

# 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>                         | (9,802,260)               | (13,960,205)              |
| <b>Cash and cash equivalents, beginning of period</b>                | 29,886,359                | 26,943,802                |
| <b>Cash and cash equivalents, end of period</b>                      | 20,084,099                | 12,983,597                |

# **Ithaca Energy Inc.**

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

Unaudited three months ended March 31, 2010

**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.

## Ithaca Energy Inc.

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Unaudited three months ended March 31, 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

## Ithaca Energy Inc.

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Unaudited three months ended March 31, 2010

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\$ |
|------------------------------|------------------------|---------------------------|
| Balance, beginning of period | 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)               |
| Balance, end of period       | 8,110,060              | 7,955,967                 |

# Ithaca Energy Inc.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Unaudited three months ended March 31, 2010

### 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<br>period | 15,307,877           | \$ 1.54                               | 11,042,875           | \$ 1.48                               |

## Ithaca Energy Inc.

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Unaudited three months ended March 31, 2010

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                       |

## Ithaca Energy Inc.

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Unaudited three months ended March 31, 2010

#### (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.

## Ithaca Energy Inc.

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Unaudited three months ended March 31, 2010

#### 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 | -         | -         | -         | -       | -                     |
| Total                        | 4,939,727 | 1,134,867 | 1,440,772 | 1,758,309 | 241,152 | 783,744               |

#### 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:

## Ithaca Energy Inc.

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Unaudited three months ended 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):

|   | March 31,<br>2010<br>US\$ | March 31,<br>2009<br>US\$ |
|---|---------------------------|---------------------------|
| 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

# Ithaca Energy Inc.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Unaudited three months ended March 31, 2010

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.

## Ithaca Energy Inc.

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Unaudited three months ended March 31, 2010

#### 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.

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

#### 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:

| Classification  | March 31, 2010<br>US\$ |             | December 31, 2009<br>US\$ |             |
|---|------------------------|-------------|---------------------------|-------------|
|   | Carrying Amount        | Fair Value  | Carrying Amount           | Fair Value  |
| 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  |
| Total   | 139,879,222            | 139,879,222 | 150,041,732               | 150,041,732 |

## Ithaca Energy Inc.

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Unaudited three months ended March 31, 2010

#### 13. SUPPLEMENTAL INFORMATION

|                                     | March 31,<br>2010<br>US\$ | March 31,<br>2009<br>US\$ |
|-------------------------------------|---------------------------|---------------------------|
| 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.

|                       | March 31, 2010<br>US\$ | December 31,<br>2009<br>US\$ |
|-----------------------|------------------------|------------------------------|
| 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.

## **Ithaca Energy Inc.**

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

Unaudited three months ended March 31, 2010

#### **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.