



NEWS RELEASE

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**Ithaca Energy Inc.**

**First Quarter 2010 Financial Results**

**Net profit for the quarter \$5.4 million**  
**Cash flow from operations \$19.6 million**

**SUMMARY OF KEY EVENTS**

*Financial*

- Net profit for the quarter of **\$5.4 million** (2009 full year profits of \$7.9 million)
- Weighted average realised price for Q1 of **\$79.95/barrel** before hedging. This compares to a weighted average realised price of \$47.27/barrel before hedging for first quarter 2009
- Positive cash flow from operations of **\$19.6 million**
- Debt-free and net current assets as at 31st March of **\$62.3 million**
- Restricted cash at the quarter end was reduced by \$5.2 million to **\$0.3 million**
- Total fixed assets increased \$3.6 million to **\$209.1 million** (\$205.5 million as at December 31, 2009), comprising \$14.6 million of capital expenditure offset by \$11.0 million of depletion and depreciation for the quarter

*Operational*

- Combined Q1 production from Jacky and Beatrice averaged 8,776 barrels of oil per day ("bopd") gross (4,193 bopd net to Ithaca) as measured at the Nigg storage facility. Peak production rates from Jacky have exceeded 11,750 bopd gross (5,581 bopd net to Ithaca) as metered at the platform
- Production potential from the Beatrice Bravo facility was increased by approximately 1,500 barrels of oil per day ("bopd") (750 bopd net to Ithaca), as a result of a well intervention program. This was significantly above Management's target of 500 bopd (250 bopd net to Ithaca)
- The Joint Venture Partners have committed to moving ahead with the Athena project with the purchase of long lead equipment and commissioning of a full project team to plan, development and finalise submission of the Environmental Statement and Field Development Plan for approval
- A letter of Intent has been signed with BW Offshore for the use of the Floating Production, Storage and Offloading ("FPSO") vessel 'BW Carmen' (to be renamed 'BW Athena') for the production of oil from the Athena Field

**HIGHLIGHTS SUBSEQUENT TO QUARTER END:**

- The Stella field appraisal well (30/6a-8) proved the presence of significant additional volumes of hydrocarbon and excellent quality reservoir. A successful Drill Stem Test was performed providing critical information for development planning to now commence. The total measured hydrocarbon column height was shown to be in excess of 820 feet and the well confirmed hydrocarbons more than 500 feet lower than in any previous wells
- As planned, a sidetrack (30/6a-8Z) was subsequently drilled and confirmed a fully hydrocarbon-saturated reservoir interval in the Andrew sandstone. Successful sampling and pressure tests have also provided essential fluid composition information to appropriately size and plan the development of the Stella field. All objectives were fully met by the drilling programme. Following this, an independent evaluation of the Company's petroleum and natural gas reserves associated is currently underway by Sproule ([www.sproule.com](http://www.sproule.com))
- On April 22 2010, the Company mandated Bank of Scotland as Lead Arranger for a \$140 Million Senior Secured Borrowing Base Facility and subsequently has agreed a Term Sheet for the facilities
- Coiled tubing work has commenced on the Beatrice Alpha platform to undertake preparatory 'clean up' work on five production wells prior to mobilization of a Hydraulic Workover Unit ("HWU") to the platform in early July 2010. The HWU will undertake the replacement of Electric Submersible Pumps in four production wells and replace tubulars in one water injection well as part of the Beatrice Complex production enhancement programme
- The Company currently has unrestricted cash resources of \$41 million on deposit

**Iain McKendrick, CEO, commented,**

"The strong Q1 results and successful appraisal well at Stella provide further testament to the solid progress made by the Company in 2010. The development of the Stella area is now sharply in focus as a main growth area for Ithaca. Through carefully deploying its resources, the Company is now poised to deliver an ambitious plan with the comfort of a Senior Debt facility agreed and strong cash flow from Beatrice and Jacky."

Further details on the above are provided in the Consolidated Financial Statements and Management's Discussion and Analysis for the first quarter ended March 31, 2010, which have been filed with securities regulatory authorities in Canada. These documents are available on the System for Electronic Document Analysis and Retrieval at [www.sedar.com](http://www.sedar.com) and provided below.

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In accordance with AIM Guidelines, Lawrie Payne, MA Marine Geology (Alberta & Columbia) and Chairman of Ithaca Energy is the qualified person that has reviewed the technical information contained in this press release.

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***Forward-looking statements***

Some of the statements in this announcement are forward-looking. Forward-looking statements include statements regarding the intent, belief and current expectations of Ithaca Energy Inc. or its officers with respect to various matters. When used in this announcement, the words “expects,” “believes,” “anticipate,” “plans,” “may,” “will,” “should”, “scheduled”, “targeted”, “estimated” and similar expressions, and the negatives thereof, whether used in connection with the estimated production levels, anticipated time of first oil, oil in place, hydrocarbon composition or otherwise, are intended to identify forward-looking statements. Such statements are not promises or guarantees, and are subject to risks and uncertainties that could cause actual outcome to differ materially from those suggested by any such statements. These forward-looking statements speak only as of the date of this announcement. Ithaca Energy Inc. expressly disclaims any obligation or undertaking to release publicly any updates or revisions to any forward-looking statement contained herein to reflect any change in its expectations with regard thereto or any change in events, conditions or circumstances on which any forward-looking statement is based except as required by applicable securities laws.

Neither TSX Venture nor its Regulation Services Provider (as that term is defined in the policies of the TSX Venture Exchange) accepts responsibility for the adequacy or accuracy of this release.

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## **ITHACA ENERGY INC.**

### **MANAGEMENT'S DISCUSSION AND ANALYSIS FOR THE QUARTER ENDED MARCH 31, 2010**

The following is management's discussion and analysis ("MD&A") of the operating and financial results of Ithaca Energy Inc. (the "Corporation" or "Ithaca" or the "Company") for the three months ended March 31, 2010. The information is provided as of May 24, 2010. The unaudited first quarter 2010 results have been compared to the results of the comparative period in 2009. This discussion and analysis should be read in conjunction with the Corporation's audited consolidated financial statements as at December 31, 2009 together with the accompanying notes and the MD&A for the 2009 fiscal year. These documents and additional information about Ithaca are available on SEDAR at [www.sedar.com](http://www.sedar.com).

Certain statements contained in this MD&A, including estimates of reserves, estimates of future cash flows and estimates of future production as well as other statements about future events or anticipated results, are forward-looking statements. The forward-looking statements contained herein are based on assumptions and are subject to known and unknown risks, uncertainties and other factors. Should the underlying assumptions prove incorrect or should one or more of these risks, uncertainties or factors materialize, actual results may vary significantly from those expected. See "Forward-Looking Information", below.

All financial data contained herein is presented in accordance with Canadian generally accepted accounting principles ("GAAP") and is expressed in United States dollars ("\$"), unless otherwise stated.

#### **BUSINESS OF THE CORPORATION**

Ithaca is an oil and gas exploration, development and production Company active in the United Kingdom's Continental Shelf ("UKCS"). The goal of Ithaca, in the near term, is to maximise production and achieve early production from the development of existing discoveries on properties held by Ithaca, to originate and participate in exploration on properties held by Ithaca, when capital permits, and to consider other opportunities for growth as they are identified from time to time by Ithaca.

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

#### **NON-GAAP MEASURES**

'Operating costs per barrel' referred to in this MD&A are not prescribed by Canadian generally accepted accounting principles (GAAP). This non-GAAP financial measure does not have any standardized meaning and therefore is unlikely to be comparable to similar measures presented by other companies. We include operating costs per barrel data because investors may use this information to analyze operating performance. The additional information should not be considered in isolation or as a substitute for measures performance prepared in accordance with Canadian GAAP. See 'results of operations' section for details.

'Cash flow from operations' referred to in this MD&A is not prescribed by Canadian generally accepted accounting principles (GAAP). The Corporation uses this measure to help

evaluate its performance. As an indicator of the Corporation's performance, cash flow from operations should not be considered as an alternative to, or more meaningful than, cash flows from operating activities as determined in accordance with Canadian GAAP. The Corporation's determination of cash flow from operations does not have any standardized meaning and therefore may not be comparable to similar measures presented by other companies. The Corporation considers cash flow from operations to be a key measure as it demonstrates the Corporation's ability to generate the cash necessary to fund operations and support activities related to its major assets. Cash flows from operations are determined by adding back changes in non-cash operating working capital to cash provided by operating activities.

## **BOE PRESENTATION**

The calculation of barrels of oil equivalent ("boe") is based on a conversion rate of six thousand cubic feet of natural gas ("mcf") to one barrel of crude oil ("bbl"). Boes may be misleading, particularly if used in isolation. A boe conversion ratio of 6 mcf: 1 bbl is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.

## **HIGHLIGHTS FIRST QUARTER 2010**

Ithaca achieved the following highlights during the first three months of 2010.

### *Financial*

- Net profit for the quarter was \$5.4 million (loss of \$12.3 million for the quarter ended March 31, 2009) driven by operating revenues from Jacky, Beatrice Alpha and Beatrice Bravo, offset by the unitary depletion increase.
- Weighted average realised price for the quarter ended March 31, 2010 was \$79.95/barrel before hedging. This compares to a weighted average price of \$47.27/barrel for first quarter 2009.
- The Corporation recorded its fourth consecutive quarter of positive cash flow from operations amounting to \$19.6 million, (\$6.5 million outflow in the comparative 2009 quarter). The variance between periods arose from the commencement of production from the Jacky field, the Beatrice Bravo re-instatement and the successful work-over campaign. There was also a higher Beatrice utilization factor and a significant increase in the commodity price.
- Debt-free and net current assets as at 31<sup>st</sup> March of \$62.3 million.
- Restricted cash at the quarter end was reduced to \$0.3 million. Bank of Scotland held \$5.2million of restricted cash as cash security for the 2010 foreign exchange forward contract. This was released in January 2010.
- In the three months to 31<sup>st</sup> March 2010 total fixed assets increased \$3.6 million to \$209.1 million (\$205.5 million as at December 31, 2009), comprising \$14.6 million of capital expenditure offset by \$11.0 million of depletion and depreciation for the quarter.

### *Operational*

- Combined production from the Jacky and Beatrice averaged 8,776 barrels of oil per day (“bopd”) gross (4,193 bopd net to Ithaca) over the three month period from January to March 2010 (“the period”) as measured at the Nigg storage facility. Overall Q1 2010 average production rates for the Beatrice Complex reflected the outage at Beatrice Alpha due to produced water handling equipment problems on 28<sup>th</sup> December 2009. Production from Jacky and Beatrice Bravo facilities continued without significant interruption since it was restored on January 11, 2010. Daily production rates from Jacky have at times exceeded 11,750 bopd gross (5,581 bopd net to Ithaca) as metered at the platform.
- On February 4, Ithaca announced that the production potential from the Beatrice Bravo facility had been increased by approximately 1,500 barrels of oil per day (“bopd”) (750 bopd net to Ithaca), as a result of a well intervention program. This was significantly above Management’s target of 500 bopd (250 bopd net to Ithaca). Approximately 1,000 bopd gross (500 bopd net to Ithaca) of the incremental production potential is attributed to the highly effective B11 well intervention which involved perforating across a previously untapped section of the Beatrice reservoir to access an undrained area of the field. Production rates from this part of the field remain above original predictions.
- On February 8, the Athena Joint Venture Partners committed to the purchase of long lead equipment. A full project team was commissioned to plan the development and finalize submission of the Environmental Statement and Field Development Plan for approval. Long lead equipment orders were placed, to the value of US\$14.85 million, for the supply of subsea equipment, subsea trees and engineering support.
- On February 11, Ithaca announced that the Galaxy II heavy duty jack-up rig, contracted to drill an appraisal well on the Stella field, came on hire and was mobilised to the spud location and to commence drilling. On February 19, the Galaxy II commenced drilling at the Stella appraisal well location in block 30/6a.
- On March 15, Ithaca signed a Letter of Intent with BW Offshore for the use of the Floating Production, Storage and Offloading (“FPSO”) vessel ‘BW Carmen’ (to be renamed ‘BW Athena’) for the production of oil from the Athena Field. It has been agreed that the contract will contain an initial fixed charter period of 3 years with an option to extend throughout the life of the field. Under the agreed schedule, the FPSO will be deployed to the Athena field in mid 2011, as previously planned. Initial gross production rates are expected to be 22,000 barrels of oil per day (“bopd”) (4,950 bopd net to Ithaca).
- On March 29, Ithaca announced that it was preparing to Drill Stem Test the Stella appraisal well, 30/6a-8, as previously planned, which would last for approximately 12 days. The well was drilled to a total measured depth of 10,863 feet to appraise the downdip extension of the gas condensate rich Palaeocene Andrew sands, the

primary reservoir of the Stella discovery. Electric wireline logs and coring were run which confirmed a 22 foot gross Andrew sand interval.

### *Corporate*

- During the quarter, Maersk Oil North Sea UK Limited exercised its option to Farm In to the High Pressure/High Temperature play in both the Company's blocks 29/4b and 29/5e which lie in the Greater Stella Area. This transaction offers the potential to drill two deep exploration wells (one on each block) in which Ithaca shall be carried for all costs up to the end of the first well on each block.
- On March 25, Graham Forbes was appointed as Chief Financial Officer to succeed Mr Wood who has held the post of interim Chief Financial Officer since December 2009.

### **HIGHLIGHTS SUBSEQUENT TO QUARTER END:**

- On April 15, Ithaca announced that the Stella field appraisal well (30/6a-8) had proved the presence of significant additional volumes of hydrocarbon and excellent quality reservoir. A successful Drill Stem Test has been performed providing critical information for development planning to now commence. The total measured hydrocarbon column height was shown to be in excess of 820 feet and the well confirmed hydrocarbons more than 500 feet lower than in any previous wells. As planned, a sidetrack well (30/6a-8Z) was subsequently drilled and confirmed a fully hydrocarbon-saturated reservoir interval in the Andrew sandstone. Successful sampling and pressure tests have also provided essential fluid composition information to appropriately size and plan the development of the Stella field. All objectives were fully met by the drilling programme.
- On April 22 2010, the Company mandated Bank of Scotland as Lead Arranger for a \$140 Million Senior Secured Borrowing Base Facility and subsequently has agreed a Term Sheet for the facilities.
- On May 1, coiled tubing work commenced on the Beatrice Alpha platform to undertake preparatory 'clean up' work on five production wells prior to mobilization of a Hydraulic Workover Unit ("HWU") to the platform in early July 2010. The HWU will undertake the replacement of Electric Submersible Pumps in four production wells and replace tubulars in one water injection well as part of the Beatrice Complex production enhancement programme
- On May 4, Ithaca announced the appointment of Mr. Ron Brenneman as non-executive director of the Company, subject to regulatory approval

### **RESULTS OF OPERATIONS**

During the quarter ended March 31, 2010, total net production averaged 4,193 bopd with an average realised price of \$79.95/bbl, (comparative quarter 2009 654 bopd with an average realised price of \$47.27/bbl) barrel before hedging. The large increase in production was due

to the additional production obtained from Beatrice Bravo and Jacky in Q1 2010 versus production from only Beatrice Alpha in Q1 2009. The increase in price is due to an increase in the 'spot' Brent oil price in the quarter.

Operating costs on a per barrel basis were \$23 for the quarter (\$218/bbl in Q1 2009). This rate has steadily reduced since the reinstatement of Beatrice Bravo production and the start-up of Jacky production in Q2 2009, as the operating costs are shared between the two fields. Operating and G&A costs have decreased on absolute terms due to the reduction in the Corporation's working interest from Q1 2009 to Q1 2010. Depletion, depreciation and accretion expense has increased significantly from Q1 2009, due to the additional production and property, plant and equipment recorded in Q1 2010, offset by the decrease in working interest noted above. The Corporation also recorded a \$2.2 million loss on derivatives, the majority of which related to unrealized losses on the revaluation of the foreign exchange forward contract. For many income statement items, no valid comparison can be drawn to the quarter ended March 31, 2009 given the significantly changed context of the production, price and net interest basis.

For the quarter ended March 31, 2010 the Corporation had a net profit of \$5.4 million. The profits were delivered by sustained production levels, higher commodity prices, a lower unit depletion cost following reserve revaluation. This compared to a net loss of \$12.3 million in Q1 2009, a period in which fixed operating costs were being borne before higher production levels were achieved.

## **SUMMARY OF QUARTERLY RESULTS**

The following table provides a summary of quarterly results of the Corporation for its eight most recently completed quarters:

|  | 31-Mar-10           | 31-Dec-09           | 30-Sep-09           | 30-Jun-09           | 31-Mar-09           | 31-Dec-08           | 30-Sep-08           | 30-Jun-08           |
|--|---------------------|---------------------|---------------------|---------------------|---------------------|---------------------|---------------------|---------------------|
|  | US\$                | US\$                | US\$                | US\$                | (Restated)<br>US\$  | US\$                | US\$                | US\$                |
| <b>REVENUE</b>                         |                     |                     |                     |                     |                     |                     |                     |                     |
| Oil Sales                              | 30,101,532          | 33,850,242          | 36,375,077          | 28,280,275          | 2,775,844           | 2,472,106           | -                   | -                   |
| Other income                           | 665,136             | 5,809,265           | 923,692             | 1,476,638           | 969,595             | -                   | -                   | -                   |
| Interest income                        | 2,202               | 16,277              | 96,456              | 146,305             | 91,950              | 143,441             | 160,635             | 126,137             |
|  | <u>30,768,870</u>   | <u>39,675,783</u>   | <u>37,395,225</u>   | <u>29,903,218</u>   | <u>3,837,389</u>    | <u>2,615,547</u>    | <u>160,635</u>      | <u>126,137</u>      |
| <b>COSTS AND EXPENSES</b>              |                     |                     |                     |                     |                     |                     |                     |                     |
| General and administrative             | 776,195             | (627,056)           | 1,727,821           | 1,273,583           | 1,534,474           | 3,287,190           | 1,954,388           | 1,680,204           |
| Loan Fee Amortization                  | -                   | -                   | -                   | -                   | -                   | 1,194,497           | 2,339,082           | 135,312             |
| (Gain) / Loss on Financial Instruments | 2,157,528           | (5,360,600)         | 4,324,781           | (5,602,293)         | (1,441,234)         | 1,777,181           | -                   | -                   |
| Revaluation of Nigg Heel of Tank       | (184,404)           | (363,409)           | (3,750)             | 483,818             | -                   | -                   | -                   | -                   |
| Operating                              | 8,689,379           | 13,065,356          | 9,179,698           | 12,056,509          | 12,648,388          | 4,587,834           | -                   | -                   |
| Depreciation and accretion             | 11,247,785          | 12,893,949          | 20,378,993          | 17,585,049          | 2,467,981           | 2,076,311           | 249,794             | 278,838             |
| (Gain) / Loss on foreign exchange      | 1,576,075           | 2,318,756           | 2,051,399           | (890,935)           | (226,546)           | 7,739,985           | 648,805             | (447,527)           |
| Stock based compensation               | 1,151,450           | 180,409             | 772,592             | 644,732             | 1,109,500           |                     |                     |                     |
| Interest and bank charges              | 4,011               | (451)               | 108,323             | 572,826             | 11,536              |                     |                     |                     |
|  | <u>25,418,019</u>   | <u>22,106,954</u>   | <u>38,539,857</u>   | <u>26,123,289</u>   | <u>16,104,099</u>   | <u>20,662,998</u>   | <u>5,192,069</u>    | <u>1,646,827</u>    |
| <b>NET PROFIT / (LOSS) BEFORE TAX</b>  | <u>5,350,851</u>    | <u>17,568,829</u>   | <u>(1,144,632)</u>  | <u>3,779,929</u>    | <u>(12,266,710)</u> | <u>(18,047,451)</u> | <u>(5,031,434)</u>  | <u>(1,520,690)</u>  |
| <b>TAXES</b>                           | -                   | (80,972)            | -                   | -                   | -                   | (347,458)           | -                   | -                   |
| <b>NET PROFIT / (LOSS) AFTER TAX</b>   | <u>5,350,851</u>    | <u>17,487,857</u>   | <u>(1,144,632)</u>  | <u>3,779,929</u>    | <u>(12,266,710)</u> | <u>(18,394,909)</u> | <u>(5,031,434)</u>  | <u>(1,520,690)</u>  |
| <b>NET PROFIT / (LOSS) PER SHARE</b>   | 0.03                | 0.11                | (0.01)              | 0.02                | (0.08)              | (0.14)              | (0.04)              | (0.01)              |
| <b>Deficit, beginning of period</b>    | (30,430,982)        | (47,918,839)        | (46,774,207)        | (50,554,136)        | (38,287,426)        | (19,892,517)        | (14,861,083)        | (13,340,393)        |
| <b>Deficit, end of period</b>          | <u>(25,080,131)</u> | <u>(30,430,982)</u> | <u>(47,918,839)</u> | <u>(46,774,207)</u> | <u>(50,554,136)</u> | <u>(38,287,426)</u> | <u>(19,892,517)</u> | <u>(14,861,083)</u> |

Significant factors and trends that have impacted the Corporation's results during the above periods include:

- The Corporation took over the operation of the producing Beatrice field in November 2008 and the Jacky field commenced its first oil production in April 2009.
- Revenue and royalties are significantly impacted by underlying commodity prices. Commodity prices have steadily risen through the periods in which the Corporation had production. The Corporation has utilized forward sales contracts to reduce the exposure to commodity price fluctuations. These contracts can cause volatility in net income as a result of unrealized gains and losses on commodity contracts held for risk management purposes.
- The Corporation's general and administrative costs rose with increased work scope. However, the Corporation's lower net average interest in properties following the Dyas II transaction resulted in a reduction in the net G&A borne by the Company. G&A costs charged out to the partners were actualized at the 2009 year end in accordance with industry practice.

- The Corporation utilized forward sales contracts and foreign exchange contracts during the period to reduce the exposure to commodity price and exchange rate fluctuations. The gains and losses on these contracts are the result of movements in the oil price and US Dollar: British Pounds Sterling exchange rate.

## LIQUIDITY AND CAPITAL RESOURCES

As at 31<sup>st</sup> March 2010, Ithaca had working capital of \$62.3 million which included a cash balance of \$20.1 million. Available cash has been, and is currently, invested on deposit with the Bank of Scotland. Management has received confirmation from the financial institution that these funds are available on demand.

During the quarter ended 31<sup>st</sup> March 2010 there was a cash outflow from operating, investing and financing activities of \$9.8 million (Comparative 2009 quarter outflow of \$14.0 million). The net outflow was largely a result of positive operating cash flows of \$19.6 million, a \$5.2 million decrease in restricted cash, offset by a \$18.7 million increase in working capital and \$14.7 million investment in fixed assets. The fixed asset investment in the quarter predominantly related to the Stella Appraisal Well and Beatrice Bravo work-overs and Athena long lead items.

Significant capital will be required to further the Corporation's currently anticipated development activities in 2010 and management expects that the Corporation will have sufficient liquidity to fund such activities through a combination of existing cash resources and cash flow from production.

## COMMITMENTS

The Corporation has the following financial commitments:

| Year ended                   | 2010      | 2011      | 2012      | 2013      | 2014    | Subsequent<br>to 2014 |
|------------------------------|-----------|-----------|-----------|-----------|---------|-----------------------|
|                              | US\$      | US\$      | US\$      | US\$      | US\$    | US\$                  |
| Office lease                 | 241,152   | 241,152   | 241,152   | 241,152   | 241,152 | 783,744               |
| Exploration license fees     | 595,826   | 893,715   | 1,199,620 | 1,517,157 | -       | -                     |
| Letter of Intent obligations | 751,860   | -         | -         | -         | -       | -                     |
| Appraisal Well               | 3,350,889 | -         | -         | -         | -       | -                     |
| Total                        | 4,939,727 | 1,134,867 | 1,440,772 | 1,758,309 | 241,152 | 783,744               |

## OUTSTANDING SHARE INFORMATION

As at 31<sup>st</sup> March, 2010, Ithaca had 162,571,973 common shares outstanding along with 15,307,877 options to acquire common shares. As at May, 2010, Ithaca had 162,846,973 common shares outstanding along with 15,032,877 options to acquire common shares. The total number of options outstanding is inclusive of 750,000 share options granted to Graham Forbes in accordance with the Company's Stock Option Plan. The options were approved by the Board of Directors at a price of CDN \$1.59 which was the closing price on the Toronto Stock Exchange (TSX) Venture Exchange on March 5, 2010. The options were granted effective March 8, 2010 and may be exercised for a period of four years from that date. One third of the options will vest at the end of each of the first, second and third years from the effective date.

## CRITICAL ACCOUNTING ESTIMATES

Ithaca's significant accounting policies are disclosed in note 2 to the December 31, 2009 consolidated financial statements. Certain accounting policies require that management make appropriate decisions with respect to the formulation of estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. These accounting policies are discussed below and are included to aid the reader in assessing the critical accounting policies and practices of the Corporation and the likelihood of materially different results being reported. Ithaca's management reviews these estimates regularly. The emergence of new information and changed circumstances may result in actual results or changes to estimated amounts that differ materially from current estimates.

The following assessment of significant accounting policies and associated estimates is not meant to be exhaustive. The Company might realize different results from the application of new accounting standards promulgated, from time to time, by various rule-making bodies. 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 as adjusted for production.

The carrying value of property, plant and equipment is reviewed annually for impairment. The carrying value is assessed to be recoverable if the sum of the undiscounted cash flows expected from the production of proved reserves exceeds the carrying value of the property, plant and equipment. If the carrying value of the property plant and equipment is not assessed to be recoverable, an impairment loss is recognized to the extent that the carrying value exceeds the sum of the discounted cash flows expected from the production of proved and probable reserves. The cost recovery ceiling test and calculation of impairment are based on estimates of 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.

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.

Financial assets or liabilities are only recognised when the entity becomes a party to the contractual provisions of the financial instrument. Financial assets and financial liabilities are, with certain exceptions, initially measured at fair value.

Derivative financial instruments are required to be recorded on the balance sheet at fair value. Any changes in fair value are immediately recorded as a net gain or loss in the statement of net income.

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.

The accrual method of accounting will require management to incorporate certain estimates of revenues, production costs and other costs as at a specific reporting date. In addition, the Company must estimate capital expenditures on capital projects that are in progress or recently completed where actual costs have not been received as of the reporting date.

### **OFF-BALANCE SHEET ARRANGEMENTS**

The Corporation has certain lease agreements which were entered into in the normal course of operations, all of which are disclosed under the heading "Commitments", above. All leases have been treated as operating leases whereby the lease payments are included in operating expenses or general and administrative expenses depending on the nature of the lease. No asset or liability value has been assigned to these leases in the balance sheet as at March 31, 2010.

### **RELATED PARTY TRANSACTIONS**

A director of the Corporation is a partner of Burstall Winger LLP who act as counsel for the Corporation. The amount of fees paid to Burstall Winger LLP in the first quarter of 2010 was \$27,000 (Comparative period 2009 \$113,000). All related party transactions are in the normal course of business and have been measured at the terms agreed to and exchange values, being the consideration established and agreed to by the parties and on normal commercial terms comparable to those charged by third parties.

### **REPORTING CURRENCY**

The Corporation generates revenues in United States dollars. The Corporation expects to receive 100% of its income over 2010 in United States dollars. Budgeted expenditure indicates that approximately 19% of 2010 expenditure is expected to be in United States dollars.

The Corporation therefore believes that the United States 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 the United States dollar, the Board of

the Corporation has a hedging policy to mitigate foreign exchange rate risk on committed expenditure. On October 12, 2009, the Corporation entered into a contract with the Bank of Scotland to hedge its British Pounds Sterling 2010 forecast operating costs, including general and administrative expenses. The hedge amounts to \$4 million per month (total \$48 million) at a \$/£ rate of no worse than \$1.60/£1.00 and allows the Corporation to benefit from spot movements down to \$1.4975: £1.00.

The Corporation is and may in the future be exposed to third-party credit risk through its contractual arrangements with its current and future joint venture partners, marketers of its petroleum production and other parties. The Corporation has not experienced any material credit loss in the collection of accounts receivable to date.

The Corporation is heavily dependent upon the production rates and oil price to fund the current development program. A price hedge was entered into on November 16, 2009 for 204,000 barrels of production over four months fixed at \$77/barrel. No further commodity price fixes have been entered into by the Corporation at this date. The forecast production budgeted to meet future expenditures is heavily reliant upon the performance of the Jacky well that came on stream on April 6, 2009 and a sustained contribution from the Beatrice field.

The Corporation is currently undergoing a VAT review by HMRC. The Corporation believes there are no liabilities arising out of the inspection which can be reasonably determined at this time.

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. All of the Corporation's operations are conducted offshore in the UKCS; as such Ithaca is exposed to operational risk associated with weather delays that can result in a material delay in project execution. Third parties operate some of the assets in which the Corporation has interests. As a result, the Corporation may have limited ability to exercise influence over the operations of these assets and their associated costs. The success and timing of these activities may be outside the Corporation's control.

It should be noted that the Corporation is not required to certify the design and evaluation of the Corporation's disclosure controls and procedures and internal control over financial reporting and it has not completed such an evaluation. Furthermore, given the size of the Corporation there are inherent limitations on the certifying officers to design and implement on a cost effective basis disclosure controls and procedures and internal control over financial reporting that may result in additional risks to the quality, reliability, transparency, and timeliness of annual filings.

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).

## **CONTROL ENVIRONMENT**

As of March 31, 2010, there were no changes in our internal control over financial reporting that occurred during 2010 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Based on their inherent limitations, disclosure controls and procedures and internal controls over financial reporting may not prevent or detect misstatements and even those options determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

## **CHANGES IN ACCOUNTING POLICIES**

The consolidated financial statements for the three months ended March 31, 2010 have been prepared following the same accounting policies and methods of computation as the consolidated financial statements as at December 31, 2009.

## **IMPACT OF FUTURE ACCOUNTING CHANGES**

In February 2008, the CICA Accounting Standards Board ("AcSB") confirmed the changeover to IFRS from GAAP will be required for publicly accountable enterprises for interim and annual financial statements effective for fiscal years beginning on or after January 1, 2011, including comparatives for 2010. Ithaca's financial statements up to and including the December 31, 2010 financial statements will continue to be reported in accordance with GAAP as it exists on each reporting date. Financial statements for the quarter ended March 31, 2011, including comparative amounts, will be prepared on an IFRS basis.

In July 2009, the International Accounting Standards Board ("IASB") issued amendments to IFRS 1 "First time adoption of IFRS" allowing additional exemptions for first-time adopters. These amendments allow an entity that used full cost accounting under its previous GAAP to elect to measure oil and gas assets including exploration and evaluation assets and development and production assets being allocated pro rata using reserves volumes or reserve values as of the date of the adoption, providing that all assets are tested for impairment on adoption. Ithaca is currently planning to adopt this exemption.

IFRS adoption is currently scheduled for the Corporation's fiscal year commencing January 1, 2011.

The Company has completed the diagnostic assessment phase by performing comparisons of the differences between Canadian GAAP and IFRS. The Company has determined that the most significant impact of IFRS conversion is to property, plant and equipment. The Company currently follows full cost accounting as prescribed in the Accounting Guideline ("AcG") 16 ,Oil and Gas Accounting-Full Cost." Conversion to IFRS may have a significant impact on how the company accounts for costs pertaining to oil and gas activities. The company is monitoring the impact of these changes on the Company's financial position. The company is currently completing the design, planning and solution development stage and all changes to IFRS required prior to January 1, 2011 will be incorporated as required.

## **FINANCIAL INSTRUMENTS AND OTHER INSTRUMENTS**

All financial instruments are initially measured in the balance sheet at fair value. Subsequent measurement of the financial instruments is based on their classification. The Corporation has classified each financial instrument into one of these five categories: held-for-trading, held-to-maturity investments, loans and receivables, available-for-sale financial assets or other financial liabilities. Loans and receivables, held-to-maturity investments and other financial liabilities are measured at amortized cost using the effective interest rate method. For all financial assets and financial liabilities that are not classified as held-for-trading, the transaction costs that are directly attributable to the acquisition or issue of a financial asset or financial liability are adjusted to the fair value initially recognized for that financial instrument. These costs are expensed using the effective interest rate method and are recorded within interest expense. Held-for-trading financial assets are measured at fair value and changes in fair value are recognized in net income.

Available-for-sale financial instruments are measured at fair value with changes in fair value recorded in other comprehensive income until the instrument is derecognized or impaired. All derivative instruments are recorded in the balance sheet at fair value unless they qualify for the expected purchase, sale and usage exemption. All changes in their fair value are recorded in income unless cash flow hedge accounting is used, in which case changes in fair value are recorded in other comprehensive income.

The Corporation has classified its derivative commodity contracts, cash and cash equivalents, and long term liability as held-for-trading, which are measured at fair value with changes being recognized in net income. Accounts receivable are classified as loans and receivables; operating bank loans, accounts payable and accrued liabilities, and long-term debt, including interest payable, are classified as other liabilities, all of which are measured at amortized cost the classification of all financial instruments is the same at inception and at March 31, 2010.

The Corporation's accounts receivables are primarily with industry partners and are subject to normal industry credit risks. The Corporation extends unsecured credit to these entities, and therefore, the collection of any receivables may be affected by changes in the economic environment or other conditions. Management believes the risk is mitigated by the financial position of the entities.

## **FORWARD-LOOKING INFORMATION**

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", "could", "scheduled", "targeted" 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;
- the sale, farming in, farming out or development of certain exploration properties using third party resources;
- supply and demand for oil, NGLs and natural gas;
- the Corporation's ability to raise capital;
- the Corporation's acquisition strategy, the criteria to be considered in connection therewith and the benefits to be derived therefrom;
- 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;
- the ability of the Corporation to optimize operations and reduce operational expenditures;
- treatment under governmental and other regulatory regimes and tax, environmental and other laws;
- production rates;
- targeted production levels; and
- timing and cost of the development of the Corporation's reserves.

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, NGLs 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;
- Ithaca's reliance on partners and their ability to meet commitments under relevant agreements; 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 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 in the North Sea;
- risks associated with offshore development and production including transport facilities;
- 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, health and safety or other legislation applicable to the Corporation's operations, and the Corporation's ability to comply with current and future environmental, health and safety 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 and Beatrice 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 unavailability 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 reserves 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.



# Ithaca Energy Inc.

## Consolidated Balance Sheets

| (unaudited)  | March 31,<br>2010<br>US\$ | December 31,<br>2009<br>US\$ |
|--|---------------------------|------------------------------|
| <b>ASSETS</b>  |                           |                              |
| Current assets                                       |                           |                              |
| Cash and cash equivalents                            | 20,084,099                | 29,886,359                   |
| Accounts receivable                                  | 81,194,150                | 67,166,377                   |
| Restricted cash (note 3)                             | -                         | 5,224,308                    |
| Deposits, prepaid expenses and other                 | 135,300                   | 351,041                      |
| Foreign exchange forward contract (note 11)          | -                         | 685,355                      |
|  | <b>101,413,549</b>        | <b>103,313,440</b>           |
| Restricted cash (note 3)                             | 334,535                   | 351,627                      |
| Property, plant and equipment (net) (note 4)         | 209,046,020               | 205,474,732                  |
|  | <b>310,794,104</b>        | <b>309,139,799</b>           |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>          |                           |                              |
| Current liabilities                                  |                           |                              |
| Accounts payable and accrued liabilities             | 37,436,649                | 43,612,899                   |
| Commodity hedge (note 11)                            | -                         | 396,780                      |
| Foreign exchange forward contract (note 11)          | 1,703,834                 | -                            |
| Long term liability on Beatrice acquisition (note 5) | 2,533,623                 | 2,718,027                    |
| Asset retirement obligations (note 6)                | 8,110,060                 | 7,955,967                    |
|  | <b>49,784,166</b>         | <b>54,683,673</b>            |
| Shareholders' equity                                 |                           |                              |
| Share capital (note 7)                               | 277,174,347               | 277,075,488                  |
| Contributed surplus (note 8)                         | 8,915,722                 | 7,811,620                    |
| Deficit  | (25,080,131)              | (30,430,982)                 |
|  | <b>261,009,938</b>        | <b>254,456,126</b>           |
|  | <b>310,794,104</b>        | <b>309,139,799</b>           |

Commitments (note 10) and contingent liability (note 17)

"Approved on behalf of the Board"

"John P. Summers"

Director

"Jack Lee"

Director

# Ithaca Energy Inc.

## Consolidated Statements of Net and Comprehensive Income / (Loss)

For the 3 months ended  
(unaudited)

|   | March 31,<br>2010<br>US\$ | March 31,<br>2009<br>US\$ |
|---|---------------------------|---------------------------|
| <b>REVENUES</b>   |                           |                           |
| Oil sales   | 30,101,532                | 2,775,844                 |
| Other income  | 665,136                   | 969,595                   |
| Interest income   | 2,202                     | 91,950                    |
|   | <u>30,768,870</u>         | <u>3,837,389</u>          |
| <b>COSTS AND EXPENSES</b>   |                           |                           |
| General and administrative  | 776,195                   | 1,534,474                 |
| Operating   | 8,689,379                 | 12,648,388                |
| Depletion, depreciation and accretion (note 4)  | 11,247,785                | 2,467,981                 |
| Loss / (gain) on foreign exchange   | 1,576,075                 | (226,546)                 |
| Revaluation of long term liability (note 5)   | (184,404)                 | -                         |
| Unrealized loss / (gain) on derivatives (note 11)   | 1,992,409                 | (1,441,234)               |
| Realized loss on derivatives (note 11)  | 165,119                   | -                         |
| Stock based compensation (note 7(c))  | 1,151,450                 | 1,109,500                 |
| Interest and bank charges   | 4,011                     | 11,536                    |
|   | <u>25,418,019</u>         | <u>16,104,099</u>         |
| <b>Profit / (loss) before income taxes</b>  | 5,350,851                 | (12,266,710)              |
| <b>Income taxes</b>   | -                         | -                         |
| <b>Net and comprehensive income / (loss)</b>  | <u>5,350,851</u>          | <u>(12,266,710)</u>       |
| <b>Net and comprehensive income / (loss) per share<br/>(basic &amp; diluted) (note 9)</b> | 0.03                      | (0.08)                    |

## Consolidated Statements of Shareholders' Equity (all amounts are US\$)

|                               | Share Capital      | Contributed Surplus | Deficit             | Total              |
|-------------------------------|--------------------|---------------------|---------------------|--------------------|
| Balance, Jan 1 2010           | 277,075,488        | 7,811,620           | (30,430,982)        | 254,456,126        |
| Stock based compensation      | -                  | 1,151,450           | -                   | 1,151,450          |
| Options exercised             | 98,859             | (47,348)            | -                   | 51,511             |
| Net income for the period     | -                  | -                   | 5,350,851           | 5,350,851          |
| <b>Balance, March 31 2010</b> | <b>277,174,347</b> | <b>8,915,722</b>    | <b>(25,080,131)</b> | <b>261,009,938</b> |
|                               | Share Capital      | Contributed Surplus | Deficit             | Total              |
| Balance, Jan 1 2009           | 277,029,766        | 5,126,285           | (38,287,426)        | 243,868,625        |
| Stock based compensation      | -                  | 1,109,500           | -                   | 1,109,500          |
| Options exercised             | -                  | -                   | -                   | -                  |
| Issued for cash               | -                  | -                   | -                   | -                  |
| Share issue costs             | -                  | -                   | -                   | -                  |
| Net loss for the period       | -                  | -                   | (12,266,710)        | (12,266,710)       |
| <b>Balance, March 31 2009</b> | <b>277,029,766</b> | <b>6,235,785</b>    | <b>(50,554,136)</b> | <b>232,711,415</b> |

# Ithaca Energy Inc.

## Consolidated Statements of Cash Flows

3 months ended  
(unaudited)

|  | March 31,<br>2010<br>US\$ | March 31,<br>2009<br>US\$ |
|--|---------------------------|---------------------------|
| <b>CASH PROVIDED BY (USED IN):</b>                                   |                           |                           |
| <b>OPERATING ACTIVITIES:</b>   |                           |                           |
| Net profit / (loss)  | 5,350,851                 | (12,266,710)              |
| Items not affecting cash   |                           |                           |
| Depletion, depreciation and accretion                                | 11,247,785                | 2,467,981                 |
| Unrealised loss / (gain) on derivatives                              | 1,992,409                 | (1,441,234)               |
| Revaluation of long term liability                                   | (184,404)                 | -                         |
| Stock based compensation   | 1,151,450                 | 1,109,500                 |
|  | 19,558,091                | (10,130,463)              |
| Changes in non-cash working capital relating to operating activities | (14,858,687)              | 7,874,830                 |
|  | 4,699,404                 | (2,255,633)               |
| <b>FINANCING ACTIVITIES:</b>   |                           |                           |
| Proceeds from issuance of shares                                     | 51,511                    | -                         |
| Decrease in restricted cash  | 5,241,400                 | -                         |
| Loan proceeds  | -                         | 6,900,359                 |
|  | 5,292,911                 | 6,900,359                 |
| <b>INVESTING ACTIVITIES:</b>   |                           |                           |
| Oil and natural gas properties                                       | (14,566,055)              | (9,970,643)               |
| Office furniture and equipment                                       | (98,922)                  | (2,283)                   |
|  | (14,664,977)              | (9,972,926)               |
| Changes in non-cash working capital relating to investing activities | (3,855,870)               | (8,254,142)               |
|  | (18,520,847)              | (18,227,068)              |
| Effect of foreign exchange on cash and cash equivalents              | (1,273,728)               | (377,863)                 |
| <b>Decrease in cash and cash equivalents</b>                         | <b>(9,802,260)</b>        | <b>(13,960,205)</b>       |
| <b>Cash and cash equivalents, beginning of period</b>                | <b>29,886,359</b>         | <b>26,943,802</b>         |
| <b>Cash and cash equivalents, end of period</b>                      | <b>20,084,099</b>         | <b>12,983,597</b>         |

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

## **1. NATURE OF OPERATIONS**

Ithaca Energy Inc. (the “**Corporation**” or “**Ithaca**”), incorporated in Alberta, Canada on April 27, 2004, is a publicly traded company involved in the exploration, development and production 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 Alternative Investment Market in the United Kingdom under the symbol “**IAE**”. Ithaca has a wholly-owned subsidiary Ithaca Energy (UK) Limited (“**Ithaca UK**”), incorporated in Scotland.

## **2. SIGNIFICANT ACCOUNTING POLICIES**

These interim consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles and follow the same accounting policies and methods of computation as, and should be read in conjunction with, the most recent annual financial statements. Certain information and disclosures normally required to be included in notes to the annual consolidated financial statements have been condensed or omitted.

### **Use of Estimates**

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of expenses during the reporting period. The recoverability of amounts shown for oil and natural gas properties is dependent upon the determination of economically recoverable reserves. The amounts recorded for depreciation, depletion, asset retirement obligation, future income taxes, accruals, derivatives, and stock based compensation are based upon estimates, as are assumptions used in the ceiling test. Actual results could differ from those estimates.

## **3 RESTRICTED CASH**

Restricted cash of \$334,535 is held by the Bank of Scotland as cash security for a Bank Guarantee that Ithaca Energy (UK) Limited provided to the Crown Estate when it was granted Field Development Plan approval for the Jacky Field.

\$5,224,308 of restricted cash held by the Bank of Scotland as cash security for the 2010 foreign exchange forward contract was released in January 2010.

#### 4. PROPERTY, PLANT AND EQUIPMENT

|  | March 31,    | December 31, |
|--|--------------|--------------|
|  | 2010         | 2009         |
|  | US\$         | US\$         |
| Oil and natural gas properties                 | 273,851,201  | 259,285,146  |
| Less accumulated depletion                     | (65,295,527) | (54,327,340) |
|  | 208,555,674  | 204,957,806  |
| Office furniture and equipment                 | 1,372,860    | 1,273,938    |
| Less accumulated depreciation and amortization | (882,514)    | (757,012)    |
|  | 490,346      | 516,926      |
| Total property, plant and equipment            | 209,046,020  | 205,474,732  |

The Corporation acquired the producing Beatrice facilities on November 10, 2008 and has therefore recognised depletion charges since that date. The depletion charge in the quarter was \$11.0 million (Q1 2009: \$2.2 million). As at March 31, 2010, oil and natural gas properties included \$193.1 million (Dec 31, 2009: \$189.5 million) relating to proved properties and \$15.5 million (Dec 31, 2009: \$15.5 million) relating to unproved properties. During the quarter ended March 31, 2010, the Corporation capitalized \$1.3 million (Q1 2009: \$1.2 million) of overhead directly related to exploration, appraisal and development activities. The Corporation did not capitalize any interest (Q1 2009: \$1.2 million) in the quarter ended March 31, 2010. Future development costs for the proved oil and gas properties are forecast to be approximately \$261.8 million (2009: \$270.9 million) and are included in the depletion calculation.

#### Disposal

The Corporation announced on July 29, 2009 that it had completed a transaction with Dyas UK Limited ("**Dyas**"), whereby Dyas purchased an interest in certain assets of the Corporation for \$101.6 million and the Corporation agreed to repay the loans of \$61.2 million and £5 million (\$8.2 million) from Dyas ("**Dyas Transaction**"). Cash of \$32.2 million was paid immediately to Ithaca and a further \$8.4 million was paid upon the outstanding transfer of an interest in Stella.

The majority of the proceeds were credited to Property, Plant and Equipment, with no gain or loss on disposal.

#### Acquisition

On October 28, 2009, the Corporation signed an agreement for the acquisition from Maersk Oil North Sea UK Limited and Maersk Oil Exploration UK Limited of additional interest in the Stella and Harrier discoveries and the Hurricane discovery. Ithaca paid \$10 million in consideration for this purchase and is committed to pay a further \$3 million at Field Development approval and \$5 million at first oil.

On the same date Ithaca entered into a "farm out" agreement with Challenger Minerals (North Sea) Limited ("**CMI**") whereby CMI is committed to pay 27% of gross Stella appraisal well costs in exchange for an option to acquire 18% equity interest in the Stella and Harrier discoveries prior to 1<sup>st</sup> August 2010, thereby carrying a part of Ithaca's share of drilling costs. Upon successful appraisal, CMI will also carry Ithaca on a further Stella or Harrier development well for up to £2 million (\$3.2 million) or 9%, whichever is lower. Following the "farm out" the Corporation's final interest in the Stella and Harrier discoveries will be 50.33% and will remain at 100% in the Hurricane discovery.

## 5. LONG TERM LIABILITY ON BEATRICE ACQUISITION

|   | March 31,<br>2010<br>US\$ | December 31,<br>2009<br>US\$ |
|---|---------------------------|------------------------------|
| <b>Balance, beginning of the period</b> | 2,718,027                 | 4,137,413                    |
| Addition                                | -                         | -                            |
| Disposal                                | -                         | (1,536,045)                  |
| Revaluation in the period               | (184,404)                 | 116,659                      |
| <b>Balance, end of the period</b>       | <b>2,533,623</b>          | <b>2,718,027</b>             |

On completion of the acquisition of the Beatrice Facilities on November 10, 2008 there were 75,000 barrels of oil in an oil storage tank at the Nigg Terminal. This volume of oil is required to be in the storage tank when the Beatrice Facilities are re-transferred. This volume of oil is valued at the price on the forward oil price curve at the expected date of re-transfer and discounted. The disposal in 2009 relates to the Dyas Transaction referred to in note 4. The liability is subject to revaluation at each financial period end. The expected date of re-transfer is likely to be more than three years.

## 6. ASSET RETIREMENT OBLIGATIONS

The total future asset retirement obligation was calculated by management based on its net ownership 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 Corporation estimates its total undiscounted asset retirement obligations to be \$11,029,764 as at March 31, 2010. The economic life and the timing of the obligations are dependent on Government legislation, commodity price and the future production profiles of the respective production and development facilities. Note that upon the acquisition of the Beatrice Field in November 2008, the Corporation did not assume the decommissioning liabilities. The liabilities disposed of in 2009 relate to the Dyas transactions.

The following table provides a reconciliation of the Corporation's total discounted asset retirement obligations:

|                                     | March 31, 2009<br>US\$ | December 31, 2009<br>US\$ |
|-------------------------------------|------------------------|---------------------------|
| <b>Balance, beginning of period</b> | 7,955,967              | 7,407,290                 |
| Additions                           | -                      | 5,530,301                 |
| Accretion                           | 154,093                | 808,140                   |
| Revision to estimates               | -                      | (362,722)                 |
| Liabilities disposed of             | -                      | (5,427,042)               |
| <b>Balance, end of period</b>       | <b>8,110,060</b>       | <b>7,955,967</b>          |

## 7. SHARE CAPITAL

### (a) Issued

The issued share capital is as follows:

| Issued   | Number of<br>common shares | Amount<br>US\$     |
|--|----------------------------|--------------------|
| <b>Balance December 31, 2008</b>                       | <b>162,261,975</b>         | <b>277,029,766</b> |
| Issued for cash - options exercised                    | 100,000                    | 23,824             |
| Transfer from Contributed Surplus on options exercised |                            | 21,898             |
| <b>Balance December 31, 2009</b>                       | <b>162,361,975</b>         | <b>277,075,488</b> |
| Issued for cash - options exercised                    | 209,998                    | 51,511             |
| Transfer from Contributed Surplus on options exercised |                            | 47,348             |
| <b>Balance March 31, 2010</b>                          | <b>162,571,973</b>         | <b>277,174,347</b> |

### (b) Stock Options

In the quarter ended March 31, 2010, the Corporation's Board of Directors granted 4,550,000 options at a weighted average exercise price of \$1.53 (C\$1.55) to employees and directors pursuant to the terms of the Corporation's stock-based compensation plan. The Corporation's stock options and exercise prices are denominated in Canadian Dollars when granted. As at March 31, 2010, 15,307,877 stock options to purchase common shares were outstanding, having an exercise price range of \$0.23 to \$3.36 (C\$0.25 to C\$3.65) per share and a vesting period of up to 3 years.

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

|                                    | March 31, 2010       |                                       | December 31, 2009    |                                       |
|------------------------------------|----------------------|---------------------------------------|----------------------|---------------------------------------|
|                                    | Number of<br>Options | Wt. Avg.<br>Exercise<br>Price<br>US\$ | Number of<br>Options | Wt. Avg.<br>Exercise<br>Price<br>US\$ |
| Balance, beginning of period       | 11,042,875           | \$ 1.48                               | 10,694,500           | \$ 1.92                               |
| Granted                            | 4,550,000            | \$ 1.53                               | 3,876,875            | \$ 0.83                               |
| Forfeited / expired                | (75,000)             | \$ 1.53                               | (3,428,500)          | \$ 2.18                               |
| Exercised                          | (209,998)            | \$ 0.25                               | (100,000)            | \$ 0.24                               |
| Options outstanding, end of period | 15,307,877           | \$ 1.54                               | 11,042,875           | \$ 1.48                               |

The following is a summary of stock options outstanding as at March 31, 2010.

| Options Outstanding             |                   |                       |                              |
|---------------------------------|-------------------|-----------------------|------------------------------|
| Range of Exercise Price         | Number of Options | Wt. Avg. Life (Years) | Wt. Avg. Exercise Price US\$ |
| \$3.60 (C\$3.65)                | 2,435,000         | 1.90                  | \$3.60                       |
| \$2.47-\$2.96 (C\$2.51-C\$3.00) | 1,285,000         | 1.17                  | \$2.55                       |
| \$1.52-\$1.77 (C\$1.54-C\$1.80) | 4,925,000         | 3.70                  | \$1.55                       |
| \$0.25-\$0.86 (C\$0.25-C\$0.87) | 6,662,877         | 3.53                  | \$0.59                       |
|                                 | 15,307,877        | 3.13                  | \$1.54                       |

The following is a summary of stock options exercisable as at March 31, 2010.

| Options Exercisable             |                   |                       |                              |
|---------------------------------|-------------------|-----------------------|------------------------------|
| Range of Exercise Price         | Number of Options | Wt. Avg. Life (Years) | Wt. Avg. Exercise Price US\$ |
| \$3.60 (C\$3.65)                | 1,590,000         | 1.89                  | \$3.60                       |
| \$2.47-\$2.96 (C\$2.51-C\$3.00) | 856,668           | 1.17                  | \$2.55                       |
| \$1.52-\$1.77 (C\$1.54-C\$1.80) | 149,999           | 2.43                  | \$1.77                       |
| \$0.25-\$0.86 (C\$0.25-C\$0.87) | 822,003           | 3.69                  | \$0.25                       |
|                                 | 3,418,670         | 2.17                  | \$2.45                       |

### (c) Stock-Based Compensation

Options granted are accounted for using the fair value method. The compensation cost charged during the quarter ended March 31, 2010 for total stock options granted was \$1,151,450 (December 31, 2009; \$2,707,233) The fair value of each stock option granted was estimated at the date of grant, using the Black-Scholes option pricing model with the following assumptions:

|                             | For the 3 months<br>ended March 31, 2010 | For the year ended<br>December 31, 2009 |
|-----------------------------|--|---|
| Risk free interest rate     | 1.71 – 1.77%                             | 2.13                                    |
| Expected dividend yield     | 0%                                       | 0%                                      |
| Expected stock volatility   | 102.15% - 102.76%                        | 94%                                     |
| Expected life of options    | 2.74 years                               | 4 years                                 |
| Weighted Average Fair Value | \$0.93                                   | \$0.83                                  |

### (d) Gemini Agreement

On September 2006 Gemini Oil & Gas Fund 11 L.P. (“Gemini”) provided non–recourse funding of \$6 million. Further to a supplemental agreement entered into in August 2008, the loan was fully repaid. Under the supplemental agreement Gemini retain rights, under certain circumstances relating to the Athena Field, to elect to receive warrants to acquire up to 3,000,000 common shares at \$3.00 per share.

## 8. CONTRIBUTED SURPLUS

|  | March 31,<br>2010<br>US\$ | December 31,<br>2009<br>US\$ |
|--|---------------------------|------------------------------|
| Balance, beginning of period                     | 7,811,620                 | 5,126,285                    |
| Stock based compensation cost                    | 1,151,450                 | 2,707,233                    |
| Transfer to share capital on exercise of options | (47,348)                  | (21,898)                     |
| Balance, end of period                           | 8,915,722                 | 7,811,620                    |

## 9. EARNINGS PER SHARE

The following reflects the income and share data used in the basic and diluted earnings per share computations:

|  | March 31,<br>2010 | March 31,<br>2009 |
|--|-------------------|-------------------|
| Weighted average number of common shares for basic earnings per share        | 162,555,640       | 162,261,975       |
| Weighted average number of common shares adjusted for the effect of dilution | 165,518,118       | 162,261,975*      |

\* At March 31, 2009, potential common shares that would be issued upon exercise of all outstanding options and warrants have been excluded as their effect would be anti-dilutive.

## 10. COMMITMENTS

As at March 31, 2010, the Corporation had the following financial commitments:

| Year ended                   | 2010             | 2011             | 2012             | 2013             | 2014           | Subsequent<br>to 2014 |
|------------------------------|------------------|------------------|------------------|------------------|----------------|-----------------------|
|                              | US\$             | US\$             | US\$             | US\$             | US\$           | US\$                  |
| Office lease                 | 241,152          | 241,152          | 241,152          | 241,152          | 241,152        | 783,744               |
| Exploration license fees     | 595,826          | 893,715          | 1,199,620        | 1,517,157        | -              | -                     |
| Letter of Intent obligations | 751,860          | -                | -                | -                | -              | -                     |
| Appraisal Well               | 3,350,889        | -                | -                | -                | -              | -                     |
| <b>Total</b>                 | <b>4,939,727</b> | <b>1,134,867</b> | <b>1,440,772</b> | <b>1,758,309</b> | <b>241,152</b> | <b>783,744</b>        |

## 11. FINANCIAL INSTRUMENTS

To estimate fair value of financial instruments, the Corporation uses quoted market prices when available, or industry accepted third-party models and valuation methodologies that utilize observable market data. In addition to market information, the company incorporates transaction specific details that market participants would utilize in a fair value measurement, including the impact of non-performance risk. The company characterizes inputs used in determining fair value using a hierarchy that prioritizes inputs depending on the degree to which they are observable. However, these fair value estimates may not necessarily be indicative of the amounts that could be realized or settled in a current market transaction. The three levels of the fair value hierarchy are as follows:

- Level 1 – inputs represent quoted prices in active markets for identical assets or liabilities (for example, exchange-traded commodity derivatives). Active markets are those in which transactions occur in sufficient frequency and volume to provide pricing information on an ongoing basis.
- Level 2 – inputs other than quoted prices included within Level 1 that are observable, either directly or indirectly, as of the reporting date. Level 2 valuations are based on inputs, including quoted forward prices for commodities, market interest rates, and volatility factors, which can be observed or corroborated in the marketplace. The company obtains information from sources such as the New York Mercantile Exchange and independent price publications.
- Level 3 – inputs that are less observable, unavailable or where the observable data does not support the majority of the instrument's fair value.

In forming estimates, the company utilizes the most observable inputs available for valuation purposes. If a fair value measurement reflects inputs of different levels within the hierarchy, the measurement is categorized based upon the lowest level of input that is significant to the fair value measurement. The valuation of over-the-counter financial swaps and collars is based on similar transactions observable in active markets or industry standard models that primarily rely on market observable inputs. Substantially all of the assumptions for industry standard models are observable in active markets throughout the full term of the instrument. These are categorized as Level 2.

The following table presents the Corporation's material financial instruments measured at fair value for each hierarchy level as of March 31, 2010:

|   | Level 1<br>US\$ | Level 2<br>US\$ | Level 3<br>US\$ | Total Fair Value<br>US\$ |
|---|-----------------|-----------------|-----------------|--------------------------|
| Long term liability on Beatrice acquisition | -               | -               | 2,533,623       | 2,533,623                |
| Foreign exchange forward contract           | -               | (1,703,834)     | -               | (1,703,834)              |

The table below presents the total gain / (loss) on derivatives that has been disclosed through the statement of net and comprehensive income / (loss):

|   | <b>March 31,<br/>2010<br/>US\$</b> | <b>March 31,<br/>2009<br/>US\$</b> |
|---|------------------------------------|------------------------------------|
| Unrealized gain / (loss) on foreign exchange forward contract | (2,389,189)                        | 1,441,234                          |
| Realized (loss) on foreign exchange forward contract          | (251,054)                          | -                                  |
| Realized gain on commodity hedges                             | 85,935                             | -                                  |
| Unrealized gain on commodity hedges                           | 396,780                            | -                                  |
| <b>Total (loss) / gain on derivatives</b>                     | <b>(2,157,528)</b>                 | <b>1,441,234</b>                   |

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 the Corporation's most significant market risk exposure. 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 as it holds undeveloped gas discoveries in its portfolio. Natural gas prices are generally influenced by oil prices 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. If the oil price had been lower by \$5 per barrel in 2010 then the profit for the quarter would have been lower by \$1,882,610.

In November, 2009, the Corporation entered into a forward swap for 51,000 barrels per month over November, December, January and February production fixing the price at \$77/barrel. This forward swap resulted in a realized gain of \$85,935 in the quarter ended March 31, 2010.

*ii) Interest Risk*

As a result of the repayment of all security held by Dyas referred to in note 4, the Corporation's exposure to the risk of changes in market interest rates is now negligible. If the Corporation utilizes floating rate debt to finance its developments and operations in the future, the Corporation may be exposed to interest rate risk to the extent that LIBOR may fluctuate. The Corporation will evaluate its annual forward cash flow requirements on a rolling monthly basis.

*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 US Dollars. 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.

On March 11, 2009, the Corporation entered into a "Window Forward Plus" contract with the Bank of Scotland to hedge circa 90% of the Corporation's known, at that time, future US Dollar to British Pound Sterling exchange rate exposure. The contract ensured that the Corporation, which incurs a substantial amount of its operating expenditure in British Pounds Sterling ("£"), was able to lock in a rate of no worse than USD1.40/£1.00 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 USD1.29/£1.00 (the "Trigger rate"). Any strengthening of the USD/£ rate beyond

the Trigger rate during any of the periods or “windows” between the transaction dates led to a rate of USD1.40/£1.00 being applied to that individual transaction. The contract, which expired December 31, 2009, covered \$49 million equivalent of British Pounds Sterling expenditure.

On October 12, 2009, the Corporation entered in to a further Window Forward Plus contract with the Bank of Scotland to hedge its forecast British Pounds Sterling 2010 operating costs, including general and administrative expenses. The hedge amounts to \$4 million per month (total \$48 million) at a US\$/£ rate of no worse than USD1.60/1.0 and a Trigger rate of USD1.4975/£1.00. A realized loss of \$251,055 has been recognized on the contract for the quarter ended March 31, 2010. The projected strengthening of the US Dollar for the remainder of the contract has resulted in an unrealized loss of \$1,703,834 as at March 31, 2010. If the US\$ had increased by \$1 (USD2.50/£1.00) in the quarter ended March 31, 2010 then the profit for the quarter would have been lower by \$7.5 million, but due to hedging, this exposure would have been limited to \$0.5 million.

#### *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. It should be noted that the Corporation has entered in to a five year marketing agreement with BP Oil International Limited to sell all of its North Sea oil production.

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, 2010 substantially all accounts receivables are current, being defined as less than 90 days, and have been paid as at the date of completion of these financial statements.

The Corporation may be exposed to certain losses in the event that counterparties to derivative financial instruments are unable to meet the terms of the contracts. The company’s exposure is limited to those counterparties holding derivative contracts with positive fair values at the reporting date. At March 31, 2010, the Corporation’s has no exposure, due to the unrealized loss position (December 31, 2009: \$685,355).

The Corporation also has credit risk arising from cash and cash equivalents held with banks and financial institutions. The maximum credit exposure associated with financial assets is the carrying values.

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, 2010, substantially all accounts payable are current.

The following table shows the timing of cash outflows relating to trade and other payables.

|                                   | <b>Within 1 year</b> | <b>1 to 5 years</b> |
|-----------------------------------|----------------------|---------------------|
|                                   | <b>US\$</b>          | <b>US\$</b>         |
| Accounts payable                  | 37,436,649           | -                   |
| Foreign exchange forward contract | 1,703,834            | -                   |
| Long term liability               | -                    | 2,533,623           |
| <b>Total</b>                      | <b>39,140,483</b>    | <b>2,533,623</b>    |

## 12. FAIR VALUES OF FINANCIAL ASSETS AND LIABILITIES

Financial instruments of the Company consist mainly of cash and cash equivalents, receivables, payables, loans and financial derivative contracts, all of which are included in these financial statements. At March 31, 2010, the classification of financial instruments and the carrying amounts reported on the balance sheet and their estimated fair values are as follows:

|   | <b>March 31, 2010</b>  |                    | <b>December 31, 2009</b> |                    |
|---|------------------------|--------------------|--------------------------|--------------------|
|   | <b>US\$</b>            |                    | <b>US\$</b>              |                    |
| <b>Classification</b>                                 | <b>Carrying Amount</b> | <b>Fair Value</b>  | <b>Carrying Amount</b>   | <b>Fair Value</b>  |
| Cash and cash equivalents (Held for trading)          | 20,084,099             | 20,084,099         | 29,886,359               | 29,886,359         |
| Restricted cash (Held for trading)                    | 334,535                | 334,535            | 5,575,935                | 5,575,935          |
| Foreign exchange forward contract (Held for trading)  | (1,703,834)            | (1,703,834)        | 685,355                  | 685,355            |
| Accounts receivable - current (Loans and Receivables) | 81,194,150             | 81,194,150         | 67,166,377               | 67,166,377         |
| Commodity hedge (Held for trading)                    | -                      | -                  | 396,780                  | 396,780            |
| Long Term Liability (Held for trading)                | 2,533,623              | 2,533,623          | 2,718,027                | 2,718,027          |
| Accounts payable (Other financial liabilities)        | 37,436,649             | 37,436,649         | 43,612,899               | 43,612,899         |
| <b>Total</b>  | <b>139,879,222</b>     | <b>139,879,222</b> | <b>150,041,732</b>       | <b>150,041,732</b> |

### 13. SUPPLEMENTAL INFORMATION

|                                     | <b>March 31,<br/>2010<br/>US\$</b> | <b>March 31,<br/>2009<br/>US\$</b> |
|-------------------------------------|------------------------------------|------------------------------------|
| Interest paid during the period     | -                                  | 980                                |
| Income taxes paid during the period | 33,971                             | 124,023                            |
| Total                               | 33,971                             | 125,003                            |

### 14. CAPITAL DISCLOSURE

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 definition of capital, the Corporation includes shareholders' equity, and working capital. Shareholders' equity includes share capital, contributed surplus, retained earnings or deficit and other comprehensive income.

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 expenditure programs.

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.

|                       | <b>March 31, 2010<br/>US\$</b> | <b>December 31,<br/>2009<br/>US\$</b> |
|-----------------------|--------------------------------|---------------------------------------|
| Debt                  | -                              | -                                     |
| Equity                | 261,009,938                    | 254,456,126                           |
| Debt as a % of Equity | N/A                            | N/A                                   |

On July 29, 2009 all debt was repaid and the Corporation is debt free with all security released.

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

**15. RELATED PARTY TRANSACTIONS**

A Director of the Corporation is a partner of Burstall Winger LLP who acts as counsel for the Corporation. The amount of fees paid to Burstall Winger LLP in the quarter ended March 31, 2010 was \$26,978 (March 31, 2009 - \$113,116). The balance outstanding at March 31, 2010 was \$Nil (March 31, 2009 - \$Nil). These amounts have been recorded at the exchange amount.

**16. SUBSEQUENT EVENTS**

On April 22, 2010, the Corporation mandated Bank of Scotland Plc, part of Lloyds Banking Group, as Lead Arranger for the provision of a US\$140 million Senior Secured Borrowing Base Facility to principally fund the development of the recently appraised Stella field and the satellite discoveries Harrier and Hurricane and/or fund future potential acquisitions of production properties in the North Sea. A Term Sheet has been agreed. Under the terms of the Mandate Letter the parties shall negotiate and finalize the Facility documents on or before June 30, 2010.

**17. CONTINGENT LIABILITY**

The Corporation is currently undergoing a VAT review by HMRC. The Corporation believes there are no liabilities arising out of the inspection which can be reasonably determined at this time.