

TWOCO PETROLEUMS LTD.

FINANCIAL STATEMENTS

MARCH 31, 2010

Notice to Reader

The accompanying unaudited interim financial statements of Twoco Petroleum Ltd. for the quarter ended March 31, 2010 have been prepared by management and approved by the Board of Directors of the Company. These statements have not been reviewed by Twoco Petroleum Ltd.'s external auditors.

Dated May 27, 2010

On behalf of Twoco Petroleum 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, 2010 <u>(unaudited)</u>	December 31, 2009 <u>(audited)</u>
Assets		
Current assets		
Accounts receivable	\$ 678,961	\$ 909,921
Prepaid expenses and deposits	<u>595,857</u>	<u>624,105</u>
	1,274,818	1,534,026
Property, plant and equipment	<u>47,248,977</u>	<u>49,221,084</u>
	<u>\$ 48,523,795</u>	<u>\$ 50,755,110</u>
Liabilities		
Current liabilities		
Bank indebtedness and credit facility (note 5)	\$ 18,203,059	\$ 18,316,692
Accounts payable and accrued liabilities	1,129,024	1,326,693
Current portion of unsecured debentures (note 3)	<u>8,185,833</u>	<u> </u>
	27,517,916	19,643,385
Unsecured debentures (note 3)	-	8,158,847
Asset retirement obligations (note 4)	3,305,684	3,252,420
Future income taxes	<u>1,386,000</u>	<u>1,965,000</u>
	<u>32,209,600</u>	<u>33,019,652</u>
Shareholders' Equity		
Share capital (note 6)	20,181,041	20,181,041
Equity portion of unsecured debentures (note 3)	20,750	20,750
Contributed surplus (note 7)	1,044,460	1,043,960
Retained earnings (deficit)	<u>(4,932,056)</u>	<u>(3,510,293)</u>
	<u>16,314,195</u>	<u>17,735,458</u>
	<u>\$ 48,523,795</u>	<u>\$ 50,755,110</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 (Deficit)**
(unaudited)

	Three Months Ended	
	March 31, 2010	March 31, 2009
Revenue		
Oil and gas sales	\$ 1,856,196	\$ 3,684,113
Less: Royalties	<u>9,437</u>	<u>(516,116)</u>
	<u>1,865,633</u>	<u>3,167,997</u>
Expenses		
Operating costs	599,636	708,969
Transportation costs	113,348	195,315
General and administrative	334,234	215,515
Interest on bank debt	167,607	132,507
Interest on capital leases	-	8,023
Interest on debentures	347,918	235,253
Stock-based compensation	500	4,181
Amortization of debenture financing charges	2,594	18,529
Depletion, amortization and accretion	<u>2,300,559</u>	<u>3,500,888</u>
	<u>3,866,396</u>	<u>5,019,180</u>
Income (loss) before income taxes	<u>(2,000,763)</u>	<u>(1,851,183)</u>
Income tax expense:		
Current		
- Future (recovery)	<u>(579,000)</u>	<u>(723,000)</u>
Net income (loss) and comprehensive income (loss)	(1,421,763)	(1,128,183)
Retained earnings (deficit), beginning of period	(3,510,293)	3,244,674
Acquisition of shares in excess of carrying value (note 6(d))	<u>-</u>	<u>(2,496)</u>
Retained earnings (deficit), end of period	<u>\$ (4,932,056)</u>	<u>\$ 2,113,995</u>
Net income (loss) and comprehensive Income (loss) per share:		
- Basic (note 6)	<u>\$ (0.10)</u>	<u>\$ (0.08)</u>
- Diluted	<u>\$ (0.10)</u>	<u>\$ (0.08)</u>

See accompanying notes to these financial statements

TWOCO PETROLEUMS LTD.

Statements of Cash Flows
(unaudited)

	Three Months Ended	
	March 31, 2010	March 31, 2009
Cash provided by (used for)		
Operating activities		
Net income (loss) and comprehensive income (loss)	\$ (1,421,763)	\$ (1,128,183)
Add items not affecting cash		
Stock-based compensation	500	4,181
Future income tax expense (recovery)	(579,000)	(723,000)
Debentures accretion	2,594	13,336
Amortization of debenture financing charges	24,392	18,529
Depletion, amortization and accretion	<u>2,300,559</u>	<u>3,500,888</u>
	327,282	1,685,751
Change in non-cash working capital (note 8(a))	<u>7,725</u>	<u>181,576</u>
	<u>335,007</u>	<u>1,867,324</u>
Financing activities		
Repayment of obligations under capital lease	-	(57,198)
Costs associated with issuance of debt	-	(128,600)
Repurchase of common shares	-	(37,076)
Financing through bank indebtedness	(113,633)	3,137,423
Redemption of convertible debentures	-	(12,000,000)
Issuance of unsecured debentures	<u>-</u>	<u>8,300,000</u>
	<u>(113,633)</u>	<u>(785,451)</u>
Investing activities:		
Acquisition of property, plant and equipment	(276,282)	(492,129)
Disposal of property, plant and equipment	1,094	-
Change in non-cash working capital (note 8(a))	<u>53,814</u>	<u>(589,753)</u>
	<u>(221,374)</u>	<u>(1,081,876)</u>
Cash inflow (outflow)	-	-
Cash and cash equivalents (bank indebtedness), beginning of period	<u>-</u>	<u>-</u>
Cash and cash equivalents, (bank indebtedness), end of period	<u>\$ -</u>	<u>\$ -</u>
Supplemental cash flow information:		
Interest paid	<u>\$ 515,525</u>	<u>\$ 362,447</u>
Taxes paid	<u>\$ -</u>	<u>\$ -</u>

The non-cash transactions described in note 8(b) have been excluded from the statements of cash flows.

See accompanying notes to these financial statements

TWOCO PETROLEUMS LTD.

Notes to Financial Statements

March 31, 2010
(unaudited)

1. Basis of presentation and going concern

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, 2009 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, 2009.

In late 2008 and continuing through into 2010, the global credit market crisis, the volatility in the price of oil and natural gas, the recession in Canada and the slowdown of economic growth in the rest of the world has created a substantially more volatile business environment. Tighter credit and equity markets, especially for small companies where the access to credit and additional equity funding is limited, has and will continue to limit certain of the Company's planned business development activities and it will continue to provide risk for the Company's future.

Subsequent to March 31, 2010, on April 21, 2010, the Company's lender proposed certain changes to the current credit facilities as described in note 5 and note 11. Management has been working on certain strategic alternatives including, but not limited to, recapitalizing the Company through financing arrangements or merging with other companies. All these alternatives will take time and management believes that it has the continued financial support of the lender and will be able to address and resolve the liquidity issues created by the current economic climate as described above. There is no assurance, however, that any or all of these alternatives will materialize or that additional funding will be available, if and when needed.

As at March 31, 2010, the Company had \$17,300,000 outstanding on its credit facility, a deficit of \$4,932,056 and incurred a loss of \$1,421,763 for the quarter then ended.

Management believes the going concern assumption is appropriate for these financial statements. Therefore, the financial statements do not reflect the adjustments that may be necessary if the going concern assumption were not applicable. If this assumption were not appropriate, adjustments to the carrying amount of the assets and liabilities, revenue and expenses and the balance sheet classification used may be necessary and could be material.

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Notes to Financial Statements

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2. New and revised accounting pronouncements

The Company has assessed new and revised accounting pronouncements that have been issued that are not yet effective and determined that the following may have an impact on the Company:

International Financial Reporting Standards

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 convergence of Canadian GAAP and IFRS.

In July 2009, the International Accounting Standards Board (“IASB”) issued amendments to IFRS 1 “First-time adoption of IFRS” allowing additional exemptions for first-time adopters. Under these amendments, oil and gas companies can elect to use historical cost under a previous GAAP as the deemed cost for oil and gas assets on the transition date to IFRS.

Business combinations

In January 2009, the CICA issued new standards for business combinations. These standards are effective January 1, 2011 and apply 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. 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. Adopting this standard is expected to have a significant impact on the way the Company accounts for future business combinations.

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3. 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 \$201,113 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.

4. 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:

	March 31, 2010	December 31, 2009
Balance, beginning of year	\$ 3,252,420	\$ 3,455,960
Accretion expense	53,264	192,237
Liabilities incurred	-	5,069
Reduction in liabilities on sales of assets	-	(234,244)
Changes in estimate	-	(166,602)
Balance, end of period	<u>\$ 3,305,684</u>	<u>\$ 3,252,420</u>

Total estimated future retirement costs of \$5,009,685 (2009 - \$5,313,793) have been inflated at a weighted average estimated inflation rate of 1.5% (2009 - 2.1%) and discounted using a weighted average credit adjusted risk-free rate of 8.00% (2009 - 6.78%).

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5. Bank indebtedness and credit facility

As at March 31, 2010, the Company has the following credit facilities:

Facility #1 – Operating Demand Loan Facility. Revolving loan used for general operations and to assist with repayment of the Company's previously existing credit facility. The facility has a maximum principal amount of \$18 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. At March 31, 2010, the Company had a balance of \$17,300,000 drawn on this facility.

Facility #2 – Non-Revolving reducing demand loan facility. Non-revolving loan by way of one draw of \$500,000, repayable in 48 monthly payments of \$10,417 plus interest. Interest is charged at rate of prime plus 2.00% per annum. At March 31, 2010 this facility had a balance owing of \$385,417. The future minimum principal payments are as follows:

2010	\$	125,000
2011		125,000
2012		125,000
2013		10,417
Total	\$	<u>385,417</u>

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 excluding bank indebtedness to fall below 1.00:1. On February 1, 2010 a general security amending agreement was issued which provides a fixed charge on such interest of the Company in specific land and petroleum and natural gas rights, including without limitation certain Alberta Crown PNG leases.

Bank indebtedness also includes \$517,642 in bank overdrafts.

On April 21, 2010, the Company's lender proposed certain changes to the current credit facilities as described in note 11.

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6. 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, 2009	<u>14,941,406</u>	<u>\$ 20,181,041</u>
Balance, March 31, 2010	<u>14,941,406</u>	<u>\$ 20,181,041</u>
Per Share Amounts		

The weighted average number of shares outstanding for the period ended March 31, 2010 was 15,941,406 (2009 - 15,406,406).

In computing diluted net income per share amounts, NIL (2009 – NIL) shares were added to the weighted average number of common shares outstanding during the period ended March 31, 2010 for the dilutive effect of stock options.

	<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	\$ (1,421,763)	14,941,406	\$ (0.10)
Dilutive securities:			
Options	-	-	-
Diluted net earnings (loss) per share	<u>\$ (1,421,763)</u>	<u>14,941,406</u>	<u>\$ (0.10)</u>

(c) During the three months ended March 31, 2010, NIL (2009 - NIL) stock options were exercised for gross cash proceeds of NIL (2009 - NIL). NIL (2009 - \$NIL) was reallocated from contributed surplus relating to those options.

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6. 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, 2010, the Company acquired NIL (2009 – 25,600) common shares at an average price of NIL (2009 – \$1.37). The excess cost of re-acquisition over stated value in the amount of NIL (2009 - \$2,496) has been charged to retained earnings.

7. Contributed Surplus

The following table reconciles the Company's contributed surplus:

	March, 31 <u>2010</u>	December 31, <u>2009</u>
Balance, beginning of period	\$ 1,043,960	\$ 874,904
Stock-based compensation expense	500	9,056
Reclassification due to redemption of debentures (a)	<u>-</u>	<u>160,000</u>
Balance, end of period	<u>\$ 1,044,460</u>	<u>\$ 1,043,960</u>

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.

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Notes to Financial Statements

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8. Supplemental Cash Flow Information

(a) Changes in Non-cash Working Capital

	March 31, 2010	March 31, 2009
Accounts receivable	\$ 230,960	\$ 864,408
Prepaid expenses and deposits	28,248	17,176
Accounts payable and accrued liabilities	<u>(197,669)</u>	<u>(1,289,761)</u>
	<u>\$ 61,539</u>	<u>\$ (408,177)</u>
Change in non-cash working capital relating to:		
Investing activities	\$ 53,814	\$ (589,753)
Operating activities	<u>7,725</u>	<u>181,576</u>
	<u>\$ 61,539</u>	<u>\$ (408,177)</u>

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

	March 31, 2010	March 31, 2009
Asset retirement liabilities incurred	<u>\$ -</u>	<u>\$ -</u>

9. 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 our 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.

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9. Capital disclosure (continued)

Due to the major acquisition of certain properties in late 2008 with debt financing, coupled with the subsequent decline in the natural gas market and pricing for the ensuing year as well as the collapse of the credit and equity markets in late 2008 and continuing into 2009 and 2010, the Company has not been able to maintain its objective and ratios as described above.

The Company's share capital is not subject to external restrictions. See note 5 for a description of external bank covenants.

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

10. 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) 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, convertible debentures payable 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.

TWOCO PETROLEUMS LTD.

Notes to Financial Statements

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(unaudited)

10. Financial instruments and risk management (continued)

(c) 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 the carrying value of accounts receivable.

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.

(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.

(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, 2010.

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 \$44,452 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, 2010 and December 31, 2009, the Company had no forward foreign exchange contracts in place, nor any significant working capital items denominated in foreign currencies.

TWOCO PETROLEUMS LTD.

Notes to Financial Statements

March 31, 2010
(unaudited)

10. Financial instruments and risk management (continued)

(g) Commodity price risk

The nature of the Company's operations results in exposure to fluctuations in commodity prices. As at March 31, 2010, the Company had no derivative contracts in place. Subsequent to March 31, 2010 the company entered into the following financial instrument contracts:

Commodity	Contract Type	Contract Period	Notional Contract Amounts	Price Range
Natural Gas	Collar	April 1 – October 31, 2010	500 GJ/d	\$3.40 - \$4.15 (\$Cdn/GJ) at AECO
Natural Gas	Collar	April 1 – October 31, 2010	500 GJ/d	\$3.35 - \$4.25 (\$Cdn/GJ) at AECO

11. Subsequent events

On April 21, 2010, the Company's lender proposed certain changes to the Company's credit facility agreement, including an increase in the interest rate of facility #1 to a rate of prime plus 3.75% effective as of April 15, 2010. The repayments of facility #1 are to be made from net proceeds of any additional borrowing, proceeds on sale of property and proceeds from equity issuance. Facility #1 remains as a demand facility with interest payable monthly. This proposal was accepted by the Company's management on May 7, 2010.

The above changes to facility #1 were made based on the lender's current assessment and interpretation of the Company's reserves and future commodity prices. These kinds of interpretations can vary from lender to lender and are subject to the lender's lending policies from time to time and the fluctuating and uncertain gas markets.

There are no changes proposed to the terms of the Company's non-revolving reducing facility #2.

The next review date for the Company's current credit facilities is expected to occur on June 30, 2010. As the available credit limits of lending on the credit facilities are based on the bank's interpretations of reserves and future commodity prices, there can be no assurance that the amount of credit facilities will not change at the next scheduled review. Please refer to notes 1 and 7 in the December 31, 2009 annual financial statements.