CONSOLIDATED FINANCIAL STATEMENTS OF

EXCELSIOR ENERGY LIMITED

FOR THE YEARS ENDED
DECEMBER 31, 2008 AND DECEMBER 31, 2007

AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the consolidated balance sheets of Excelsior Energy Limited as at December 31, 2008 and 2007 and the consolidated statements of operations, comprehensive loss and deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2008 and 2007 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

(Signed) "*KPMG LLP*"
Chartered Accountants

Calgary, Canada
April 22, 2009

EXCELSIOR ENERGY LIMITED

CONSOLIDATED BALANCE SHEETS

As at December 31,	**2008**	2007
ASSETS		
Current		
Cash and cash equivalents	**$ 13,748,057**	$ 15,848,648
Accounts receivable	**427,548**	436,288
Prepaids and deposits	**48,724**	47,995
	14,224,329	16,332,931
Petroleum and natural gas properties (note 6)	**65,064,068**	51,113,122
Property and equipment (note 7)	**23,135**	26,478
	$ 79,311,532	$ 67,472,531
LIABILITIES		
Current		
Accounts payable and accrued liabilities	**$ 2,745,131**	$ 1,995,125
Future income tax liability (note 15)	**3,216,483**	-
Asset retirement obligations (note 8)	**8,129**	5,059
Non-controlling interest (note 9)	**278,423**	-
	6,248,166	2,000,184
SHAREHOLDERS' EQUITY		
Share capital (note 13)	**77,863,071**	70,181,826
Contributed surplus (note 13)	**8,882,893**	4,219,879
Warrants (note 13)	**27,447**	1,379,606
Deficit	**(13,710,045)**	(10,308,964)
	73,063,366	65,472,347
	$ 79,311,532	$ 67,472,531

Future operations (note 2)
Commitments and contingencies (notes 5, 13 & 18)
Subsequent events (note 19)
See accompanying notes to the consolidated financial statements.

Approved on behalf of the Board

(Signed) *"James Howe"*
James Howe, Director

(Signed) *"David A. Winter"*
David A. Winter, Director

EXCELSIOR ENERGY LIMITED

CONSOLIDATED STATEMENTS OF OPERATIONS, COMPREHENSIVE LOSS AND DEFICIT

For the years ended December 31,	2008	2007
REVENUE		
Gas revenue	**$ 108,001**	$ 76,335
Royalties	**(16,496)**	(16,585)
Interest and other income	**317,672**	374,764
	409,177	434,514
EXPENSES AND OTHER INCOME		
Operating expenses	**35,102**	19,115
General and administrative	**1,537,808**	1,232,441
Stock-based compensation (note 13)	**3,283,408**	3,967,164
Depreciation, depletion and accretion	**259,751**	157,115
Gain on reorganization of North Sea Assets (note 9)	**(614,544)**	-
Foreign currency translation gain	**(4,857)**	-
	4,496,668	5,375,835
Loss before income taxes and non-controlling interest	**(4,087,491)**	(4,941,321)
Future income tax reduction (note 15)	**666,445**	-
Loss before non-controlling interest	**(3,421,046)**	(4,941,321)
Non-controlling interest (note 9)	**19,965**	-
NET LOSS AND COMPREHENSIVE LOSS	**(3,401,081)**	(4,941,321)
Deficit, beginning of year	**(10,308,964)**	(5,367,643)
DEFICIT, end of year	**(13,710,045)**	$(10,308,964)
Loss per share		
Basic and diluted (note 14)	$ (0.03)	$ (0.07)

See accompanying notes to the consolidated financial statements.

EXCELSIOR ENERGY LIMITED

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the years ended December 31,	**2008**	2007
CASH FLOWS FROM (USED IN) OPERATING ACTIVITIES		
Net loss and comprehensive loss for the year	**$ (3,401,081)**	$ (4,941,321)
Items not affecting cash		
Depreciation, depletion and accretion	**259,751**	157,115
Stock-based compensation	**3,283,408**	3,967,164
Gain on sale of marketable securities	**-**	(4,660)
Gain on reorganization of North Sea assets	**(614,544)**	-
Non-controlling interest	**(19,965)**	-
Future income tax reduction	**(666,445)**	-
Foreign currency translation gain	**(4,857)**	-
	(1,163,733)	(821,702)
Changes in non-cash working capital items (note 16)	**76,876**	(201,838)
	(1,086,857)	(1,023,540)
CASH FLOWS FROM (USED IN) INVESTING ACTIVITIES		
Expenditures on petroleum and natural gas properties	**(14,285,031)**	(32,472,009)
Expenditures on property and equipment	**-**	(9,817)
Expenditures on furniture and fixtures	**(6,321)**	-
Proceeds from sale of marketable securities	**-**	6,670
Net cash received from acquisition of PrivateCo (note 5)	**-**	1,141,230
Changes in non-cash working capital items (note 16)	**693,978**	1,641,660
	(13,597,374)	(29,692,266)
CASH FLOWS FROM (USED IN) FINANCING ACTIVITIES		
Issuance of share capital, net of issue costs	**11,591,620**	42,554,517
Issuance of shares by subsidiary (note 9)	**1,000,000**	-
Changes in non-cash working capital items (note 16)	**(7,980)**	43,980
	12,583,640	42,598,497
CHANGE IN CASH AND CASH EQUIVALENTS	**(2,100,591)**	11,882,691
CASH and cash equivalents, beginning of year	**15,848,648**	3,965,957
CASH and cash equivalents, end of year	**$ 13,748,057**	$ 15,848,648
Cash and cash equivalents consist of		
Cash	**$ 598,057**	$ 222,017
Guaranteed investment certificates with Canadian chartered banks	**13,150,000**	15,626,631
	$ 13,748,057	$ 15,848,648

See accompanying notes to the consolidated financial statements.

1. NATURE OF OPERATIONS

Excelsior Energy Limited ("Excelsior" or the "Company") is a development stage enterprise active in oil sands exploration, development and appraisal in the Hangingstone ("Hangingstone Asset" or "Hangingstone") and West Surmont ("Surmont Asset" or "Surmont") areas near Fort McMurray, Alberta and exploration in the UK North Sea. The Company also holds a minor interest in a producing gas well in Alberta. The Company's purpose is to develop, extract and sell bitumen from oil sands deposits in Alberta and develop, extract and sell oil from the UK North Sea.

The Hangingstone Asset consists of a 39 section block which Excelsior operates and has a 75% working interest ownership. The exploration and development activity at Hangingstone supports the Company's plan to submit an experimental in situ combustion pilot project application with regulatory authorities in 2009. Excelsior investigated various bitumen recovery mechanisms and developed an in situ combustion process that could potentially reduce the large requirements for capital, fuel gas and process water associated with existing thermal recovery practices. It is anticipated regulatory approval will require approximately one year. Upon receipt of regulatory approval the Company will commence implementation and commissioning of the pilot in the first quarter of 2011 with expected bitumen production in 2011. The Surmont Asset consists of an 18 section block which Excelsior operates and has a 64.3% working interest ownership and one section with 75% ownership. The exploration activity is still underway at Surmont with further delineation required to support a pilot project. Excelsior does not have production revenue from its oil sands assets.

The Company indirectly owns 75% of Excelsior Energy North Sea Limited ("EENS"), a company incorporated under the laws of Scotland. EENS is active in exploration in the United Kingdom Continental Shelf ("UKCS") holding a 100% working interest in Blocks 16/1a and 16/6c in the UK North Sea. EENS has completed seismic reprocessing and interpretation on the blocks and is required to determine whether it will undertake drilling activity by November 30, 2009 or forfeit the licence. EENS does not have production in its North Sea property.

2. FUTURE OPERATIONS

These financial statements are prepared on the assumption that the Company will continue as a going concern and realize its assets and discharge its liabilities in the normal course of business. The Company has working capital of $11.5 million; however, the Company continues to incur operating losses, use cash resources to support operations and has flow through and drilling commitments (note 18). The recoverability of the amounts shown for oil and gas assets is dependent upon the ability of the Company to obtain financing necessary to complete the exploration and development and the discovery of economically recoverable oil and gas resources. If the going concern assumption is inappropriate, adjustments would be necessary to the carrying values of assets and liabilities, reported revenues and expenses, and the balance sheet classifications used in the consolidated financial statements.

3. SIGNIFICANT ACCOUNTING POLICIES

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles. These consolidated financial statements have, in management's opinion, been prepared within the framework of the accounting policies summarized as follows:

Principles of consolidation

The consolidated financial statements include the accounts of the Company and its 75% ownership of ENS Energy Ltd. ("ENS") which has a wholly owned subsidiary - EENS. All intercompany accounts and transactions have been eliminated.

Use of estimates

Timely preparation of the financial statements in conformity with Canadian generally accepted accounting principles requires that management make estimates and assumptions and use judgment regarding assets, liabilities, revenues and expenses. Such estimates primarily relate to unsettled transactions and events as of the date of the financial statements. Accordingly, actual results may differ from estimated amounts as future confirming events occur.

Amounts recorded for depletion and amounts used for asset impairment calculations are based on estimates of oil and natural gas reserves, future commodity prices, cash flows and costs required to develop these reserves.

The estimate related to asset retirement obligations requires estimates of the amount and timing of future abandonment liabilities, inflation, and interest rates. The recognition of amounts in relation to stock-based compensation requires estimates related to valuation of stock options at the time of issuance. The determination of the Company's future income taxes and other tax liabilities requires interpretation of complex laws and regulations subject to audit and potential reassessment after the lapse of considerable time.

By their nature, these estimates are subject to measurement uncertainty and the effect of changes in such estimates on the financial statements of current and future periods could be material.

Cash and cash equivalents

Cash and cash equivalents include cash and bank balances and short term deposits with original maturities of less than three months or redeemable on demand.

Petroleum and natural gas properties

The Company accounts for petroleum and natural gas activities using the full cost method of accounting whereby all costs in each country cost centre associated with the acquisition, exploration and development of petroleum and natural gas reserves are capitalized. Such costs include lease acquisition costs, geological and geophysical expenditures, lease rentals on non-productive properties, cost of drilling both productive and non-productive wells including production equipment and processing facilities, pre-operating costs and direct administrative expenses. Proceeds received from

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

Petroleum and natural gas properties (continued)

disposal of oil and gas properties will be credited against the accumulated costs and no gain or loss is recognized, except when the disposition results in a change in the depletion rate by more than 20%.

Costs of acquiring and evaluating unproved properties are initially excluded from the costs subject to the depletion calculation. These properties are assessed periodically for impairment. When proved reserves are assigned or the property is considered to be impaired, the cost of the property or the amount of impairment is added to the costs subject to depletion.

An impairment loss is recognized when the carrying amount of oil and gas assets in a cost centre is not recoverable and exceeds its fair value. The carrying amount is assessed as recoverable when the sum of the undiscounted cash flows expected from proved reserves plus the cost of unproved properties, net of impairments, exceeds the carrying amount of the assets. When the carrying amount is assessed not to be recoverable, an impairment loss is recognized to the extent that the carrying amount of the assets exceeds the sum of the discounted cash flows from proved and probable reserves plus the cost of unproved properties, net of impairments. The cash flows are estimated using expected future product prices and costs and are discounted using a risk-free interest rate.

Depletion of petroleum and natural gas properties is provided using the unit-of-production method based upon estimated net proven petroleum and natural gas reserves before the deduction of royalties as determined by independent engineers. For depletion purposes, relative volumes of petroleum and natural gas production and reserves are converted to a common unit of measurement on the basis of their relative energy content where six thousand cubic feet of gas equates to one barrel of oil.

Property and equipment

Property and equipment are stated at cost less accumulated depreciation. Depreciation is provided for over the estimated useful lives of the asset using the declining balance method at the following rates:

Furniture and equipment	20%
Computer equipment	30%
Computer software	100%

Future income taxes

The Company follows the asset and liability method of accounting for income taxes. Under this method, future income tax assets and liabilities are determined based on differences between financial reporting and income tax bases of assets and liabilities, and are measured using the substantively enacted tax rates and laws that will be in effect when the differences are expected to reverse. The effect on future income tax assets and liabilities of a change in tax rates is recognized in net income in the period in which the change occurs. To the extent that the Company does not consider it more likely than not that a future income tax asset will be recovered, it provides a valuation allowance against the excess.

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

Asset retirement obligations

The Company records the fair value of an asset retirement obligation as a liability in the period which it incurs a legal obligation associated with the retirement of long-lived tangible assets that result from the acquisition, construction, and development of the assets. The associated asset retirement costs are capitalized as part of the carrying amount of the related long-lived assets. They are depleted and depreciated using a unit-of-production method over the life of the estimated gross proved reserves. Subsequent to the initial measurement of the asset retirement obligation, the obligations are adjusted at the end of each period to reflect the passage of time and changes in the estimated future cash flows underlying the obligation.

Stock-based compensation

The Company accounts for its stock-based compensation plan using the fair value method. Under the fair value method, compensation expense is recorded based on the fair value of the stock options and warrants at the date of grant as estimated using the Black-Scholes option pricing model. The amount of compensation cost so determined is credited to contributed surplus or warrants. Upon exercise of the options, the consideration received together with the amount previously recognized in contributed surplus is credited to share capital.

Joint operations

A portion of the Company’s exploration, development and production activities are conducted jointly with others and, accordingly, these consolidated financial statements reflect only the Company’s proportionate interest in such activities.

Flow-through common shares

The resource expenditure deductions for income tax purposes related to exploration and development activities funded by flow-through share arrangements are renounced to shareholders. To recognize the forgone tax benefits to the Company, the carrying value of the shares issued is reduced by the tax effect when the tax benefits are renounced to shareholders.

Foreign currency translation

The Company’s foreign subsidiary has integrated operations and a Canadian dollar functional currency. The Company uses the temporal method when translating foreign currency transactions and the financial statements of its integrated subsidiary. Under this method, monetary items denominated in a foreign currency are translated into Canadian dollars at the rate of exchange in effect at the balance sheet date and non-monetary items are translated at rates of exchange in effect when the assets were acquired or obligations incurred. Revenues and expenses are translated at historical exchange rates. Foreign exchange gains and losses are included in the determination of earnings or losses.

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

Revenue recognition

Revenue from the sale of petroleum and natural gas is recognized on volumes delivered to customers. Delivery occurs when the customer has taken title and has assumed the risks and rewards of ownership, prices are fixed or determinable and collectibility is reasonably assured.

Per share information

The Company uses the treasury stock method to determine the dilutive effect of stock options and other dilutive instruments. The treasury method assumes that proceeds received from the exercise of in-the-money stock options and warrants are used to repurchase common shares at the average price during the period. Basic earnings per share are computed by dividing the net income by the weighted average number of common shares outstanding for the period. Diluted per share amounts reflect the potential dilution that could occur if the securities or other contracts to issue common shares were exercised or converted to common shares.

Financial instruments

All financial instruments are initially measured on the balance sheet at fair value. Subsequent measurement of financial assets and liabilities except those held-for-trading and available for sale are measured at amortized cost determined using the effective interest rate method. Held-for-trading financial assets are measured at fair value with changes in fair value recognized in earnings. Available-for sale financial assets are measured at fair value with changes in fair value recognized in comprehensive income and reclassified to earnings when impaired.

Cash and cash equivalents are held-for-trading and the fair values approximate their carrying value due to their short-term nature. Accounts receivable are classified as loans and receivables and the fair values approximate their carrying value due to the short-term nature of these instruments. They are recorded at cost, which upon their initial measurement is equal to their fair value. Subsequent measures of accounts receivable are recorded at amortized cost, which is generally the amount on initial recognition less an allowance for doubtful accounts. Accounts payable and accrued liabilities are classified as other financial liabilities and the fair values approximate their carrying value due to the short-term nature of these instruments.

The Company has elected to expense transaction costs as incurred.

4. CHANGES IN ACCOUNTING POLICIES

Capital disclosure

On January 1, 2008, the Company prospectively adopted the new CICA accounting standard – Section 1535, Capital Disclosures which establishes standards for disclosing information about an entity's objectives, policies and processes for managing its capital structure. The disclosures have been included in note 10.

Financial instruments - disclosures and presentation

On January 1, 2008, the Company prospectively adopted the following new standards: Financial Instruments – Disclosure and Financial Instruments – Presentation (Sections 3862 and 3863 issued by the CICA). The disclosures provide additional information on the risks associated with financial instruments and how to manage those risks. The additional disclosures required by these standards are provided in note 12.

New accounting standards

a) Goodwill and intangible assets

In February 2008, the Accounting Standards Board ("AcSB") issued Section 3064, *Goodwill and Intangible Assets*, and amended Section 1000, *Financial Statement Concepts*, clarifying the criteria for the recognition of assets, intangible assets and internally developed intangible assets. The standard is effective for fiscal years beginning on or after October 1, 2008. The Company is currently evaluating the impact these sections will have on its consolidated financial statements.

b) Non controlling interests

In December 2008, Canadian accounting standard setters issued Sections 1601, Business Combinations, and 1602, Non-Controlling Interests. Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 provides guidance on accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. These standards are effective for fiscal years beginning on or after January 1, 2011. The Company is currently evaluating the impact of this standard on its consolidated financial statements.

c) International financial reporting standards

In February 2008, Canadian accounting standard setters announced that International Financial Reporting Standards will replace Canada's current Generally Accepted Accounting Principles ("GAAP") for all publicly accountable profit-oriented enterprises for fiscal years beginning on or after January 1, 2011. The eventual changeover to IFRS represents changes due to new accounting standards. The transition from current Canadian GAAP to IFRS is a significant undertaking that may materially affect the Company's reported financial position and results of operations.

5. ACQUISITION OF PRIVATECO

On July 13, 2007, the Company acquired 1250162 Alberta Ltd. ("PrivateCo") pursuant to a share purchase agreement. PrivateCo's net assets consisted primarily of a right to earn a 22.5% working interest in the Hangingstone Asset. The PrivateCo acquisition increased the Company's working interest to 75%, after fulfilling its farm-in earning obligations in March 2007. In addition to its Hangingstone interest, PrivateCo had $1,200,398 in working capital at the closing date. The transaction contemplates the issuance of up to 16,000,000 common shares of the Company. At closing, the Company issued 10,000,000 common shares to acquire all the common shares of PrivateCo. Up to an additional 6,000,000 common shares of the Company will be issued upon certain reserves performance thresholds being met. As at December 31, 2008, no amount has been recorded for the contingent consideration of 6,000,000 common shares as the occurrence of the future event is not determinable and a reasonable estimate can not be made.

The transaction has been accounted for as a net asset purchase. The purchase price of PrivateCo was based on the fair value of the consideration provided and was allocated as follows:

Net Assets Acquired	
Cash and cash equivalents	$ 1,181,084
Accounts receivable	19,314
Petroleum and natural gas properties	9,899,602
	$ 11,100,000

Purchase Price Consideration	
10,000,000 common shares issued	$ 11,060,146
Costs of acquisition	39,854
	$ 11,100,000

6. PETROLEUM AND NATURAL GAS PROPERTIES

			2008	2007
	Cost	**Accumulated Depletion and Depreciation**	**Net**	Net
Canada	**$ 65,587,558**	**$ 882,914**	**$ 64,704,644**	$ 50,919,570
North Sea	**1,895,943**	**1,536,519**	**359,424**	193,552
	$ 67,483,501	**$ 2,419,433**	**$ 65,064,068**	$ 51,113,122

In 2008, the Company incurred capital expenditures of $14,033,531 (2007 - $50,656,577) on the Hangingstone and Surmont properties. No overhead charges have been capitalized to petroleum and natural gas properties.

Costs for unproven properties in the amount of $65,064,068 (2007 - $50,850,129) were excluded from the costs subject to depletion and depreciation, representing accumulated costs incurred at Hangingstone, Surmont and in the North Sea.

6. PETROLEUM AND NATURAL GAS PROPERTIES (continued)

The Company performed a ceiling test calculation at December 31, 2008 for the producing gas property which resulted in an impairment of $172,157 (2007 - $101,521). The impairment has been included in depreciation, depletion and accretion in the statement of operations. The future prices used in the ceiling test were based on December 31, 2008 commodity price forecasts of the Company's independent reserve evaluators, adjusted for the Company's quality differentials. The following table summarizes the future benchmark prices used in the December 31, 2008 reserve report:

	Alberta AECO-C Spot Price $/Mcf
2009	6.82
2010	7.56
2011	7.84
2012	8.38
2013	9.20

Prices will escalate at approximately 2.0% (2007 – 2.2%) per annum thereafter.

7. PROPERTY AND EQUIPMENT

			2008	2007
	Cost	**Accumulated Depreciation**	**Net**	Net
Furniture and equipment	**$ 16,686**	**$ 4,736**	**$ 11,950**	$ 10,473
Computer equipment	**21,943**	**10,956**	**10,987**	12,726
Computer software	**11,098**	**10,900**	**198**	3,279
	$ 49,727	**$ 26,592**	**$ 23,135**	$ 26,478

8. ASSET RETIREMENT OBLIGATIONS

The following table presents the changes in the asset retirement obligations associated with the retirement of oil and gas properties.

	2008	2007
Asset retirement obligations, beginning of year	**$ 5,059**	$ 4,707
Revisions	**1,440**	-
Accretion expense	**1,630**	352
Asset retirement obligations, end of year	**$ 8,129**	$ 5,059

The Company has estimated the total undiscounted amount required to settle the asset retirement obligations to be $8,688 (2007 - $11,760). These obligations will be settled at the end of the useful life of the underlying asset, which currently extends up to 3 years into the future. This amount has been discounted using a credit-adjusted risk-free interest rate of 7.5% (2007 – 7.5%) and an inflation rate of 2.79% (2007 – 2.79%).

9. REORGANIZATION OF NORTH SEA ASSETS

In April 2008, the Company restructured its holding in its subsidiary, EENS. Excelsior incorporated a subsidiary ENS Energy Ltd. ("ENS"), and exchanged all of the common shares of EENS for 12,000,000 common shares of ENS. Subsequent to the restructuring, ENS closed a $1.0 million private placement equity financing consisting of common shares and common share purchase warrants. The financing had the effect of reducing the Company's interest in ENS from 100% to 75% as Excelsior did not participate in the financing. The 25% reduction in its holding resulted in a dilution gain to the Company of $614,544 and a reduction of petroleum and natural gas properties of $87,068, relating to the Company's North Sea assets. The balance of $278,423 at December 31, 2008 represents the non-controlling interest's share of the net assets of ENS.

10. CAPITAL MANAGEMENT

The Company's objective for managing its capital structure is to ensure it has the financial capacity, liquidity and flexibility to fund its investment in its unconventional resources.

The Company considers its capital structure to include shareholders' equity. The Company's oil sands property requires significant capital investment prior to cash flow generation. At this early stage of its oil sands development, the Company's access to debt is limited and it relies on equity issuances to fund capital investments.

The Company monitors capital to maintain a sufficient working capital position to fund annualized administrative expenses and capital investments. The Company prepares annual capital expenditure budgets which are updated as necessary depending on varying factors including successful capital deployment, current and forecast prices and general industry conditions. The Company will issue shares and may from time to time adjust its capital spending to maintain or adjust the capital structure.

The Company's working capital is calculated as follows:

	2008	2007
Cash and cash equivalents	**$ 13,748,057**	$ 15,848,648
Non cash current assets	**476,272**	484,283
Current liabilities	**(2,745,131)**	(1,995,125)
Net working capital	**$ 11,479,198**	$ 14,337,806

The Company's share capital is not subject to external restrictions. The Company has not paid or declared any dividends since the date of incorporation, nor are any contemplated in the foreseeable future.

There were no changes in the Company's approach to capital management during the year ended December 31, 2008.

11. FINANCIAL INSTRUMENTS

Financial instruments of the Company include cash and cash equivalents, accounts receivable and accounts payable and accrued liabilities. The fair value of cash and cash equivalents, accounts receivable and accounts payable and accrued liabilities approximate their carrying amounts due to their short-terms to maturity.

12. FINANCIAL RISK MANAGEMENT

Overview

The Company has exposure to the following risks from its use of financial instruments:

- Credit risk
- Liquidity risk
- Market risk

The Company's risk management policies are established to identify and analyze the risks faced by the Company, to set appropriate risk limits and controls, and to monitor risks and adherence to market conditions and the Company's activities.

Credit risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Company's receivables from joint interest partners. As at December 31, 2008 the Company's receivables included $24,248 (December 31, 2007 - $15,307) from joint interest partners and $81,404 (December 31, 2007 - $57,527) of other trade receivables.

The Company receives its gas revenue from its non-operated property from a joint interest partner typically within one to three months of the joint interest bill being issued. The Company historically has not experienced any collection issues with its joint interest partner. Joint interest receivables for operations where the Company is the operator are typically collected within one to three months of the joint interest bill being issued to the partner. The Company attempts to mitigate the risk from joint interest receivables by obtaining partner approval of significant capital expenditures prior to expenditure. However, the receivables are from participants in the petroleum and natural gas sector, and collection of the outstanding balances is dependent on industry factors such as commodity price fluctuations, escalating costs and the risk of unsuccessful drilling. In addition, further risk exists with joint interest partners as disagreements occasionally arise that increase the potential for non-collection. The Company does not typically obtain collateral from petroleum and natural gas marketers or joint interest partners; however the Company will request a cash call advance for major projects before commencing operations.

12. FINANCIAL RISK MANAGEMENT (continued)

Credit risk (continued)

The carrying amount of accounts receivable and cash and cash equivalents represents the maximum credit exposure. The Company does not have an allowance for doubtful accounts as at December 31, 2008 and 2007 and did not provide for any doubtful accounts. The Company wrote-off $32,674 of receivables during the year ended December 31, 2008 (2007 - $17,499). The Company's receivables from joint interest partners and other trade receivables as at December 31, 2008 are analyzed in the table below:

Joint interest partners and other trade receivables	
Neither impaired no past due	$ 81,404
Not impaired and past due in the following period	
Within 30 days	23,668
31-60 days	580
61-90 days	-
Over 90 days	-

Cash and cash equivalents consist of cash and bank balances and short-term deposits with original maturity of less than 90 days or redeemable on demand. The Company manages the credit exposure related to short-term investments by selecting guaranteed investment certificates, avoiding complex investment vehicles with higher risk such as asset backed commercial paper.

Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they are due. The Company's approach to managing liquidity is to ensure, as far as possible, that it will have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions without incurring unacceptable losses or risking harm to the Company's reputation.

The Company prepares annual capital expenditure budgets, which are regularly monitored and updated as considered necessary. Further, the Company utilizes authorizations for expenditures on both operated and non-operated projects to further manager capital expenditures. To facilitate its capital expenditure program the Company uses equity financing. The Company's financial obligations relate to accounts payable and accrued liabilities which are due in 2009.

Market risk

Market risk is the risk that changes in market prices, such as foreign exchange rates, commodity prices, and interest rates will affect the Company's net earnings or the value of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable limits, while maximizing returns.

The Company has minimal exposure to market risk as it has no debt or significant production and has minimal activity in the U.K. North Sea. The Company has not utilized any financial instruments to manage exposure to changes in interest rates, commodity prices or foreign exchange rates.

13. SHARE CAPITAL

a) Authorized

Unlimited number of common voting shares
Unlimited number of preferred shares issuable in series

b) Changes in share capital

	Number	Amount
Balance January 1, 2007	27,336,768	$ 9,602,706
Common shares issued for cash, net of issue costs (note 13b i)	9,293,332	2,867,133
Common shares issued for Hangingstone property, net of issue costs (note 13b ii)	8,647,359	7,900,195
Issued for finder's fee on Hangingstone property (note 13b iii)	500,000	412,000
Issued on exercise of warrants	145,249	142,009
Transfer of fair value on exercise of warrants	-	15,180
Common shares issued for cash, net of issue costs (note 13b iv)	39,385,000	31,589,754
Issued to acquire PrivateCo, net of issue costs (note 5)	10,000,000	11,060,146
Issued on exercise of options	107,683	29,669
Transfer from contributed surplus on exercise of options	-	14,787
Common shares issued for cash, net of issue costs (note 13b v)	11,104,000	6,548,247
Balance December 31, 2007	106,519,391	70,181,826
Common shares, net of issue costs (note 13b vi)	2,305,500	1,112,048
Tax effect of flow through shares issued in 2007	-	(4,106,450)
Common shares, net of issue costs (note 13b vii)	34,235,699	10,675,647
Balance December 31, 2008	**143,060,590**	**$ 77,863,071**

(i) In March 2007, the Company closed a non-brokered private placement issuing 6,275,332 common shares at $0.30 per share and 3,018,000 flow-through common shares at $0.40 per share for proceeds after issue costs of $2,867,133. The Company has commitments to incur and renounce $1,207,200 of eligible expenditures by December 31, 2008.

(ii) In February 2007, the Company executed a farm-in agreement to earn up to 52.5% interest in the Hangingstone oil sands property. The Company made an initial payment of $1,400,000 cash and issued 2,333,333 common shares priced at $0.41 per share to satisfy the initial consideration. These common shares were issued in May 2007. The Company issued an additional 6,314,026 common shares at $1.10 per share in June, 2007, pursuant to the farm-in agreement, for an additional working interest in the Hangingstone asset.

(iii) The Company issued 500,000 common shares as a finder's fee for the Hangingstone oil sands property. 200,000 common shares at $0.41 per share were issued upon signing the farm-in agreement for the Hangingstone property and an additional 300,000 common shares at $1.10 per share were issued when the Company elected to earn an additional working interest in the Hangingstone property for gross proceeds of $412,000.

13. SHARE CAPITAL (continued)

b) Changes in share capital (continued)

(iv) The Company completed a private placement for gross proceeds of $35,001,250 on June 25, 2007. The private placement comprised of 31,765,000 units issued at a subscription price of $0.85 per unit and 7,620,000 flow through common shares at a price of $1.05 per flow-through share. The Company had commitments to incur and renounce $8,001,000 of eligible expenditures by December 31, 2008 (note 18). Each unit is comprised of one common share in the capital of the Company and one common share purchase warrant (a “Warrant”) of the Company, with each Warrant entitling the holder thereof to acquire an additional 0.05 common share at no additional cost should the common shares of the Company not be listed and posted for trading on the TSX Venture Exchange on or before the expiration of 120 days from the closing of the private placement, being October 23, 2007 (see note 13d). The brokers were also issued warrants to purchase 2,260,620 common shares at a price of $1.00 per share. These warrants were assessed a fair value of $1,256,905 (see note 13d). Net proceeds after issue costs were $31,589,754.

(v) The Company completed a private placement for gross proceeds of $7,217,600 on December 12, 2007. The private placement comprised of 11,104,000 common shares issued on a flow-through basis at a price of $0.65 per flow-through share. The Company had commitments to incur and renounce $7,217,600 of eligible expenditures by December 31, 2008 (note 18). The brokers were also issued warrants to purchase 656,190 common shares at a price of $0.75 per share. These warrants were assessed a fair value of $122,701 (see note 13d). Net proceeds after issue costs and fair value of warrants were $6,548,247.

(vi) In January 2008, the Company closed the second tranche of a December 2007 private placement issuing 2,305,500 common shares at $0.52 per share. The brokers were issued warrants to purchase 138,330 common shares at a price of $0.75 per share. These warrants were assessed a fair value of $27,447 (see note 13d). Issue costs, net of future income taxes of $19,789, were $59,365 resulting in net proceeds of $1,112,048.

(vii) In September 2008, the Company completed a private placement comprised of 7,065,799 common shares issued at a subscription price of $0.29 per share and 27,169,900 flow-through common shares at a price of $0.34 per flow-through share. The Company has a commitment to incur and renounce $9,237,766 of eligible expenditures by December 31, 2009. Issue costs, net of future income taxes of $203,733, were $611,200 resulting in net proceeds of $10,675,647.

13. SHARE CAPITAL (continued)

c) Stock options

The Company has established a stock option plan under which it may grant options to directors, officers, employees and service providers up to 10% of the issued and outstanding common shares. Stock options vest one-third at the time of grant, and one-third each on the first and second anniversaries of the grant date. Under this plan, stock options are granted with an exercise price equal to market at the date of the grant.

The Company used the Black Scholes pricing model to determine the fair value of the stock options granted using the following assumptions:

	2008	2007
Risk-free interest rate	**2.11%-3.29%**	3.89% – 4.72%
Expected life (years)	**5 years**	1 – 5 years
Expected volatility	**106%-122%**	113% – 143%
Dividend yield	**0%**	0%
Weighted average fair value per option	**$0.23**	$1.08
Forfeiture rate	**0%**	0%

	2008		2007	
	Number of Options	**Weighted Average Exercise Price**	Number of Options	Weighted Average Exercise Price
Outstanding, beginning of year	**7,462,825**	**$1.06**	1,399,341	0.25
Granted	**6,935,000**	**0.23**	6,275,010	1.22
Forfeited	**(858,826)**	**0.90**	(103,843)	0.36
Exercised	**-**	**-**	(107,683)	0.28
Cancelled	**(4,477,710)**	**1.44**	-	-
Outstanding, end of year	**9,061,289**	**$0.25**	7,462,825	$ 1.06

13. SHARE CAPITAL (continued)

c) Stock options (continued)

The following table summarizes the information about stock options outstanding and exercisable at December 31, 2008.

Exercise Price	Options Outstanding	Options Exercisable	Remaining Life (years)
$1.05	83,333	83,333	2.3
0.20	1,092,956	1,092,956	3.4
0.45	500,000	333,333	3.4
0.40	450,000	300,000	3.4
0.50	75,000	25,000	4.2
0.38	350,000	116,667	4.4
0.43	250,000	83,333	4.5
0.46	1,935,000	645,000	4.5
0.10	4,325,000	1,441,667	5.0
Total	9,061,289	4,121,289	

d) Warrants

The Company used the Black Scholes pricing model to determine the fair value of warrants issued using the following assumptions:

	2008	2007
Risk-free interest rate	**3.29%**	3.82% – 4.72%
Expected volatility	**122%**	117% – 143%
Expected life	**1 year**	1 year
Dividend yield	**nil**	nil
Weighted average fair value per warrant	**$0.20**	$0.47

	Warrants Outstanding	Amount
Balance, January 1, 2007	2,017,041	$ 126,806
Warrants issued	34,681,810	1,379,606
Transfer to share capital on exercise of warrants	(145,249)	(15,180)
Warrants expired	(33,636,792)	(111,626)
Balance, December 31, 2007	2,916,810	1,379,606
Warrants issued (note 13b vi)	138,330	27,447
Warrants expired	(2,916,810)	(1,379,606)
Balance, December 31, 2008	**138,330**	**$ 27,447**

13. SHARE CAPITAL (continued)

d) Warrants (continued)

The following table summarizes the warrants outstanding and exercisable at December 31, 2008.

Exercise Price	Warrants Outstanding	Warrants Exercisable	Expiry Date
0.75	138,330	138,330	January 2009

e) Contributed surplus

	2008	2007
Balance, beginning of period	**$ 4,219,879**	$ 155,876
Stock-based compensation	**3,283,408**	3,967,164
Fair value of expired warrants	**1,379,606**	111,626
Transfer to share capital on exercise of stock options	-	(14,787)
Balance, end of period	**$ 8,882,893**	$ 4,219,879

14. LOSS PER SHARE

Basic loss per common share is calculated using the weighted average number of shares outstanding during the year. The weighted average number of common shares outstanding is as follows:

	2008	2007
Basic and diluted weighted average number of common shares outstanding during the year	**119,986,718**	65,768,355

As the Company is in a net loss position, 8,599,955 common shares (2007 – 8,647,660) that would be issued on the exercise of stock options, warrants and issued on certain performance thresholds being met (note 18) have been excluded from the calculation as these are anti-dilutive in nature.

15. FUTURE INCOME TAXES

a) The components of future income tax balances are as follows:

	2008	2007
Non-capital losses	**$ 2,040,733**	$ 1,502,122
Share issue costs	**762,060**	778,147
Capital losses	**14,188**	14,188
Asset retirement obligations	**2,032**	1,265
Petroleum and natural gas properties and property and equipment	**(6,035,496)**	(1,974,470)
	(3,216,483)	321,252
Valuation allowance	**-**	(321,252)
	$(3,216,483)	$ -

b) The provision for income taxes recorded in the consolidated financial statements differs from the amount which would be obtained by applying the statutory income tax rate of 29.5% (2007 – 32.49%) to the loss for the year as follows:

	2008	2007
Loss before income taxes and non controlling interest	**$(4,087,491)**	$ (4,941,321)
Expected income tax reduction	**(1,205,810)**	$ (1,605,435)
Stock based compensation	**968,605**	1,288,932
Gain on reorganization of North Sea assets	**(181,290)**	-
Effective decrease in tax rate	**63,849**	912
Change in valuation allowance	**(321,252)**	362,361
Other	**9,453**	(46,770)
Future income tax reduction	**(666,445)**	$ -

For income tax purposes, the Company has $8,163,000 of non-capital losses from prior years which can be applied to reduce future years' taxable income. These losses expire from 2009 – 2028.

16. SUPPLEMENTAL CASH FLOW INFORMATION

Changes in non cash working capital:

	2008	2007
Operating activities		
Accounts receivable	**$ 30,725**	$ (248,036)
Prepaids and deposits	**(729)**	(47,995)
Accounts payable and accrued liabilities	**46,880**	94,193
	$ 76,876	$ (201,838)
Investing activities		
Accounts receivable	**$ (21,985)**	$ 19,314
Accounts payable and accrued liabilities	**715,963**	1,622,346
	$ 693,978	$ 1,641,660
Financing activities		
Accounts receivable	**$ -**	$ 36,000
Accounts payable and accrued liabilities	**(7,980)**	7,980
	$ (7,980)	$ 43,980

Interest income in the amount of $211,818 was received in the year ended December 31, 2008 (2007 - $327,372).

17. RELATED PARTY TRANSACTIONS

The Company utilizes the services of a law firm of which a director of the Company is a partner. During the year ended December 31, 2007, the Company recorded $35,851 as share issue costs and $2,815 in general and administrative expenses for legal fees with this firm.

The Company utilizes the services of a law firm of which a former officer of the Company is a partner. During the year ended December 31, 2007, the Company recorded $23,411 in general and administrative expenses and $14,207 in share issue costs for legal fees with this firm.

These transactions were in the normal course of business and were measured at the exchange amount agreed to by both the parties.

18. COMMITMENTS

The Company entered into a farmin agreement to acquire up to a 75% working interest in Surmont. The Company currently has a 64.3% working interest at Surmont and could earn up to 75% working interest by funding a nine core drilling program to a maximum of $6,750,000, by March 31, 2010. The Company has also agreed to pay a supplemental payment of $2,900,000 by March 31, 2011. This supplemental payment can be satisfied by funding the farmor’s 25% share of continuing operations at Hangingstone or Surmont. At December 31, 2008 the obligation under the supplemental payment totalled $2,273,000. With completion of the 2008/2009 winter drilling program in March 2009, the obligation under the supplemental bonus is approximately $300,000.

18. COMMITMENTS (continued)

The Company, through its subsidiary EENS, has licence P1500 in the UKCS. Under the terms of the licence, EENS is required to elect by November 30, 2009 to drill an exploratory well or relinquish the licence at no further cost. The budget to drill a well is estimated to be $16 million and will require ENS to issue equity or arrange alternate financing to fund the drilling commitment.

The Company has commitments to incur and renounce $16,425,800 of eligible expenditures, to subscribers of its flow through private placements, by December 31, 2008 and $9,237,766 of eligible expenditures by December 31, 2009. As at December 31, 2008, the Company had incurred approximately $18,080,000 of eligible expenditures.

The Company acquired PrivateCo pursuant to a share purchase agreement in 2007 (note 5). PrivateCo's net assets consisted primarily of a right to earn a 22.5% working interest in the Hangingstone oil sands asset. The share purchase agreement contemplates up to an additional 6,000,000 common shares of the Company to be issued upon certain reserves performance thresholds being met on the Hangingstone property prior to December 31, 2010. These performance thresholds were not met at December 31, 2008 and accordingly no common shares were issued.

The Company has committed to leasing office space in the aggregate amount of $108,108 over the next two years. Annual payments are as follows:

2009	$ 64,865
2010	43,243
	$ 108,108

19. SUBSEQUENT EVENTS

The Board of Directors of ENS Energy Ltd. approved the grant of 1,600,000 stock options to purchase common shares of ENS exercisable at $0.25 per share in February 2009.

The Company, through its subisidiary EENS, was awarded licence P1691 in the 25th bid round in the UKCS. EENS is required to acquire and reprocess seismic over the following two years and elect to drill an exploratory well by March 31, 2011 or relinquish the licence.

20. COMPARATIVE FIGURES

Certain comparative figures have been reclassified to conform with current years' presentation.