

**TWOCO PETROLEUMS LTD.**

**FINANCIAL STATEMENTS**

**MARCH 31, 2009**

### Notice to Reader

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The accompanying unaudited interim financial statements of Twoco Petroleums Ltd. for the quarter ended March 31, 2009 have been prepared by management and approved by the Board of Directors of the Company. These statements have not been reviewed by Twoco Petroleums Ltd.'s external auditors.

Dated May 27, 2009

**On behalf of Twoco Petroleums Ltd.**

(signed) "Wayne A. Malinowski"  
Wayne A. Malinowski  
President

(signed) "Tim Bashforth"  
Tim Bashforth  
Secretary and Treasurer

**TWOCO PETROLEUMS LTD.**

**Balance Sheets**  
(unaudited)

	March 31, 2009 <u>(unaudited)</u>	December 31, 2008 <u>(audited)</u>
<b>Assets</b>		
Current assets		
Accounts receivable	\$ 1,143,483	\$ 2,007,891
Prepaid expenses and deposits	<u>601,784</u>	<u>618,960</u>
	1,745,267	2,626,851
Property, plant and equipment	<u>58,411,157</u>	<u>61,371,471</u>
	<u>\$ 60,156,424</u>	<u>\$ 63,998,322</u>
<b>Liabilities</b>		
Current liabilities		
Bank indebtedness and credit facility (note 7)	\$ 19,376,172	\$ 16,238,749
Accounts payable and accrued liabilities	1,332,689	2,622,449
Current portion of capital lease obligation	300,639	320,819
Convertible debentures (notes 5)	<u>-</u>	<u>11,968,135</u>
	21,009,500	31,150,152
Obligations under capital leases	181,993	219,011
Unsecured debentures (note 4)	8,150,650	-
Asset retirement obligations (note 6)	3,504,410	3,455,960
Future income taxes	<u>3,954,000</u>	<u>4,677,000</u>
	<u>36,800,553</u>	<u>39,502,123</u>
<b>Shareholders' Equity</b>		
Share capital (note 8)	20,182,041	20,216,621
Equity portion of convertible debentures (note 5)	-	160,000
Warrants on unsecured debentures (note 4)	20,750	-
Contributed surplus (note 9)	1,039,085	874,904
Retained earnings	<u>2,113,995</u>	<u>3,244,674</u>
	<u>23,355,871</u>	<u>24,496,199</u>
	<u>\$ 60,156,424</u>	<u>\$ 63,998,322</u>

Approved by the Board:

(signed) "Wayne A. Malinowski", Director

(signed) "Larry C. Mah", Director

See accompanying notes to these financial statements

**TWOCO PETROLEUMS LTD.**

**Statements of Income (Loss), Comprehensive Income (Loss) and Retained Earnings**  
(unaudited)

	Three Months Ended	
	March 31, 2009	March 31, 2008
<b>Revenue</b>		
Oil and gas sales	\$ 3,684,113	\$ 4,931,346
Less: Royalties	<u>(516,116)</u>	<u>(855,162)</u>
	3,167,997	4,076,184
Interest	<u>-</u>	<u>5</u>
	<u>3,167,997</u>	<u>4,076,189</u>
<b>Expenses</b>		
Operating costs	708,969	609,330
Transportation costs	195,315	187,207
General and administrative	215,515	278,419
Interest on bank debt	132,507	78,110
Interest on capital leases	8,023	11,375
Interest on convertible debentures	235,253	235,251
Stock-based compensation	4,181	3,056
Amortization of convertible debentures financing charges	18,529	18,532
Depletion, amortization and accretion	<u>3,500,888</u>	<u>2,280,801</u>
	<u>5,019,180</u>	<u>3,702,081</u>
Income (loss) before income taxes	<u>(1,851,183)</u>	<u>374,108</u>
Income tax expense:		
Current		
- Future (recovery)	<u>(723,000)</u>	<u>(12,350)</u>
<b>Net income (loss) and comprehensive income (loss)</b>	(1,128,183)	386,458
Retained earnings, beginning of period	3,244,674	2,923,649
Acquisition of shares in excess of carrying value	<u>(2,496)</u>	<u>(121,186)</u>
<b>Retained earnings, end of period</b>	<u>\$ 2,113,995</u>	<u>\$ 3,188,921</u>
Net income (loss) and comprehensive Income (loss) per share:		
- Basic	<u>\$ (0.08)</u>	<u>\$ 0.03</u>
- Diluted	<u>\$ (0.08)</u>	<u>\$ 0.02</u>

See accompanying notes to these financial statements

**TWOCO PETROLEUMS LTD.**

**Statements of Cash Flows**  
(unaudited)

	Three Months Ended	
	March 31, 2009	March 31, 2008
Cash provided by (used for)		
<b>Operating activities</b>		
Net income (loss) and comprehensive income (loss)	\$ (1,128,183)	\$ 386,458
Add items not affecting cash		
Stock-based compensation	4,181	3,056
Future income tax expense (recovery)	(723,000)	(12,350)
Convertible debentures accretion	13,336	13,333
Amortization of convertible debentures financing charges	18,529	18,532
Depletion, amortization and accretion	<u>3,500,888</u>	<u>2,280,801</u>
	1,685,751	2,689,830
Change in non-cash working capital (note 10)	<u>181,576</u>	<u>(124,249)</u>
	<u>1,867,327</u>	<u>2,565,581</u>
<b>Financing activities</b>		
Repayment of obligations under capital lease	(57,198)	(53,845)
Financing costs on unsecured debentures	(128,600)	-
Exercise of stock options	-	625,000
Repurchase of common shares	(37,076)	(210,110)
Financing through bank indebtedness	3,137,423	-
Redemption of convertible debentures	(12,000,000)	-
Issuance of unsecured debentures	<u>8,300,000</u>	<u>-</u>
	<u>(785,451)</u>	<u>361,045</u>
<b>Investing activities:</b>		
Acquisition of property, plant and equipment	(492,123)	(1,317,249)
Change in non-cash working capital (note 10)	<u>(589,753)</u>	<u>119,892</u>
	<u>(1,081,876)</u>	<u>(1,197,357)</u>
Cash inflow (outflow)	-	1,729,269
Cash and cash equivalents (bank indebtedness), beginning of period	<u>-</u>	<u>(6,209,859)</u>
Cash and cash equivalents, (bank indebtedness), end of period	<u>\$ -</u>	<u>\$ (4,480,590)</u>
Cash and cash equivalents (bank indebtedness) is comprised of:		
Indebtedness with bank	\$ (19,376,172)	\$ (4,480,590)
Reclassified to financing activities – December 31, 2008	16,238,749	-
Reclassified to financing activities – March 31, 2009	<u>3,137,423</u>	<u>-</u>
	<u>\$ -</u>	<u>\$ (4,480,590)</u>
Supplemental cash flow information:		
Interest paid	<u>\$ 362,447</u>	<u>\$ 311,403</u>

See accompanying notes to these financial statements

# TWOCO PETROLEUMS LTD.

## Notes to Financial Statements

March 31, 2009  
(unaudited)

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1. Basis of presentation

The interim financial statements of Twoco Petroleum Ltd. ("the Company") have been prepared by management in accordance with Canadian generally accepted accounting principles. The interim financial statements have been prepared following the same accounting policies and methods of computation as those utilized in the December 31, 2008 annual financial statements. The interim financial statements contain disclosures which are supplemental to the Company's annual financial statements. Certain disclosures which are normally required to be included in the notes to the annual financial statements have been condensed or omitted. The interim financial statements should be read in conjunction with the Company's audited financial statements and notes thereto for the year ended December 31, 2008.

2. Future accounting pronouncements

In January 2006, the CICA Accounting Standards Board ("AcSB") adopted a strategic plan for the direction of accounting standards in Canada. As part of the plan, accounting standards in Canada for public companies are expected to converge with International Financial Reporting Standards ("IFRS") for reporting periods beginning on or after January 1, 2011. The Company continues to monitor and assess the impact of the convergence of Canadian GAAP and IFRS.

Business combinations

In January 2009, the CICA issued new standards for Business Combinations. This standard is effective January 1, 2011 and applies prospectively to business combinations for which the acquisition date is on or after the first annual reporting period beginning on or after January 1, 2011 for the Company. Early adoption is permitted. This standard replaces Handbook Section 1581 Business Combinations, and harmonizes the Canadian standards with IFRS. This standard was amended to require additional use of fair value measurements, recognition of additional assets and liabilities, and increased disclosure. The adoption of this standard will not have a material impact on the Company's financial statements.

3. Changes in accounting policies

Goodwill and intangible assets

As of January 1, 2009, the Company is required to adopt CICA Section 3064, "Goodwill and Intangible Assets", which replaces CICA Section 3062. This new guidance reinforces a principles-based approach to the recognition of costs as assets in accordance with the definition of an asset and the criteria for asset recognition under CICA Section 1000, "Financial Statement Concepts". Section 3064 clarifies the application of the concept of matching revenues and expenses in Section 1000 to eliminate the current practice of recognizing as assets items that do not meet the definition and recognition criteria. Under this new guidance, fewer items meet the criteria for capitalization. The adoption of this standard has not had a material impact on the Company's financial statements.

## TWOCO PETROLEUMS LTD.

### Notes to Financial Statements

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#### 4. Unsecured debentures

On March 31, 2009, the Company closed a private placement financing through the issuance of \$8.3 million of unsecured debentures ("Debentures") and warrants ("Warrants") to purchase common shares. The Debentures bear interest at a rate of 17% per annum, payable commencing June 30, 2009 and quarterly thereafter and will mature two years following the closing date. Finder's fees and commissions of \$128,600 have been netted against debentures payable.

Subscribers received one-half of one share purchase warrant, for each \$1.00 of principal amount of Debentures. Each whole share purchase warrant entitles the holder thereof to purchase a common share of the Company at a price of \$1.20 per share at any time prior to 4:00 pm (Calgary time) on March 31, 2011.

The value of the warrants was determined to be \$20,750. The portion of the Debentures classified as debt was determined to be \$8,279,250. The debt portion of the Debentures will accrete up to the face value over the term to maturity.

#### 5. Convertible debentures

On March 31, 2006, the Company closed a private placement financing through the issuance of \$12 million of redeemable, convertible, unsecured debentures ("Convertible Debentures"). The Convertible Debentures bore interest at a rate of 7.5% per annum payable quarterly and matured on March 31, 2009 at which time they were redeemed in full. Accretion of \$13,333 has been recognized in interest expense for the three month period ended March 31, 2009 (March 31, 2008 - \$13,333). Amortization expense of \$18,532 has been recognized for the three months ended March 31, 2009, (March 31, 2008 - \$18,352) relating to financing fees and commissions.

The Convertible Debentures were convertible into common shares of the Company at the holder's option at any time prior to March 31, 2009 (the "Maturity Date") at a conversion price equal to \$7.50 per share for a period of two years from the closing date and thereafter at a price of \$8.25 until the Maturity Date. The Company had the ability to redeem the Convertible Debentures if the closing price of its common shares on the TSX Venture Exchange exceeded \$8.25 for 21 consecutive trading days or in certain circumstances where an offer was made to acquire common shares of the Company. The present value of this conversion benefit of \$160,000 was recorded on the financial statements as the equity portion of convertible debentures. The Convertible Debentures matured on March 31, 2009 and were fully redeemed. The equity portion of the debentures was included in contributed surplus as the conditions for conversion were never met (note 9).

The overall effective interest rate on the Convertible Debentures is 8.58% (2007 – 8.58%).

**TWOCO PETROLEUMS LTD.**

**Notes to Financial Statements**

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6. Asset Retirement Obligations

The total future asset retirement obligation was estimated by management based on the Company's net ownership interest in all wells and facilities, estimated costs to reclaim and abandon said wells and facilities and the estimated timing of such abandonment.

The following table reconciles the Company's total asset retirement obligations:

	<u>March 31,</u> <u>2009</u>	<u>December 31,</u> <u>2008</u>
Balance, beginning of year	\$ 3,455,960	\$ 2,762,151
Accretion expense	48,450	155,834
Liabilities incurred	-	381,137
Liabilities incurred due to changes in estimate	-	156,838
Liabilities settled	<u>-</u>	<u>-</u>
Balance, end of period	<u>\$ 3,504,410</u>	<u>\$ 3,455,960</u>

Total estimated future retirement costs of \$5,313,793 (2008 - \$5,313,793) have been inflated at a weighted average estimated inflation rate of 2.1% (2008 - 2.1%) and discounted using a weighted average credit adjusted risk-free rate of 6.78% (2008 - 6.78%).

7. Bank indebtedness and credit facility

As at March 31, 2009, the Company has a revolving demand credit facility with a maximum availability of \$20.0 (2008 - \$20.0) million and a \$1.5 (2008 - \$1.5) million general lease line of credit. The interest rate at March 31, 2009 was prime of 2.5% (2008 - prime of 3.5%). The effective interest rate for 2009 was 2.83% (2008 - 4.73%). The credit facility is secured by a demand debenture of \$25.0 million plus a floating charge over all the assets of the Company. Under the terms of the credit facility agreement, the Company is required to meet certain financial and other reporting requirements.

The Company had drawn \$19.4 million on the credit facility at March 31, 2009 (2008 - \$16.2 million).

**TWOCO PETROLEUMS LTD.**

**Notes to Financial Statements**

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8. Share capital

(a) Authorized

Unlimited voting common shares  
Unlimited non-voting preferred shares

(b) Issued

	<u>Number</u>	<u>Stated Value</u>
Common Shares		
Balance, December 31, 2008	14,967,006	\$ 20,216,620
Pursuant to a normal course issuer bid	(25,600)	(34,579)
Exercise of stock options	-	-
Balance, March 31, 2009	<u>14,941,406</u>	<u>\$ 20,182,041</u>

Per Share Amounts

The weighted average number of shares outstanding for the period ended March 31, 2009 was 15,344,318 (2008 - 15,247,549).

In computing diluted net income per share amounts, NIL (2008 - 391,505) shares were added to the weighted average number of common shares outstanding during the period ended March 31, 2009 for the dilutive effect of stock options.

The following reconciles the denominators for basic and diluted net earnings per share calculations:

	<u>Net Earnings (loss) (numerator)</u>	<u>Weighted Average Shares (denominator)</u>	<u>Per Share Amount</u>
Common Shares			
Basic net earnings (loss) per share	\$ (1,128,183)	14,957,719	\$ (0.08)
Dilutive securities:			
Options	-	-	
Diluted net earnings (loss) per share	<u>\$ (1,128,183)</u>	<u>14,957,719</u>	<u>\$ (0.08)</u>

(c) During the three months ended March 31, 2009, NIL (2008 - 500,000) stock options were exercised for gross cash proceeds of NIL (2008 - \$625,000). NIL (2008 - \$221,926) was reallocated from contributed surplus relating to those options.

## TWOCO PETROLEUMS LTD.

### Notes to Financial Statements

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#### 8. Share capital, continued

- (d) On October 16, 2008, the Company commenced a normal course issuer bid under which it can repurchase up to 750,000 of its common shares until October 16, 2009. All common shares purchased by the Company will be returned to treasury and cancelled. Although the Company has the intention to acquire common shares, it is not obliged to make any purchases pursuant to this 2008 issuer bid. For the period ended March 31, 2009, the Company acquired 25,600 (2008 – NIL) common shares at an average price of \$1.37 (2008 - NIL). The excess cost of re-acquisition over stated value in the amount of \$2,496 (2008 - NIL) has been charged to retained earnings.
- (e) On October 16, 2007, the Company commenced a normal course issuer bid under which it can repurchase up to 750,000 of its common shares until October 16, 2008. All common shares purchased by the Company will be returned to treasury and cancelled. Although the Company has the intention to acquire common shares, it is not obliged to make any purchases pursuant to this 2007 issuer bid. For the period ended March 31, 2009, the Company acquired NIL (2008 – 66,500) common shares at an average price of \$NIL (2008 - \$3,16). The excess cost of re-acquisition over stated value in the amount of \$NIL (2008 - \$121,186) has been charged to retained earnings.

#### 9. Contributed Surplus

The following table reconciles the Company's contributed surplus:

	March, 31 2009	December 31, 2008
Balance, beginning of period	\$ 874,904	\$ 1,128,929
Stock-based compensation expense	4,181	16,725
Exercise of stock options	-	(270,750)
Reclassification due to redemption of debentures (a)	<u>160,000</u>	<u>-</u>
Balance, end of period	<u>\$ 1,039,085</u>	<u>\$ 874,904</u>

##### (a) Redemption of convertible debentures

On March 31, 2009, all convertible debentures were fully redeemed. The equity portion of these debentures was reclassified to contributed surplus as the conditions to trigger conversion was not met. The value assigned to the equity portion of the convertible debentures has thus been reclassified to contributed surplus.

**TWOCO PETROLEUMS LTD.**

**Notes to Financial Statements**

**March 31, 2009**  
(unaudited)

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10. Supplemental Cash Flow Information

(a) Changes in Non-cash Working Capital

	<u>March 31,</u> <u>2009</u>	<u>March 31,</u> <u>2008</u>
Accounts receivable	\$ 864,408	(156,374)
Prepaid expenses and deposits	17,176	7,206
Accounts payable and accrued liabilities	<u>(1,289,761)</u>	<u>144,811</u>
	<u>\$ (408,177)</u>	<u>\$ (4,357)</u>
Change in non-cash working capital relating to:		
Investing activities	\$ (589,753)	\$ 119,892
Operating activities	<u>181,576</u>	<u>(124,249)</u>
	<u>\$ (408,177)</u>	<u>\$ (4,357)</u>

(b) The following non-cash transactions have been excluded from the statements of cash flows:

	<u>March 31,</u> <u>2009</u>	<u>March 31,</u> <u>2008</u>
Asset retirement liabilities incurred	<u>\$ -</u>	<u>\$ (32,461)</u>

11. Capital disclosure

The Company's objectives when managing capital are: (i) to maintain a flexible capital structure, which optimizes the cost of capital at acceptable risk; and (ii) to maintain investor, creditor and market confidence to sustain the future development of the business.

The Company manages its capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of its underlying assets. The Company considers its capital structure to include shareholders' equity, debt and working capital. To maintain or adjust the capital structure, the Company may from time to time, issue shares, raise debt and/or adjust its capital spending to manage its current and projected debt levels.

The Company monitors capital based on the current and projected ratios of debt to cash flow and debt to capital employed. The Company's objective is to maintain a debt to cash flow from operations ratio of less than two times. The ratio may increase at certain times as a result of acquisitions. To facilitate the management of this ratio, the Company prepares annual budgets, which are updated depending on varying factors such as general market conditions and successful capital deployment. The annual budget is approved by the Board of Directors.

The Company's share capital is not subject to external restrictions.

There were no changes in the Company's approach to capital management from the previous year.

## TWOCO PETROLEUMS LTD.

### Notes to Financial Statements

March 31, 2009

(unaudited)

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#### 12. Financial instruments and risk management

##### (a) Fair values

The Company's financial instruments consist of accounts receivable, accounts payable and accrued liabilities, unsecured debentures, and bank indebtedness and credit facility. The fair value of these instruments approximate their carrying amounts due to their short terms to maturity or because they bear interest at market rates for similar instruments. The fair value of the unsecured debentures approximates carrying amount as the debentures mature in the short term and interest rates are not expected to fluctuate materially during that time.

##### (b) Credit risk

Virtually all of the Company's accounts receivable are due from joint venture partners in the oil and gas industry and from purchasers of the Company's petroleum and natural gas production and are subject to normal industry credit risks. The Company generally extends unsecured credit to these parties and therefore, the collection of accounts receivable may be affected by changes in economic or other conditions. Management believes the risk is mitigated by the size and reputation of the companies to which they extend credit. The Company's maximum exposure to credit risk on the sale of petroleum and natural gas production is approximately two months of production.

Receivables from petroleum and natural gas marketers are normally collected on the twenty-fifth day of the month following production. Receivables related to the sale of the Company's petroleum and natural gas production are from major marketing companies with investment grade credit ratings. The Company historically has not experienced any collection issues with its petroleum and natural gas marketers.

Joint venture receivables are typically collected within one to three months of the joint venture bill being issued to the partner. The Company attempts to mitigate the risk from joint venture receivables by obtaining partner approval of significant capital expenditures prior to expenditure and issuing cash calls on large capital projects from its partners on capital projects before they commence. The Company reviews the financial status of joint venture partners before partner approval is obtained.

##### (c) Liquidity risk

Liquidity risk relates to the risk the Company will encounter difficulty in meeting obligations associated with financial liabilities. The financial liabilities on its balance sheet consist of accounts payable and accrued liabilities, obligations under capital lease, unsecured debentures and bank indebtedness. Management closely monitors cash flow requirements to ensure that it has sufficient cash on demand or borrowing capacity to meet operational and financial obligations.

##### (d) 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. These risks are generally outside the control of the Company. The objective of the Company is to mitigate market risk exposures within acceptable limits, while maximizing returns.

**TWOCO PETROLEUMS LTD.**

**Notes to Financial Statements**

**March 31, 2009**  
(unaudited)

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12. Financial instruments and risk management (continued)

(e) Interest rate risk

The Company is exposed to interest rate cash flow risk on its outstanding bank indebtedness which has a floating interest rate and would impact the Company's future cash flows. The Company had no interest rate swaps or hedges at March 31, 2009.

In regards to interest rate cash flow risk, an increase or decrease of one percent to the effective interest rate for the Company would have impacted net earnings by \$47,000 for the period.

(f) Foreign currency risk

The Company is exposed to foreign currency fluctuations as crude oil and natural gas prices are referenced to U.S. dollar denominated prices. As at March 31, 2009 and December 31, 2008, the Company had no forward foreign exchange contracts in place, nor any significant working capital items denominated in foreign currencies.

(g) Commodity price risk

The nature of the Company's operations results in exposure to fluctuations in commodity prices. As at March 31, 2009, the Company had no derivative contracts in place.

13. Subsequent events

On April 28, 2009, the Company acquired the following financing facilities to replace the existing credit facilities:

Facility #1 – Operating Demand Loan Facility. Revolving loan used for the general operations and to assist with repayment of the Company's existing credit facility. The facility has a maximum principal amount of \$19.0 million. The interest rate varies from prime plus 0.5% to prime plus 1.50% based on the Company's net debt to trailing cash flow ratio.

Facility #2 – Non-Revolving reducing demand loan facility. Non-revolving loan by way of one draw of \$500,000, repayable in 48 blended monthly payments. Interest is charged at rate of prime plus 2.00% per annum.

The financing facilities are secured by a general security agreement granting a mortgage, pledge, charge and security interest in all of the Company's property, assets and undertakings. The facility agreement requires that the Company not allow its working capital ratio to fall below 1.00:1.