures for 2009 from mid April onwards, see "Post Year End Results". The foreign exchange losses in the final quarter of 2008 reflect the strong appreciation of the US Dollar versus the British Pound over this period, with the losses being the revaluation of British Pound cash balances held at year end to meet near term anticipated British Pound expenditures, such as costs relating to the Jacky development.

The Corporation issued stock options to Directors and employees in February, September and December 2008, which resulted in a stock based compensation charge of \$3,529,252. The total charge for options in 2007 was \$1,109,396.

General and administrative expenses increased in 2008 versus 2007 reflective of the Corporation's increased activities year on year. As in 2007 and prior years, the Corporation continued its compensation policy of combining share options with competitive salaries and benefits packages to attract the best qualified staff. The Corporation continued to issue share options during the year as its share equity base expanded and as it added new employees. The Corporation intends to review the ongoing share option program annually against market conditions.

US \$	2008	2007
Staff costs	6,270,990	4,458,863
Stock compensation expense	3,529,252	1,109,396
Office costs and other administrative expenses	6,214,226	4,581,848

Less - capitalized overheads	7,662,576	4,114,360
TOTAL	8,351,892	6,035,747

### *Activity Summary in the UK North Sea*

#### *Greater Beatrice Area*

On January 14, 2008, Ithaca commenced drilling on its 100% Polly Prospect on Block 12/26c near the Beatrice oilfield in the Inner Moray Firth area of the United Kingdom's continental shelf. On January 23, 2008, the Corporation successfully completed a farmout of an interest in its Polly prospect. North Sea Energy Corporation agreed to pay 30% of the dry hole costs of drilling the Polly well, drilled in the Inner Moray Firth area, in consideration of which, it earned a 20% interest in block 12/26c which is a portion of Ithaca's 100% owned License P. 1392. The resulting interests in the well and prospect were Ithaca 80% and North Sea Energy Corporation 20%. Post the Dyas Transaction the Corporation's interest was further reduced to 59.8%. The well has been suspended for future evaluation having encountered oil in the Beatrice Sandstone and the discovery will be considered for further activity when ranked with other upside opportunities in the Beatrice area

On February 11, 2008, Ithaca commenced a well on the Manuel prospect in block 11/29 which is 12 kilometres west of the Beatrice field. Net costs to the Corporation were reduced through several farm-out agreements with third parties such that Ithaca paid 52.5% for an 81.73% retained interest (reduced further to 61.09% post the Dyas Transaction). The well encountered oil saturated sands of Jurassic age of less than reservoir quality.

#### *Jacky*

The 67.28% Jacky field received Field Development Plan approval from the Department of Climate Change ("DECC") on November 10, 2008. First production is currently expected on or around the end of March 2009 at an anticipated 2009 gross rate of 7,500 bopd.

#### *Beatrice*

On November 10, 2008 Ithaca announced that it had closed a deal to lease 100% of the Beatrice oilfield and Nigg Terminal (net 74.75% following completion of the Dyas Transaction) from Talisman for a minimum of 3 years, extendable at Ithaca's election for the duration of production, in consideration for the sum of £10 million (approximately US\$16.5 million at the time). After cessation of production Beatrice will be returned to Talisman who will conduct decommissioning and abandonment of the facilities. Ithaca has appointed Wood Group Engineering (North Sea) Limited to be the Duty Holder for the Beatrice facilities under UK offshore regulations.

Included in the Beatrice transaction are the offshore facilities of three platforms, Alpha, Bravo and Charlie, operatorship of the Nigg onshore storage and trans-shipment terminal and a 16 inch diameter pipeline from the Alpha platform to the Nigg facility.

The acquisition of the Beatrice field provided Ithaca Energy with its first oil production and control of the infrastructure in the area.

The Corporation entered in to a sales agreement with BP Oil International Limited (“BPOIL”) on December 23 2008 to market the Beatrice and Jacky crude oil through to December 31, 2009, extendable by mutual consent for a further year. This agreement prices the monthly production against set benchmarks resulting in regular payments, irrespective of when BPOIL elects to lift the oil from the Nigg tanks. Under a separate transaction, the Corporation has agreed to lease the spare Nigg oil tanks to BPOIL for a fixed monthly payment for a term of one year.

#### *Athena*

On March 10, 2008 Ithaca commenced a well on Ithaca’s then 70% owned Block 14/18b (Ithaca 52.33% post Dyas Transaction) to test a potential southern extension of the Athena oil pool. The well penetrated the Lower Cretaceous Leek sands, however, although the formation was found to be oil-bearing, it was of lower quality than is found in the Athena Reservoir and the well has been suspended pending evaluation and possible sidetracking and use in the Athena development scheme.

On July 21, 2008, the Corporation announced that it had successfully tested 28 degree API sweet oil at a stable rate of 2,330 barrels of oil per day (“bopd”) from its third well (14/18b-18) on the Athena project.

Following the dramatic decline in the oil price during the second half of 2008, the Athena development has been put on hold until such time as the oil price recovers and the Corporation sees a price correction in the oil services sector.

### **POST YEAR END EVENTS**

#### *Carna Well*

On December 26, 2008 the Corporation commenced the drilling of the 43/21b-A well, to explore the Carna prospect in the UKCS Southern Gas Basin. The Carna prospect, operated by Venture North Sea Gas Limited, is a significant potential gas-bearing structure located in Block 43/21b, in which Ithaca Energy has a 29.9% interest, post the Dyas Transaction. Through a farm-out agreement, net dry hole costs to the Corporation were 22.4% of the total. The prospect lies adjacent the Garrow and Kilmar gas fields. On March 20, 2009, the Corporation confirmed that the Carna Gas well had been successfully tested at stabilised rates in line with expectations. Given that over 90% of the drilling was conducted post year end, no asset retirement obligation has been recorded in 2008 for this well.

#### *Rig Deferral*

The Ensco 92 rig was contracted to conduct the Jacky completion work, but due to the Ensco 92 rig working on the Carna Well and the planned test, agreement was reached with Ensco Offshore UK Limited to defer the commitment to the Ensco 92 for up to one year and Ithaca has contracted with Northern Offshore for the immediate mobilisation of the Energy Enhancer jack-up rig to conduct the Jacky completion. The deferred commitment, net to the Corporation, is \$4.05 million.

### *Foreign Exchange Contract*

On March 11, 2009, the Corporation entered in to a “Window Forward Plus” contract with the Bank of Scotland to hedge circa 90% of the Corporation’s known future US Dollar to British Pound Sterling exchange rate exposure. The contract ensures that the Corporation, which incurs a substantial amount of its expenditure in British Pounds Sterling, is able to lock in a US\$/£ rate of no worse than 1.40:1.0 for a series of foreign exchange transactions throughout the year and yet continues to benefit from any additional strengthening of the US Dollar down to 1.29:1 (the “Trigger” rate). Any strengthening of the US\$/£ rate beyond the Trigger rate during any of the periods or “windows” between the transaction dates will lead to a rate of 1.40:1.00 being applied to that individual transaction. The contract covers \$49 million equivalent of British Pounds Sterling expenditure.

### **LIQUIDITY AND CAPITAL RESOURCES**

Total cash inflow from financing activities in the year ended December 31, 2008 was \$112.5 million (2007 \$98.5 million); substantially as a result of the August share issue and the draw down of the RBS Facility.

During the year ended December 31, 2008 there was a cash outflow from operating activities of \$26.0 million compared to a cash outflow from operating activities of \$1.6 million for the corresponding period in 2007. This cash outflow is due largely to the operating loss from the Beatrice field, general and administrative costs, realized foreign exchange losses and changes in working capital, principally being an increase in stock resulting from the Beatrice acquisition. The Corporation expects to have a cash inflow from operating activities for the next year as Beatrice production continues and the Jacky field comes onstream. During 2008 there was a cash outflow from investing activities of \$155.8 million being principally the drilling of the Greater Beatrice Area and Athena wells.

Significant capital will be required to further the Corporation’s anticipated development activities in 2009 and 2010 and these are expected to be met through a combination of existing cash resources, cash flows from production and selective farm-outs. The Corporation is assuming that both the debt and equity markets are closed and therefore has budgeted for its expenditure program accordingly. The Corporation has an established track record in the equity markets and will be opportunistic in accessing further equity as and when such markets are once again open, however the Corporation is confident that it will be able to manage its portfolio in the absence of such funding for the foreseeable future.

The Corporation expects to continue to develop the existing licences held and to acquire new licences through participation in future licensing rounds and farm-ins from third parties.

### **CRITICAL ACCOUNTING ESTIMATES**

Management is required to make judgments, assumptions and estimates in the application of generally accepted accounting principles that have a significant impact on the financial results of the Corporation.

Capitalized costs relating to the exploration and development of oil and gas reserves, along with estimated future capital expenditures required in order to develop proved reserves, are depleted and depreciated on a unit-of-production basis using estimated proved reserves.

The carrying value of property, plant and equipment is reviewed annually for impairment. Impairment occurs when the carrying value of the assets is not recoverable by the future undiscounted cash flows. The cost recovery ceiling test is based on estimates of proved reserves, production rates, oil and gas prices, future costs and other relevant assumptions. By their nature, these estimates are subject to measurement uncertainty and the impact on the financial statements could be material. The Corporation recognised an impairment of \$24.1 million on unproved oil and gas properties for the year 2008.

Liability recognition for asset retirement obligations associated with oil and gas wells are determined using estimated costs discounted based on the estimated life of the asset. These capitalized costs are amortized on a unit-of-production basis, consistent with depletion and depreciation. Over time, the liability is accreted up to the actual expected cash outlay to perform the abandonment and reclamation.

In order to recognize stock based compensation expense, the Corporation estimates the fair value of stock options granted using assumptions related to interest rates, expected life of the option, volatility of the underlying security and expected dividend yields. These assumptions may vary over time.

The determination of the Corporation's income and other tax liabilities requires interpretation of complex laws and regulations. Tax filings are subject to audit and potential reassessment after the lapse of considerable time. Accordingly, the actual income tax liability may differ significantly from that estimated and recorded on the financial statements.

## **REPORTING CURRENCY**

The Beatrice field produces oil as will the Jacky field expected on production by the end of March, 2009. These assets will generate US Dollar revenues. As such, it is the intention of the Corporation to maintain the majority of its debt in US Dollars. The Corporation's debt as at year end is denominated exclusively in US Dollars.

The Corporation expects to receive 100% of its income over 2009 in US Dollars. Budgeted expenditure indicates that approximately 20% to 40% of 2009 expenditure is expected to be in US Dollars, the range being uncertainty over the currency for payment related to the planned Stella appraisal well. The foreign exchange contract entered in to on March 11, 2009 has increased the effective US Dollar weighting of known expenditures in 2009 to over 90%.

The corporation therefore believes that the US Dollar remains the appropriate reporting currency.

## **RISKS AND UNCERTAINTIES**

The business of exploring for, developing and producing oil and natural gas reserves is inherently risky. There is substantial risk that the manpower and capital employed will not result in the finding of new reserves in economic quantities. There is a risk that the sale of reserves may be delayed due to processing constraints, lack of pipeline capacity or lack of markets. The price the Corporation will receive for its oil and natural gas production may fluctuate continuously and, for the most part, is beyond the Corporation's control.

The Corporation is exposed to financial risks including financial market volatility, fluctuation in

interest rates and various foreign exchange rates. Given the increasing development expenditure and operating costs in currencies other than US Dollars, the Board of the Corporation has agreed a hedging policy to mitigate foreign exchange rate risk on committed expenditure. On March 11, 2008 the Corporation entered in to a series of foreign exchange contracts in which it locked the price of approximately 90% of its known forward Pounds Sterling exposure through to the end of 2009.

The Corporation is dependent upon the production rates and oil price to fund the current development program as it has concluded that in the near term debt and equity markets are effectively closed. In the event that the markets remain closed to development finance the business will look to meet any liquidity shortfalls through the selected divestment of its portfolio. The forecast production budgeted to meet future expenditures is reliant upon the performance of the single Jacky well due on stream on or about the end of March 2009.

The Corporation is also subject to the risks associated with owning oil and natural gas properties, including environmental risks associated with air, land and water. The Corporation takes out market insurance to mitigate many of these operational, construction and environmental risks. In all areas of the Corporation's business there is competition with entities that may have greater technical and financial resources. There are numerous uncertainties in estimating the Corporation's reserve base due to the complexities in estimating the magnitude and timing of future production, revenue, expenses and capital.

For additional detail regarding the Corporation's risks and uncertainties, refer to the Corporation's most recent Annual Information Form filed on SEDAR at [www.sedar.com](http://www.sedar.com).

## RELATED PARTIES

A Director of the Corporation is a partner in Burstall Winger LLP who act as counsel for the Corporation. The amount of fees paid on an arms length basis to Burstall Winger LLP in 2008 were \$0.4 million (2007 \$0.4 million).

## COMMITMENTS

The Corporation has the following financial commitments:

	2009	2010	2011	2012	2013
General & Administrative	\$ 320,000	\$ 320,000	\$ 320,000	\$ 320,000	\$ 320,000
Exploration activities	\$ 245,400	\$ 245,400			
Inner Moray Firth	\$ 27,078,000				
Rig Commitment	\$ 4,049,955				
Exploration well		\$ 14,000,000			

The general and administrative commitment relates to the office lease. The exploration commitments cover license fees. The Inner Moray Firth commitment is for the liquidated damages payable to Talisman in the event that the Corporation returns the Beatrice facilities to Talisman within the first year of the lease period. The rig commitment relates to the deferral of the Ensco 92 rig in favour of the Energy Enhancer jack up to complete the Jacky well. The

exploration well is the remaining commitment to drill under the 24<sup>th</sup> Round awards. These commitments are expected to be met through existing cash balances, production from the Beatrice and Jacky fields and selective farm-outs.

## **DISCLOSURE CONTROLS AND PROCEDURES**

Disclosure controls and procedures have been designed to ensure that information required to be disclosed by the Corporation is accumulated and communicated to management as appropriate to allow timely decisions regarding required disclosure. The Corporation's Chief Executive Officer and Chief Financial Officer have concluded, based on their evaluation as of December 31, 2008, that the Corporation's disclosure controls and procedures are effective to provide reasonable assurance that material information related to the Corporation is made known to them by others within those entities. It should be noted that, while the Corporation's disclosure controls and procedures provide a reasonable level of assurance and that they are effective, they do not expect that the disclosure controls and procedures will prevent all errors and fraud. A control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met.

## **INTERNAL CONTROLS OVER FINANCIAL REPORTING**

The Chief Executive Officer and Chief Financial Officer of the Corporation are responsible for designing internal controls over financial reporting or causing them to be designed under their supervision in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP. We have assessed the design of our internal controls over financial reporting as the Corporation has grown throughout the year and during this process we have identified certain weaknesses in internal controls over financial reporting during the year which are as follows:

- Due to the limited number of staff at the Corporation, it is not possible to achieve complete segregation of duties; and
- Due to the size of the Corporation and the limited number of staff, the Corporation does not have the technical accounting expertise and knowledge to address all complex and non-routine accounting transactions that may arise.

Weaknesses in the Corporation's internal controls over financial reporting could result in a risk that a material misstatement may not be prevented or detected and having noted the weaknesses Management and the Board of Directors are committed to developing the systems of internal control over financial reporting to remove the weaknesses noted above and have therefore implemented a new financial software package that provides accurate monthly reporting on a project basis allowing Management to monitor actual results against budgeted or expected results in a timely manner. In addition, when complex accounting and technical issues arise during the preparation of the quarterly financial statements, external consulting expertise is engaged.

## **CHANGES IN ACCOUNTING POLICIES, INCLUDING INITIAL ADOPTIONS**

### *Transition to International Financial Reporting Statements (“IFRS”)*

In January 2006, the AcSB adopted a strategic plan for the direction of accounting standards in Canada. Accounting standards for public companies in Canada are expected to converge with the International Financial Reporting Standards (“IFRS”) by 2011.

In anticipation of this conversion, the Corporation is ensuring that all finance staff are appropriately trained. Comparatives will be prepared during the 2010 financial year. In addition, the Corporation has recently installed new accounting software that is IFRS compliant. The management are confident that the Corporation will be properly prepared ahead of the transition date. It should also be noted that as the Corporation is operationally run from the United Kingdom, most financial staff are already familiar with IFRS reporting.

### *Goodwill and Intangible Assets*

In February 2008, the AcSB issued Section 3064, “Goodwill and Intangible Assets” and amended Section 1000, “Financial Statement Concepts” clarifying the criteria for the recognition of assets, intangible assets and internally developed intangible assets. Items that no longer meet the definition of an asset are no longer recognized with assets. The standard is effective for fiscal years beginning on or after October 1, 2008 and early adoption is permitted. The Corporation is currently evaluating the impact these sections will have, if any, on the consolidated financial statements.

## **OUTSTANDING SHARE INFORMATION**

As of March 26, 2009, there are 162,261,975 common shares of the Corporation outstanding and 172,956,475 common shares diluted. There are 10,694,500 options to purchase common shares outstanding.