THIS IS EXHIBIT "A" REFERRED TO IN THE

AFFIDAVIT OF ARTHUR MILLHOLLAND

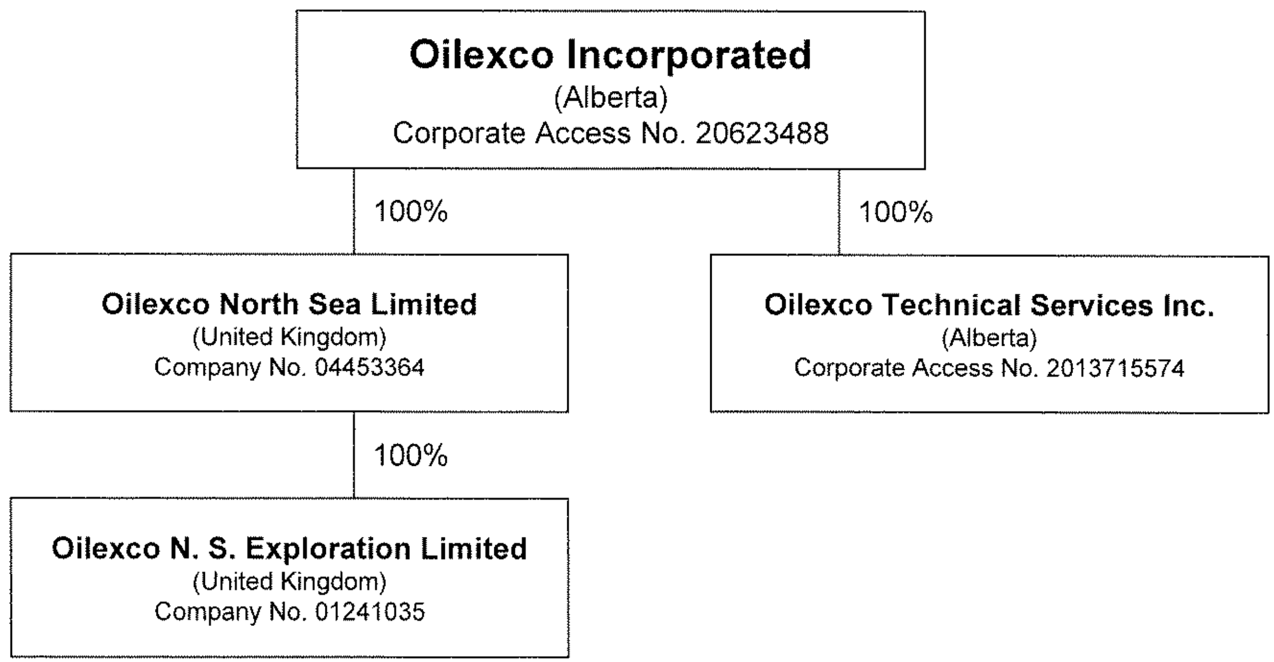
SWORN BEFORE ME THIS 4TH DAY OF FEBRUARY, 2009

Dallas Romeril

A Commissioner for Oaths
in and for the Province of Alberta

Dallas S. Romeril
Student-at-Law

Oilexco Incorporated – Corporate Organisation Chart



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SWORN BEFORE ME THIS 4TH DAY OF FEBRUARY, 2009

Dallas Romeril

A Commissioner for Oaths
in and for the Province of Alberta

Dallas S. Romeril
Student-at-Law

DIAMOND
OFFSHORE

31 December 2008

VIA FAX No. 1-403-263-3251

Oilexco Incorporated
Suite 3200, 715 5th Avenue SW
Calgary, Alberta, Canada T2P 2X6
Fax number: 403 263 3251

Attn: Brian Ward

Re: Deed of Guarantee issued by Oilexco, Inc. ("Guarantor") to Diamond Offshore Drilling (UK) Limited pursuant to Agreement Number 2006/128 effective from 3rd November 2006, as amended, between Oilexco North Sea Limited and Diamond Offshore Drilling (UK) Limited for use of the semisubmersible drilling rig *Ocean Guardian*

Dear Mr. Ward:

Please be advised that Diamond Offshore Drilling (UK) Limited ("Contractor") hereby notifies you that Oilexco North Sea Limited ("Company") is in breach of its obligations to Contractor in accordance with the terms of the above referenced drilling agreement.

Company is in breach of its agreement with Contractor by failing to make timely payment for amounts invoiced.

The following invoices are currently overdue:

Invoice number 1640809162 dated 30 Sep 2008 unpaid balance of $4,364,427
Invoice number 1640810181 dated 31 Oct 2008 unpaid balance of $6,405.525

As Guarantor of the obligations undertaken by Company under the terms of a Deed of Guarantee entered on 21 December 2006, Contractor makes written demand upon Guarantor and seeks to have Guarantor ensure that Company cures the breach and timely performs its obligations under the referenced drilling agreement. In the alternative, Contractor seeks to have Guarantor perform Company's obligations under the agreement.

Very truly yours,

William C. Long
Director
Diamond Offshore Drilling (UK) Limited

DIAMOND OFFSHORE DRILLING (UK) LIMITED
Howe Moss Drive, Kirkhill Industrial Estate
Dyce, Aberdeen AB2 0GL
United Kindom

G-E-M-S
GLOBAL EXCELLENCE MANAGEMENT SYSTEM

THIS IS EXHIBIT "C" REFERRED TO IN THE

AFFIDAVIT OF ARTHUR MILLHOLLAND

SWORN BEFORE ME THIS 4TH DAY OF FEBRUARY, 2009

Dallas Romeril

A Commissioner for Oaths
in and for the Province of Alberta

Dallas S. Romeril
Student-at-Law

Rule 2. 29

Form 2.14B

Statement of affairs

Name of Company	Company number
Oilexco North Sea Limited	04453364
In the High Court of Justice, Chancery Division, Companies Court	Court case number 202

(a) Insert name and address of registered office of the company

Statement as to the affairs of (a) Oilexco North Sea Limited
1 More London Place, London, SE1 2AF

(b) Insert date

on the (b) 7 January 2009, the date that the company entered administration.

Statement of Truth

I believe that the facts stated in this statement of affairs are a full, true and complete statement of the affairs

of the above named company as at (b) 7 January 2009 the date that the company entered administration.

Full name

Signed ARTHUR S MILLHOLLAND

Dated 29th January 2009

A - Summary of Assets

Assets	Book Value (£)	Estimated to Realise (£)
Assets subject to fixed charge:	0	0
Not Applicable		
Assets subject to floating charge:		
Gross Book Value - Brenda	238,836,008	400,180,013
Gross Book Value - Nicol	76,746,820	104,742,624
Gross Book Value - Balmoral (B-Block)	72,971,738	66,671,458
Gross Book Value - Other Capital Assets	564,369,442	534,882,270
Assets Retirement Obligation (re Total Capital Assets)	(18,324,168)	-
Accumulated Depletion & Depreciation (re Total Capital Assets but excluding 4Q 2008)	(138,381,600)	-
JV Inventory - Net to ONSL (re Sterling field)	324,279	324,279
Investment in Oilexco North Sea Exploration	15,287,282	-
Prepayments (Re: Development Completion and Drilling Equipment)	4,086,279	4,086,279
Accounts Receivable	29,144,647	29,144,647
Uncharged assets:	0	0
Not Applicable		
Estimated total assets available for preferential creditors	**845,060,727**	**1,140,031,570**

Signature ____________ Date 29th January 2009

A1 - Summary of Liabilities

	(£)	Estimated to realise (£)
Estimated total assets available for preferential creditors (Carried from page A)	**845,060,727**	**1,140,031,570**
Liabilities		
Preferential creditors -	0	0
Estimated deficiency/surplus as regards preferential creditors	**845,060,727**	**1,140,031,570**
Estimated prescribed part of net property where applicable (to carry forward)	0	0
Estimated total assets available for floating charge holders	**845,060,727**	**1,140,031,570**
Debts secured by floating charges	478,944,605	478,944,605
Estimated deficiency/surplus of assets after floating charges	**366,116,122**	**661,086,965**
Estimated prescribed part of net property where applicable (brought down)	0	0
Total Assets available to unsecured creditors	**366,116,122**	**661,086,965**
Unsecured non-preferential claims (excluding any shortfall to floating charge holders)	130,661,355	130,661,355
Estimated deficiency/surplus as regards non preferential creditors (excluding any shortfall to floating charge holders)	**235,454,767**	**530,425,610**
Shortfall to floating charge holders (brought down)	0	0
Estimated deficiency/surplus as regards creditors	**235,454,767**	**530,425,610**
Issued and called up capital	1	1
Capital Contribution Reserve (Cash Contributions)	191,920,952	191,920,952
Estimated total deficiency/surplus as regards members	**43,533,814**	**338,504,657**

Signature ______________ Date 29th January 2007

THIS IS EXHIBIT "D" REFERRED TO IN THE
AFFIDAVIT OF ARTHUR MILLHOLLAND
SWORN BEFORE ME THIS 4TH DAY OF FEBRUARY, 2009

Dallas Romeril

A Commissioner for Oaths
in and for the Province of Alberta

Dallas S. Romeril
Student-at-Law

OILEXCO INCORPORATED

UNDERTAKING

TO: Toronto Stock Exchange (the "Exchange")

RE: Oilexco Incorporated (the "Company")

Please accept this undertaking as confirmation that the Company will request to have included in any insolvency order that may be required to be obtained on or before December 31, 2009, the following language:

> "THIS COURT ORDERS that notwithstanding anything stated herein, the Toronto Stock Exchange is not prohibited, solely by the terms of this Order, from delisting the common shares of Oilexco Incorporated trading under the symbol OIL:TSX."

This undertaking is provided to the Exchange by the Company on the understanding that the Exchange will not delist the common shares of the Company from the Exchange prior to February 9, 2009.

DATED this 9th day of January, 2009.

OILEXCO INCORPORATED

Per: ______________________

Arthur S. Millholland,
President and Chief Executive Officer

DOCS #267592 v. 1

THIS IS EXHIBIT "E" REFERRED TO IN THE
AFFIDAVIT OF ARTHUR MILLHOLLAND
SWORN BEFORE ME THIS 4TH DAY OF FEBRUARY, 2009

Dallas Romeril

A Commissioner for Oaths
in and for the Province of Alberta

Dallas S. Romeril
Student-at-Law

Schlumberger

The Directors
Oilexco Incorporated
Suite 3200
715 5th Avenue SW
Calgary
Alberta, Canada
T2P 2X6

14th January 2009

Dear Sirs

We refer to the guarantee given by you in May 2006 (the "**Guarantee**") for the obligations of Oilexco North Sea Limited (the "**Company**") under contract number 2006/102 for the provision of Directional Drilling, MWD/LWD Services and Cementing and Wireline Services (the "**Contract**").

We advised in our letter to the Company dated 7 January 2009 ("**Demand Letter**"), a copy of which is attached hereto, that, due to the fact that the Company has been placed in administration, we require full payment of all sums currently due under the Contract as set out in the attached schedule.

We hereby demand that you immediately pay to us the liabilities of the Company as specified below:-

Outstanding receivables	£6,273,674.28
Additional work scope	£927,478.44
Total	£7,201,152.72

In accordance with clause 2 of the Guarantee, you shall also be responsible for payment of the costs and expenses incurred by us in enforcing the Guarantee.

Interest at BoE rate +3%, in accordance with the terms of the Contract, Section II, Clause 14.9, will continue to accrue until the date of settlement.

This demand is without prejudice to and shall not be construed as a waiver of any other rights or remedies which we may have, including the right to make further demands in respect of sums payable to us.

Yours faithfully

For and on behalf of
Schlumberger Offshore Services Limited

THIS IS EXHIBIT “F” REFERRED TO IN THE
AFFIDAVIT OF ARTHUR MILLHOLLAND
SWORN BEFORE ME THIS 4TH DAY OF FEBRUARY, 2009

Dallas Romeril

A Commissioner for Oaths
in and for the Province of Alberta

Dallas S. Romeril
Student-at-Law

The Royal Bank of Scotland

Global Banking & Markets
7th Floor
135 Bishopsgate
London EC2M 3UR
Telephone: 0207 085 5000
Facsimile: 0207 085 4003
www.rbs.com/gbm

28 January 2009

Oilexco Incorporated
Suite 3200
715-5th Avenue SW
Calgary, Alberta
Canada T2P 2X6

FAO: Managing Director

Oilexco North Sea Limited
Balmoral House
74 Carden Place
Aberdeen AB10 1UL

FAO: Service Vice President Operations

Dear Sirs

Senior facility agreement dated 25 January 2006 between, amongst others, Oilexco North Sea Limited (the "Company"), Oilexco Incorporated (the "Guarantor") and The Royal Bank of Scotland plc ("RBS") as Senior Agent and in various other capacities (as amended from time to time, including by way of amendment and restatement agreement dated 17 December 2008 between the Company and RBS, the "Facility Agreement")

1. We refer to the Facility Agreement. Terms defined in the Facility Agreement (whether expressly or by incorporation) have the same meaning in this demand notice unless given a different meaning in this demand notice.

2. Pursuant to clause 19.1 (*Guarantee and indemnity*) of the Facility Agreement, the Guarantor irrevocably and unconditionally (i) guarantees to each Finance Party punctual performance by the Company of all of the Company's obligations under the Finance Documents and (ii) undertakes with each Finance Party that whenever the Company does not pay any amount when due under or in connection with any Finance Document, the Guarantor shall immediately on demand pay that amount as if it were the principal obligor.

3. Acceleration notices under the Supplemental Tranche and the Borrowing Base Tranche have been served on the Company under clause 24.22 (*Acceleration*) of the Facility Agreement thereby making all of the Utilisations under each Tranche, together with accrued interest, and all other amounts accrued or outstanding under the Finance Documents relating to each Tranche immediately due and payable.

4. All amounts payable by the Company under the acceleration notice referred to in paragraph 3. above, remain outstanding.

5. Accordingly, the Finance Parties hereby demand, under clause 19.1 (*Guarantee and indemnity*) of the Facility Agreement, immediate payment by the Guarantor of all amounts outstanding under the Finance Documents.

6. This demand notice and any non-contractual obligations arising out of or in connection with this demand notice are governed by English law.

Yours faithfully

....

authorised signatory for

The Royal Bank of Scotland plc

(as Supplemental Agent and Senior Agent)

THIS IS EXHIBIT "G" REFERRED TO IN THE
AFFIDAVIT OF ARTHUR MILLHOLLAND
SWORN BEFORE ME THIS 4TH DAY OF FEBRUARY, 2009

Dallas Romeril

A Commissioner for Oaths
in and for the Province of Alberta

Dallas S. Romeril
Student-at-Law

The Royal Bank of Scotland

Global Banking & Markets
7th Floor
135 Bishopsgate
London EC2M 3UR
Telephone: 0207 085 5000
Facsimile: 0207 085 4003
www.rbs.com/gbm

28 January 2009

Oilexco Incorporated
Suite 3200
715-5th Avenue SW
Calgary, Alberta
Canada T2P 2X6

FAO: Managing Director

Oilexco North Sea Limited
Balmoral House
74 Carden Place
Aberdeen AB10 1UL

FAO: Service Vice President Operations

Dear Sirs

Pre-development facility agreement dated 26 February 2007 between Oilexco North Sea Limited (the "Company"), Oilexco Incorporated (the "Guarantor") and The Royal Bank of Scotland plc ("RBS") as Facility Agent and in various other capacities (as amended from time to time, including by way of amendment agreement dated 17 December 2008 between the Company and RBS, the "Facility Agreement")

1. We refer to the Facility Agreement. Terms defined in the Facility Agreement (whether expressly or by incorporation) have the same meaning in this demand notice unless given a different meaning in this demand notice.
2. Pursuant to clause 19.1 (*Guarantee and indemnity*) of the Facility Agreement the Guarantor irrevocably and unconditionally (i) guarantees to each Finance Party punctual performance by the Company of all of the Company's obligations under the Finance Documents and (ii) undertakes with each Finance Party that whenever the Company does not pay any amount when due under or in connection with any Finance Document, the Guarantor shall immediately on demand pay that amount as if it were the principal obligor.
3. An acceleration notice has been served on the Company under clause 23.22 (*Acceleration*) of the Facility Agreement thereby making all of the Utilisations, together with accrued interest, and all other amounts accrued or outstanding under the Finance Documents immediately due and payable.
4. All amounts payable by the Company under the acceleration notice referred to in paragraph 3. above, remain outstanding.

5. Accordingly, the Finance Parties hereby demand, under clause 19.1 (*Guarantee and indemnity*) of the Facility Agreement, immediate payment by the Guarantor of all amounts outstanding under the Finance Documents.

6. This demand notice and any non-contractual obligations arising out of or in connection with this demand notice are governed by English law.

Yours faithfully

....

authorised signatory for

The Royal Bank of Scotland plc

(as Facility Agent)

THIS IS EXHIBIT “H” REFERRED TO IN THE
AFFIDAVIT OF ARTHUR MILLHOLLAND
SWORN BEFORE ME THIS 4TH DAY OF FEBRUARY, 2009

Dallas Romeril

A Commissioner for Oaths
in and for the Province of Alberta

Dallas S. Romeril
Student-at-Law

OILEXCO INCORPORATED

CONSOLIDATED FINANCIAL STATEMENTS

As at December 31, 2007 and 2006 and for each of the three years in the period ended December 31, 2007

AUDITORS' REPORT

To the Shareholders of
Oilexco Incorporated:

We have audited the consolidated balance sheets of Oilexco Incorporated as at December 31, 2007 and 2006 and the consolidated statements of income (loss) and retained earnings (deficit), comprehensive income (loss) and accumulated other comprehensive income and cash flows for each of the three years in the period ended December 31, 2007. 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, 2007 and 2006 and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2007 in accordance with Canadian generally accepted accounting principles.

Calgary, Alberta
March 7, 2008

(signed) "Deloitte & Touche LLP"
Chartered Accountants

OILEXCO INCORPORATED
Consolidated Balance Sheets
As at December 31
(in thousands of United States dollars)

		2007		2006
Assets				
Current Assets				
Cash and Cash Equivalents	$	**81,865**	$	81,951
Accounts Receivable		**87,130**		9,398
Prepaids and Deposits (Note 3)		**9,112**		4,111
Inventory (Note 4)		**3,192**		-
		181,299		95,460
Deferred Financing Costs (Note 6)		**7,938**		3,705
Future Income Tax-Asset (Note 12)		**4,289**		44,384
Property, Plant and Equipment (Note 5)		**1,016,106**		467,704
	$	**1,209,632**	$	611,253
Liabilities and Shareholders' Equity				
Current Liabilities				
Accounts Payable and Accrued Liabilities	$	**120,923**	$	55,645
Capital Lease Obligation (Note 7)		**1,023**		828
Current Portion of Bank Loans (Note 6)		**13,070**		57,967
Current Portion of Derivative Contracts (Note 6)		**17,310**		-
		152,326		114,440
Bank Loans (Note 6)		**420,937**		193,321
Capital Lease Obligation (Note 7)		**3,120**		3,411
Derivative Contracts (Note 6)		**23,035**		5,049
Asset Retirement Obligations (Note 8)		**33,821**		6,513
		633,239		322,734
Commitments (Note 14)				
Shareholders' Equity				
Share Capital (Note 9)		**420,950**		297,384
Contributed Surplus (Note 10)		**36,531**		27,208
Accumulated Other Comprehensive Income (Note 16)		**94,884**		16,158
Retained Earnings (Deficit) (Note 16)		**24,028**		(52,231)
		576,393		288,519
	$	**1,209,632**	$	611,253

The accompanying notes form an integral part of these consolidated financial statements.

Approved on behalf of the Board:

Signed "Arthur S. Millholland"
Director

Signed "W. Fraser Grant "
Director

OILEXCO INCORPORATED
Consolidated Statements of Income (Loss) and Retained Earnings (Deficit)
For the Years Ended December 31
(in thousands of United States dollars except per unit amounts)

	2007	2006	2005
Revenues			
Oil and Gas Sales	$ **339,563**	$ 3,396	$ 4,268
Inter-Field Tariff	**2,059**	984	871
Interest Income	**3,766**	4,397	786
	345,388	8,777	5,925
Expenses			
General and Administrative	**25,149**	9,800	6,625
Operating	**51,011**	4,031	3,859
Depletion, Depreciation and Accretion (Note 5)	**116,603**	3,057	1,437
Impairment of Oil and Gas Property Assets (Note 5)	**-**	12,471	1,610
(Gain) Loss on Foreign Exchange	**(39,512)**	14,876	(1,052)
Stock-Based Compensation (Notes 9 and 10)	**14,189**	8,566	10,225
Loss on Derivatives	**37,316**	5,049	-
Interest and Bank Charges	**23,058**	8,307	-
	227,814	66,157	22,704
Income (Loss) Before Income Taxes and Discontinued Operations	**117,574**	(57,380)	(16,779)
Current Income Taxes (Note 12)	**(1,221)**	(717)	-
Future Income Tax (Provision)/Recovery (Note 12)	**(40,094)**	44,384	-
Income (Loss) After Income Taxes before Discontinued Operations	**76,259**	(13,713)	(16,779)
(Loss) Income of Discontinued Operations (Note 11)	**-**	(298)	434
Net Income (Loss)	**76,259**	(14,011)	(16,345)
Deficit, Beginning of Year	**(52,231)**	(38,220)	(21,875)
Retained Earnings (Deficit), End of Year	$ **24,028**	$ (52,231)	$ (38,220)
Basic Net Income (Loss) per Share (Note 9)	$ **0.36**	$ (0.07)	$ (0.12)
Diluted Net Income (Loss) per Share (Note 9)	$ **0.34**	$ (0.07)	$ (0.12)

The accompanying notes form an integral part of these consolidated financial statements.

OILEXCO INCORPORATED
Consolidated Statements of Comprehensive Income (Loss) and Accumulated Other Comprehensive Income
For the Years Ended December 31
(in thousands of United States dollars)

	2007	2006	2005
Net Income (Loss)	$ **76,259**	$ (14,011)	$ (16,345)
Other comprehensive income			
Unrealized gains on translation of consolidated financial statements into reporting currency	**78,726**	1,466	14,692
Comprehensive Income (Loss)	$ **154,985**	$ (12,545)	$ (1,653)
Accumulated Other Comprehensive Income, Beginning of Year	$ **16,158**	$ 14,692	$ -
Other Comprehensive Income	**78,726**	1,466	14,692
Accumulated Other Comprehensive Income, End of Year (Note 2)	$ **94,884**	$ 16,158	$ 14,692

The accompanying notes form an integral part of these consolidated financial statements.

OILEXCO INCORPORATED
Consolidated Statements of Cash Flows
For the Years Ended December 31
(in thousands of United States dollars)

	2007	2006	2005
Cash Flows from Operating Activities			
Income (Loss) before Discontinued Operations	$ **76,259**	$ (13,713)	$ (16,779)
Items Not Involving Cash:			
Depletion, Depreciation and Accretion	**116,603**	3,057	1,437
Impairment of Oil and Gas Property Assets	**-**	12,471	1,610
Unrealized (Gain) Loss on Foreign Exchange	**(38,424)**	16,176	2,978
Stock-Based Compensation	**14,189**	8,566	10,225
Future Income Taxes	**40,094**	(44,384)	-
Non-cash Interest and Bank Charges	**1,758**	496	-
Unrealized Loss on Derivatives	**35,451**	5,049	-
	245,930	(12,282)	(529)
Changes in Non-Cash Working Capital	**(37,914)**	4,393	(3,437)
	208,016	(7,889)	(3,966)
Cash Flows from Financing Activities			
Proceeds from Issuance of Shares, net of Issue Costs	**118,016**	13,189	180,827
Net Proceeds of Bank Loans	**174,595**	236,833	17,077
Repayment of Bank Loans	**-**	(17,831)	-
Changes in Non-Cash Working Capital	**-**	(726)	609
	292,611	231,465	198,513
Cash Flows from Investing Activities			
Additions to Plant, Property and Equipment	**(518,520)**	(296,232)	(90,874)
Changes in Non-Cash Working Capital	**19,624**	37,898	(1,713)
	(498,896)	(258,334)	(92,587)
Net Increase (Decrease) in Cash	**1,731**	(34,758)	101,960
Net effect of foreign exchange on cash held in foreign currencies	**(1,817)**	1,301	(3,266)
Net cash flows of discontinued operations	**-**	926	244
Cash and Cash Equivalents, Beginning of Year	**81,951**	114,482	15,544
Cash and Cash Equivalents, End of Year	$ **81,865**	$ 81,951	$ 114,482

Supplemental Information – (Note 13)

The accompanying notes form an integral part of these consolidated financial statements.

All amounts (except for share information) are presented in thousands of United States dollars ("$").

1. DESCRIPTION OF BUSINESS

Oilexco Incorporated and its wholly-owned subsidiary Oilexco North Sea Limited (together the "Company") are involved in the exploration, development and production of oil and natural gas in the UK North Sea. Currently, the Company's production is from the Brenda, Nicol, Balmoral, Glamis and Stirling Fields located in the UK Central North Sea.

Oilexco America, Inc, a second wholly-owned subsidiary of Oilexco Incorporated was sold effective December 31, 2006 and is classified as discontinued operations for comparative purposes.

2. SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements of the Company are prepared in accordance with Canadian Generally Accepted Accounting Principles ("GAAP").

Principles of Consolidation

The consolidated financial statements include the accounts of Oilexco Incorporated and its wholly-owned subsidiaries. All inter-company transactions and balances have been eliminated on consolidation.

Measurement Uncertainty

The preparation of consolidated financial statements in accordance with Canadian GAAP requires management to make estimates and assumptions and to use judgment regarding assets, liabilities, revenues and expenses. Accordingly, actual results may differ from those estimated amounts.

Recorded amounts for depletion and depreciation, asset retirement obligations and abandonment costs, and amounts used for impairment calculations are based on estimates of oil and natural gas reserves and future costs required to develop those reserves. By their nature, these estimates and the related future cash flows and costs are subject to measurement uncertainty. Actual results may vary from these estimates and the effect on the consolidated financial statements of future periods could be significant.

Cash and Cash Equivalents

Cash and cash equivalents include cash in banks and short-term deposits with a maturity date of less than 90 days on the date of purchase.

Inventory

Inventories of materials and supplies are stated at the lower of cost and net realizable value. Cost is determined on the first-in, first out method.

Property, Plant and Equipment

The Company follows the full cost method of accounting for oil and natural gas properties and related expenditures, whereby all costs relating to the exploration for and development of oil and natural gas reserves are capitalized and accumulated in cost centres on a country by country basis. Such costs include land acquisition, license fees, geological and geophysical, drilling, equipment and facilities, carrying charges on non-producing properties and related overhead. Unevaluated properties are assessed periodically to ascertain whether impairment has occurred. When proven reserves are assigned or the property is considered to be impaired, the cost of the property or the amount of the impairment is added to costs subject to depletion. In 2007, the Company has one cost centre in the United Kingdom. In 2006 the Company had two cost centres; one in the United States and one in the United Kingdom.

Proceeds from the sale of oil and natural gas properties are applied against capitalized costs, with no gain or loss recognized unless such a sale alters the rate of depletion by 20% or more.

The costs relating to each cost centre are depleted on the unit-of-production method based on estimated proven reserves before royalties in each country. Oil and natural gas reserves and production are converted into equivalent units based on estimated relative energy content on a 6:1 basis.

A limit is placed on the aggregate carrying value of oil and gas properties and a ceiling test completed at least annually for each cost centre. A quarterly ceiling test may be performed when events or circumstances indicate an impairment loss may have occurred since the last annual ceiling test. An impairment loss exists when the carrying amount of the Company's oil and natural gas properties exceeds the estimated undiscounted future net cash flows associated with the Company's proved reserves. If an impairment loss is determined to exist, the costs carried on the balance sheet in excess of the discounted future net cash flows associated with the Company's proved and probable reserves are charged to income.

Furniture and equipment are depreciated on a declining-balance basis at 20% per year. Leasehold improvements are amortized straight-line over 5 years.

Joint Interest Operations

Substantially all of the Company's oil and natural gas activities are carried out jointly with others. These consolidated financial statements reflect only the Company's proportionate interest in such activities.

Asset Retirement Obligations

The Company recognizes a liability for future retirement obligations associated with the Company's capital assets. The fair value of the asset retirement obligation ("ARO") is estimated and recorded on a discounted basis over the expected life of the assets. This amount is capitalized as part of the cost of the related capital asset and amortized over its useful life. The liability accretes until the Company settles the retirement obligations, with the accretion charge included in depletion, depreciation and accretion expense. The retirement obligations and underlining assumptions are updated periodically pursuant to a third party evaluation of Company reserves and the related estimated future costs for asset decommissioning. Actual costs incurred upon settlement of the ARO will be charged against the ARO liability recorded. Any difference between the actual costs incurred upon settlement of the ARO and the recorded liability will be recognized as a gain or loss in the statement of operations in the period in which the settlement occurs.

Future Income Taxes

The Company follows the liability method of accounting for income taxes, whereby future income tax assets and liabilities are recognized at the substantively enacted rates for the difference between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. The effect of a change in income tax rates on future income tax assets and future income tax liabilities is recognized in income in the period in which the change occurs. A valuation allowance is recorded against any future income tax asset if the Company is not "more likely than not" to be able to utilize the associated tax deductions.

Foreign Currency Translation

Monetary assets and liabilities denominated in a foreign currency are translated at the exchange rate prevailing at the balance-sheet date. Non-monetary assets and liabilities and transactions denominated in a foreign currency are translated at the exchange rates in effect at the transaction date.

Integrated foreign subsidiaries are accounted for using the temporal method. Under this method, monetary assets and liabilities are translated at the exchange rate in effect at the balance-sheet date. Non-monetary assets are translated at historical rates. Revenue and expenses are translated at average rates for the period. Foreign exchange gains and losses are included in net loss in the period in which they arise.

Financial statements for periods up to and including September 30, 2007 have been translated from Canadian dollars (the functional currency) into United States dollars (the reporting currency) using the current rate method. Using this method, all consolidated assets and liabilities have been translated using the exchange rate at the balance-sheet dates, while shareholders' equity has been translated using the historical rates of exchange in effect on the dates of the corresponding transactions. The consolidated statements of income (loss) and retained earnings (deficit) and cash flows have been translated using the prevailing average exchange rates for the periods. Any resulting exchange differences due to this translation are included in shareholders' equity as accumulated other comprehensive income.

Financial statements for periods after September 30, 2007 are both measured and reported in United States dollars. Accordingly, there is no translation adjustment required for the purposes of preparing the consolidated financial statements after this date.

On January 1, 2006, the Company adopted the U.S. dollar as the reporting currency while maintaining a Canadian dollar functional currency.

Effective October 1, 2007, the functional currency was changed from the Canadian dollar to the U.S. dollar for Oilexco Incorporated. The measurement change is due to a combination of a gradual overall increase in the operational exposure to U.S. dollars and a substantive increase in revenues denominated in U.S dollars. The change results in aligning both functional and reporting currencies in U.S. dollars as at October 1, 2007.

The change has been accounted for prospectively and does not affect prior periods as reported in U.S. dollars. Accordingly, the translation adjustment that was recorded as at September 30, 2007 in the amount of $94.8 million remains as a separate component of shareholder equity, presented as accumulated other comprehensive income.

Deferred Financing Costs

Costs incurred relating to the negotiation of revolving debt financing are set up as deferred financing costs on the balance sheet and amortized over the original term of the revolving debt facilities or amortized using the effective interest rate method for fixed term debt.

Revenue Recognition

Oil and gas revenues associated with the sale of the Company's natural gas, natural gas liquids and crude oil are recognized when title passes to the customer. Inter-field tariff revenue is recognized based on pipeline usage.

Prospect Evaluation Expenses

The Company expenses amounts incurred in the evaluation and development of potential business ventures until related business arrangements are consummated. Project-related costs incurred thereafter are capitalized and amortized over the life of the project. These costs are assessed at least annually for impairment based on expected future cash flows.

Stock-Based Compensation

The Company follows the fair value method of accounting for stock options. The Black-Scholes option-pricing model is used to determine fair value at the time the options are granted. The related expense is amortized to earnings over the options' vesting period with a corresponding increase in contributed surplus. Consideration received on the exercise of an option is credited to share capital, along with the related stock-based compensation previously recognized in contributed surplus.

Capitalized Interest and Fees

Interest costs and facility fees associated with major development projects are capitalized until the project is substantially completed. These costs are subsequently depleted together with the related assets.

Leases

The Company classifies leases entered into as either capital or operating. Leases that transfer substantially all of the benefits and risks of ownership to the Company are accounted for as capital leases, included in capital assets and depleted on the same basis as capital assets. All other leases are accounted for as operating leases and rental payments are expensed as incurred.

Per Share Data

Basic net income (loss) per share is calculated using the weighted average number of shares outstanding during the year. The treasury stock method is used in calculating diluted earnings per share. This method assumes that only in-the-money stock options and warrants are exercised and that any proceeds would be used to purchase common shares at the average market price during the year.

NEW ACCOUNTING POLICIES

Financial Instruments and Hedging Activities

Effective January 1, 2007, the Company adopted the Canadian Institute of Chartered Accountants ("CICA") Section 3855, "Financial Instruments Recognition and Measurement," Section 3861, "Financial Instruments Disclosure and Presentation," and Section 3865, "Hedges". The Company has adopted these standards in accordance with the transitional provisions in each respective section.

Financial Instruments

The new CICA sections provide standards for recognizing and measuring financial instruments in the balance sheet and the standards for reporting gains and losses in the financial statements. Financial instruments are required to be reviewed and classified into the following categories: financial assets and liabilities held for trading, loans and receivables, investments held to maturity, financial assets available for sale and other financial liabilities. Measurement of the financial instruments is based on their classification.

The Company has made the following classifications:

- Cash and cash equivalents are classified as financial assets held for trading and are measured at their fair value. Gains and losses related to periodical revaluation are recorded in net income.
- Accounts receivable and deposits are classified as loans and receivables and are initially measured at their fair value. Subsequent periodical revaluations are recorded at their amortized cost using the effective interest rate method.
- Bank loans, capital lease obligation, accounts payable and accrued liabilities are classified as other liabilities and are initially measured at their fair value. Subsequent periodical revaluations are recorded at their amortized cost using the effective interest rate method.
- Derivative contracts currently in place are classified as held for trading and are measured at their fair value. Gains and losses related to periodical revaluation are recorded in net income.

Derivative Instruments and Risk Management

The Company may use derivative financial instruments to manage its exposure to market risks resulting from fluctuations in foreign exchange rates, interest rates and commodity prices. The Company does not enter into derivative financial instruments for trading or speculative purposes. All new derivative contracts are reviewed and the Company may choose to designate a derivative instrument as a hedge and apply hedge accounting if the hedging relationship meets the respective requirements.

All existing derivative contracts are designated as held for trading and recorded at their fair value as at the balance sheet date with any resulting unrealized gain or loss recognized directly in income. Fair values are determined based on forward market prices obtained from a third party for the particular commodity contract derivatives as at the balance sheet date.

Embedded Derivatives

An embedded derivative is a component of a financial instrument or non-financial instrument (the "host instrument") of which the characteristics are similar to a derivative instrument. This component needs to be treated as a separate financial derivative when its economic characteristics and risks are not clearly and closely related to those of the host instrument. Embedded derivatives are measured at their fair value with subsequent changes recognized directly in income. The Company has elected January 1, 2003 as its transition date for accounting for any potential embedded derivatives. The Company currently has no embedded derivatives.

Financial Instruments – Disclosure and Presentation

Section 3861 establishes standards for enhancing financial statement users' understanding of the significance of financial instruments to an entity's financial position, performance and cash flows. It establishes standards for presentation of financial instruments and non-financial derivatives, and identifies the information that should be disclosed about them. This section sets forth standards on the presentation and classification of financial instruments between liabilities and equity, the classification of related interest, dividends, losses and gains, and the circumstances in which financial assets and liabilities are offset. The standard outlines required disclosures surrounding factors that affect the amount, timing and certainty of an entity's future cash flows relating to financial instruments. Disclosure of information about the nature and extent of an entity's use of financial instruments, the business purposes they serve, the risks associated with them and management's policies for controlling those risks are also required.

Comprehensive Income

Effective January 1, 2007, the Company adopted Section 1530 "Comprehensive Income". It describes reporting and disclosure recommendations with respect to comprehensive income and its components. Comprehensive income consists of net earnings and other comprehensive income ("OCI") and represents the change in shareholders' equity which results from transactions and events from sources other than the Company's shareholders. These transactions and events include changes in the currency translation adjustment and unrealized gains and losses resulting from changes in fair value of available for sale financial instruments, unrealized gains on translation of consolidated financial statements into reporting currency, and the effective portion of the change in fair value of any designated cash flow hedges.

The adoption of this section resulted in a new statement, "Consolidated Statements of Comprehensive Income (Loss) and Accumulated Other Comprehensive Income", being included as a part of the Company's consolidated financial statements. Accumulated Other Comprehensive Income is a new equity category comprised of the cumulative amounts of OCI.

Equity

Effective January 1, 2007, the Company adopted CICA Section 3251 that establishes standards for the presentation of equity and changes in equity during the reporting period. This section specifies that changes in equity for the period arising from net income (loss), OCI, other changes in retained earnings (deficit), changes in contributed surplus, and changes in share capital are presented separately.

Accounting Changes

Effective January 1, 2007, the Company adopted the revised recommendations of CICA Handbook Section 1506, "Accounting Changes".

The new recommendations permit voluntary changes in accounting policy only if they result in financial statements which provide more relevant and reliable financial information. Accounting policy changes must be applied retrospectively unless it is impractical to determine the period or cumulative impact of the change in policy, or unless the change is otherwise permitted. Additionally, when an entity has not applied a new primary source of GAAP that has been issued but is not yet effective, the entity must disclose that fact along with information relevant to assessing the possible impact that application of the new primary source of GAAP will have on the entity's financial statements in the period of initial application.

Other Pronouncements

In February 2008, the 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. Items that no longer meet the definition of an asset are no longer recognized with assets. The standard is effective for fiscal years beginning on or after October 1, 2008 and early adoption is permitted. The Company is currently evaluating the impact these sections will have, if any, on the consolidated financial statements.

In January 2006, the AcSB adopted a strategic plan for the direction of accounting standards in Canada. Accounting standards for public companies in Canada are expected to converge with the International Financial Reporting Standards ("IFRS") by 2011. As of December 31, 2008 the Company will be required to provide preliminary disclosure of policy impacts upon adopting IFRS. The Company is in initial stages of assessing IFRS and its impacts on the consolidated financial statements.

In December 2006, AcSB issued Sections 1535 "Capital Disclosures", which will require companies to disclose their objectives, policies and processes for managing capital commencing January 1, 2008. In addition, disclosures are to include whether companies have complied with externally imposed capital requirements. The adoption of new capital disclosure requirements is being reviewed by the Company and will result in additional capital disclosures in the first quarter of 2008.

The AcSB issued Section 3031, "Inventories", which is effective January 1, 2008. Section 3031 also clarifies that major spare parts and standby equipment not in use should be included in property plant and equipment, and provides more guidance on the measurement and disclosure requirements for inventory. The Company is evaluating the impact of Section 3031 on its consolidated statements for the additional disclosures commencing in the first quarter of 2008 and does not expect any measurement differences.

In December 2006, the CICA approved Handbook Section Handbook Section 3862 "Financial Instruments Disclosures", and Handbook Section 3863 "Financial Instruments Presentation". The objective of Section 3862 is to require entities to provide disclosures in their financial statements that enable users to evaluate both the significance of financial instruments for the entity's financial position and performance; and the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the balance sheet date, and how the entity manages those risks. The purpose of Section 3863 is to enhance financial statement users' understanding of the significance of financial instruments to an entity's financial position, performance and cash flows. These sections apply to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007 and the latter two will replace S.3861. The Company will adopt these new disclosure requirements in the first quarter of 2008 and is evaluating the additional disclosure requirements.

3. PREPAIDS AND DEPOSITS

Prepaids and deposits include mainly prepaid capital expenditures, insurance and operating expenses summarized as follows:

		2007		2006
Prepaid insurance	$	**3,962**	$	2,777
Prepaid drilling equipment		**2,140**		691
Prepaid development equipment		**839**		-
Prepaid operations		**1,136**		547
Deposits		**825**		-
Other		**210**		96
	$	**9,112**	$	4,111

4. INVENTORY

As at December 31, 2007, inventory held by the Company amounted to approximately $3.2 million ($nil in 2006). The inventory represents consumable material and supplies for the Balmoral and Stirling Fields, acquired as part of the Balmoral Acquisition (discussed further in Note 5).

5. PROPERTY, PLANT AND EQUIPMENT

		2007		2006
Oil and Natural Gas Properties and Equipment	$	**1,148,832**	$	491,127
Accumulated Depletion and Impairment		**(139,682)**		(24,303)
		1,009,150		466,824
Building, Furniture and Office Equipment		**7,852**		1,233
Accumulated Depreciation		**(896)**		(353)
		6,956		880
	$	**1,016,106**	$	467,704

During the year, the Company recorded depletion, depreciation and accretion expense in the amount $116.6 million ($3.1 million in 2006 and $1.4 million in 2005).

In 2007 the Company capitalized approximately $3.5 million ($1.5 million in 2006 and $0.8 million in 2005) of administrative costs to its oil and natural gas properties. Additionally, capitalized interest and financing costs relating to the Shelley and Ptarmigan development projects in the UK cost centre was approximately $8.0 million for the year ended December 31, 2007 ($3.8 million in 2006 and $1.2 million in 2005 for the Brenda and Nicol projects).

Undeveloped and unproved oil and natural gas properties that are excluded from the calculation of depletion and depreciation amounted to approximately $205.6 million as at December 31, 2007 ($59.3 million as at December 31, 2006 and $190.4 million as at December 31, 2005).

Acquisition of Interest in Balmoral

On December 19, 2007, the Company, through its wholly-owned subsidiary, Oilexco North Sea Limited, purchased from CNR International (U.K.) Limited ("CNR") its interests in the Balmoral Floating Production Vessel ("FPV") and the Balmoral, Glamis and Sterling production fields, and certain exploration acreage ("the Balmoral Properties"). The purchase price amounted to approximately $50.2 million.

Upon closing the Balmoral Properties acquisition, the Company signed a Decommisioning Security Agreement that provided for a letter of credit from Royal Bank of Scotland ("RBS") in favour of CNR and ENI UK Limited ("ENI") (the previous owner of the Balmoral Properties) in the total amount of $63.0 million. The purchase price and the letters of credit were financed through the Company's existing RBS facilities. The letters of credit are subject to annual renewals.

Impairment

To assess the impairment of oil and gas properties and equipment, the Company performs a ceiling test calculation on a quarterly basis. As at December 31, 2007, there was no impairment loss recognized, compared to $12.5 million recognized in 2006 and $1.6 million in 2005.

The benchmark prices used in the impairment calculation for 2007 are as follows:

		$/Barrel
2008	$	**87.61**
2009		**83.97**
2010		**82.57**
2011		**80.65**
2012		**80.10**
Average remainder	$	**83.89**

Nicol Farm-in Agreement

Further to a farm-in agreement between Oilexco North Sea Limited, ConocoPhillips (U.K.) Limited ("COP") and ENI signed in 2005, the Company drilled an appraisal well and obtained a 70% working interest in the Nicol field.

In April 2006, the Company ("Buyer") signed a Sales Purchase Agreement with COP and ENI ("Sellers") which provides for the conditional purchase of the remaining 30% interest in Nicol by December 31, 2009, subject to:

- Sellers collectively lifting a total of 1.25 million BBLS;
- Buyer pays all expenditures associated with the development and production of Nicol up to the completion date;
- Sellers will pay the operator (Buyer) transportation and processing costs in a single tariff; and
- Legal consents, approvals and waivers.

The Company has determined that it is at sole risk for the development costs incurred under the agreement. These costs, totaling $83.2 million as at December 31, 2007 ($18.0 million 2006), have been included in capital assets.

6. BANK INDEBTEDNESS

The Company has the following bank facilities in place, all with the Royal Bank of Scotland ("RBS"):

		Total Available		Outstanding as at December 31, 2007	Interest rate per annum	Maturity Date
Senior Facility	$	500,000	$	331,572	LIBOR + 1.5 %	Dec. 31, 2012
Pre-Development Facility	$	198,500	$	99,236	LIBOR + 3.0 – 5.5 %	Jan. 31, 2009
Overdraft	$	3,000	$	-	LIBOR + 1.5 %	On demand

Senior Facility

Under the terms of the Senior Facility agreement the use of initial cash flow from Brenda/Nicol production was limited to expenses and costs related to Brenda and Nicol fields until project completion. The agreement provided for the project to be completed after 1.56 million barrels of oil had been recovered (net to the Company) from Brenda/Nicol. The Company achieved this project completion status on September 6, 2007, at which time the cash flow derived from Brenda/Nicol became unrestricted or "free" for Company use.

On October 19, 2007, an Amendment and Restatement Agreement in respect of the Senior Facility was signed with RBS. The agreement extends both the available amount from $275 million to $500 million and the maturity date to December 31, 2012. The interest rates are based on LIBOR plus a margin of 1.5%, down from a prior agreement margin of 1.75%. The Senior Facility is secured by a first floating charge over the assets of Oilexco North Sea Limited, a guarantee from Oilexco Incorporated, supported by charges over Oilexco Incorporated's shares of Oilexco North Sea Limited, assignment of insurance proceeds from the Brenda, Nicol and Balmoral fields, and a first charge over Oilexco North Sea Limited's bank accounts.

In 2007, the Company was charged an additional financing fee of approximately $2.1 million in respect of the Senior Facility amendment. In 2006, upon establishment of the Senior Facility a financing fee of $4.8 million was charged. These charges are being amortized over the life of the facility. As at December 31, 2007, the remaining deferred financing costs on the senior facility amounted to approximately $4.9 million.

As at December 31, 2007, the outstanding Senior Facility balance was approximately $331.6 million, including a current portion of $9.8 million and excluding accrued interest of approximately $1.4 million. The interest charges in respect of the Senior Facility amounted to approximately $19.6 million in 2007 (at an overall average rate of 6.8% per annum) compared to $9.9 million in 2006 and $ nil in 2005.

Pre-Development Facility

On February 26, 2007, a Pre-Development Credit Facility ("Pre-Development Facility") was signed with RBS for £40 million. The Pre-Development Facility is repayable at any time subject to certain conditions and matures on January 31, 2008. The interest rates are based on LIBOR plus a margin of 4% per annum. The interest is payable on interest periods elected by the Company for each drawing (each such interest period to be one, two, three or six months in duration) and interest must be paid at the end of the selected interest period. The Pre-Development Facility is subordinated to the existing Senior Facility. The Pre-Development Facility is secured by a second ranking charge over the assets of Oilexco North Sea Limited, a guarantee from Oilexco Incorporated and a second ranking charge over Oilexco Incorporated's shares of Oilexco North Sea Limited.

On July 6, 2007, an Amendment and Restatement Agreement in respect of the Pre-Development Facility was signed with RBS. The agreement extends both the amount of funds available under this facility up to £100 million (approximately $198.5 million at December 31, 2007) and the maturity date until January 31, 2009. The interest rates are based on LIBOR plus a margin and the margin is applied as follows:

- the first £40 million at 3% per annum
- the next £40 million - £70 million at 4% per annum
- the next £70 million - £100 million at 5.5% per annum

As at December 31, 2007 the outstanding Pre-Development Facility balance was $99.2 million. Interest payable as at December 31, 2007 was $1.8 million. Interest charged for the year ended December 31, 2007 on the Pre-Development Facility was approximately $6.6 million (at an overall average rate of 9.9% per annum) and was capitalized to Shelley and Ptarmigan development projects.

During 2007, the Company was charged approximately $4.4 million in finance fees related to establishing the Pre-Development Facility and the July Amendment and Restatement Agreement. These charges are being amortized over the life of the facility and are being capitalized to the related project developments. As at December 31, 2007, the remaining deferred financing costs totaled $3.0 million.

Facilities Repayment Schedules

As at December 31, 2007, aggregate maturities on total bank loans of $434.0 million including accrued interest payable of $3.2 million were approximately as follows:

- within current year; 2008 – $13.1 million
- 2009 - $222.6 million
- 2010 - $152.4 million
- 2011 - $45.9 million

Pursuant to the amended Senior Facility agreement, loan repayment obligations are required to reduce the amount borrowed to an amount no greater than the borrowing base. The amount of the borrowing base may fluctuate over time, particularly due to changes in oil prices and reserves booked by the Company. Accordingly, for each balance sheet date, the timing of repayment is estimated based on the most recent re-determination of the borrowing base and repayment schedules may change in future periods.

As at December 31, 2007, the Company has letters of credit in place in the total amount of $63 million on the Senior Facility borrowing base related to the Balmoral acquisition. Pursuant to the amended RBS agreement, fees are payable quarterly at a rate of 1.625% per annum.

Overdraft

The Company has a multi-currency overdraft facility of £1.5 million (approximately $3.0 million) with RBS, repayable on demand. This facility was not utilized as at December 31, 2007.

Commodity Contracts

On January 25, 2006, as part of the Senior Facility agreement, the Company entered into a costless collar agreement with RBS in order to secure its future cash flow and to enhance the repayment of the loan facility with RBS by limiting the Company's exposure to downward fluctuations in the price of oil. The collar is comprised of the following components:

- calls on 7.1 million barrels from 2007 to 2010 with a floor price of $40 per barrel and a cap price of $88 per barrel; (4.8 million barrels remain for period 2008 to 2010)
- put options for 1.6 million barrels over the period from October 2006 to March 2007 with a strike price of $40 per barrel.

As a result of a significant increase in oil prices during 2007 a mark-to-market valuation resulted in an unrealized loss on the collar of approximately $35.4 million recognized in the Company's income statement for the year ended December 31, 2007 ($5 million in 2006).

During the year ended December 31, 2007 the Company incurred $1.9 million in realized losses on the collar derivative.

As at December 31, 2007, based on the mark-to-market valuation, approximately $17.3 million of the remaining derivative contract obligations related to 2008 are included in current liabilities and $23.0 million has been reflected as long term related to 2009 and 2010.

7. **CAPITAL LEASE OBLIGATION**

During the fourth quarter of 2006, the Company entered into a capital lease agreement to purchase a pump and other manifold related subsea equipment with a total book value of approximately $4.7 million. The respective lease obligation amounted to approximately $4.1 million as at December 31, 2007 (including approximately $1.0 million payable within one year). Interest expense (at 7.5% per annum) recognized in relation to this lease agreement amounted to approximately $.3 million in 2007. Under this capital lease agreement, the Company is committed to annual payments of approximately $1.0 million until 2011.

8. **ASSET RETIREMENT OBLIGATIONS**

As at December 31, 2007, the Company's asset retirement obligations, relate to the restoration and abandonment costs of the Brenda, Nicol, Balmoral, Glamis and Stirling fields and were calculated using a credit-adjusted risk-free discount rate of 6.0% and an inflation rate of 2%. The assumptions are reviewed periodically by management and are also based on third party reserve reports. The total undiscounted amount of cash flows required to settle the obligations is estimated at approximately $74.7 million, and the majority of this obligation is expected to be settled in approximately 15 years. Any difference between the recorded asset retirement obligation and the actual retirement costs incurred will be recorded as a gain or loss in the settlement period.

The following table presents the reconciliation of the beginning and ending obligations associated with the retirement of the properties:

		2007		2006
Balance, Beginning of Year	$	**6,513**	$	6,737
Change in Estimate		**(533)**		(1,267)
Obligations on Acquisitions		**27,427**		-
Accretion		**334**		352
Effect of Foreign Exchange		**80**		691
Balance, end of year	$	**33,821**	$	6,513

9. **SHARE CAPITAL**

(a) **Authorized**

Unlimited number of voting common shares without nominal or par value.

Unlimited number of preferred shares issuable in series, the number in each series, designation, rights, privileges, restrictions and conditions to be determined by the Board of Directors of the Company at the date of issuance.

(b) **Issued**

	Number	Amount
Balance January 1, 2006	192,738,927	$ **280,924**
Issued Pursuant to Exercise of Agent's Warrants	4,702,900	**12,531**
Issued Pursuant to Exercise of Stock Options	451,000	**658**
Fair Value Assigned to Warrants Exercised	-	**2,895**
Contributed Surplus on Stock Options Exercised	-	**376**
Balance December 31, 2006	197,892,827	**297,384**
Issued Pursuant to a Public Offering	15,000,000	**99,703**
Issued Pursuant to Over-Allotment	2,250,000	**15,181**
Issued Pursuant to Exercise of Stock Options	4,464,000	**10,313**
Contributed Surplus on Stock Options Exercised	-	**5,550**
Share Issue Costs	-	**(7,181)**
Balance December 31, 2007	219,606,827	$ **420,950**

(c) **Warrants**

	Balance January 1, 2006	**Exercised**	**Balance December 31, 2006**	**Expiry Date**
Agents Warrants				
at $1.80 (C$2.22)*	1,860,000	1,860,000	-	June 27, 2006
at $2.42 (C$3.00)*	323,100	323,100	-	February 10, 2006
at $3.17 (C$3.70)*	2,119,800	2,119,800	-	December 22, 2006
RBS Warrants				
at $2.38 (C$3.00)*	400,000	400,000	-	November 22, 2006
	4,702,900	4,702,900	-	
Weighted Average Exercise Price*	$2.51 (C$3.01)	$2.51 (C$3.01)	-	

	Balance January 1, 2007	**Granted**	**Balance December 31, 2007**	**Expiry Date**
RBS Warrants				
at $7.27 (C$8.55)*	-	500,000	500,000	February 26, 2009
Weighted Average Exercise Price*	-	$7.27 £ 3.75	$7.27 £ 3.75	

*The exercise price and weighted average exercise price have been converted into U.S. dollars based on the foreign exchange rate in effect at the date of issuance.

In February 2007, the Company issued 500,000 common share purchase warrants to RBS as part of the Pre-Development Facility consideration. The warrants are exercisable at £3.75 ($7.27) and expire on February 26, 2009. The fair value allocated to these warrants using the Black-Scholes option-model (with the assumptions as presented below) was approximately $0.7 million and was included in the income statement as interest and bank charges.

	2007
Risk Free Interest Rate	**5.45%**
Weighted Average Years	**2.0**
Expected Volatility	**50%**
Expected Dividend Yield	**0%**

(d) Stock Options

Stock options entitling the holder to purchase common shares of the Company have been granted to officers, directors, employees and certain consultants of the Company. Stock options vest immediately and are exercisable for a period of five years from the date of grant. The number of shares reserved for issuance under the plan is limited to 10% of the issued and outstanding common shares of the Company.

Exercise prices for stock options granted are determined by the closing market price on the day before the grant or, if the Company is in a black-out period at the time of the grant, then by the closing market price 48 hours after the dissemination of information which ends the black-out period.

At December 31, 2007, 17,696,000 stock options to purchase common shares were outstanding, having an exercise price range of $0.50 to $12.56 (C$0.62 to C$12.63) per share with an average remaining contractual life of 2.7 years.

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

	2007		2006		2005	
	Number of Options	**Wt. Avg. Exercise Price***	**Number of Options**	**Wt. Avg. Exercise Price***	**Number of Options**	**Wt. Avg. Exercise Price***
Balance, Beginning of Year	**19,200,000**	**$ 2.58**	14,926,000	$ 2.03	10,086,000	$ 1.53
Granted	**2,960,000**	**10.68**	4,725,000	4.19	5,480,000	2.78
Exercised	**(4,464,000)**	**2.02**	(451,000)	1.26	(640,000)	0.61
Balance, End of Year	**17,696,000**	**$ 4.08**	19,200,000	$ 2.58	14,926,000	$ 2.03
Exercisable, End of Year	**17,696,000**	**$ 4.08**	19,200,000	$ 2.58	14,926,000	$ 2.03

*The weighted average exercise price has been converted into U.S. dollars based on the foreign exchange rate in effect at the date of issuance.

The following is a summary of stock options outstanding and exercisable as at December 31, 2007:

Range of Exercise Price	Options Outstanding and Exercisable: Number of Options	Wt. Avg. Life (Years)	Wt. Avg. Exercise Price*
$0.50 – $3.23 (C$0.62 – C$3.75)*	10,641,000	1.9	$ **2.14**
$4.23 - $5.90 (C$4.75 – C$6.58)*	4,165,000	3.5	**4.27**
$6.11 - $8.33 (C$7.04 – C$9.45)*	995,000	4.2	**7.41**
$10.76 - $12.56 (C$11.57 – C$12.63)*	1,895,000	5.0	**12.51**
	17,696,000	2.7	$ **4.08**

*The exercise price and weighted average exercise price have been converted into U.S. dollars based on the foreign exchange rate in effect at the date of issuance.

(e) Stock-Based Compensation

In 2007, the Company has recognized compensation expense of approximately $14.2 million ($8.6 million in 2006 and $10.2 million in 2005) based on an estimation of the fair value of each option on the grant date, using the Black-Scholes option-pricing model with the following assumptions:

	2007	2006	2005
Risk Free Interest Rate	**3.75% to 5.45%**	4.30% to 5.45%	3.75% to 4.75%
Weighted Average Years	**5.0**	5.0	5.0
Expected Volatility	**42% to 50%**	40% to 50%	80%
Expected Dividend Yield	**0%**	0%	0%
Weighted Average Fair Value	**$4.79**	$1.81	$1.87

(f) Income (Loss) Per Share Data

Basic	2007	2006	2005
Net Income (Loss)	**$76,259**	$(14,011)	$(16,345)
Weighted Average Shares Outstanding	**213,732,169**	195,805,228	135,225,000
Per Share Before Discontinued Operations	**$0.36**	$(0.07)	$(0.12)
Per Share	**$0.36**	$(0.07)	$(0.12)

Diluted	2007	2006	2005
Net Income (Loss)	**$76,259**	$(14,011)	$(16,345)
Weighted Average Shares Outstanding	**226,488,333**	195,805,228	135,225,000
Per Share Before Discontinued Operations	**$0.34**	$(0.07)	$(0.12)
Per Share	**$0.34**	$(0.07)	$(0.12)

The diluted calculation reflects the effect of dilutive outstanding stock options and warrants on the weighted average shares for each year where there is net income. Anti-dilutive options (1,845,000 at C$12.63) that were granted December 2007 have been excluded from the calculation.

10. CONTRIBUTED SURPLUS

	2007	2006
Balance, Beginning of Year	$ **27,208**	$ 19,018
Stock-based Compensation Expense	**14,189**	8,566
Warrants – Valuation Expense	**684**	-
Transfer to Share Capital on Exercise of Options	**(5,550)**	(376)
Balance, End of Year	$ **36,531**	$ 27,208

11. DISCONTINUED OPERATIONS

	2007	2006	2005
Revenues – Oil and Gas Sales	$ -	$ 904	$ 1,063
Less:			
Royalties	-	180	212
Operating Costs – Oil and Gas Production	-	129	155
DD&A	-	86	65
Other	-	52	197
Net result of Discontinued Operations		457	434
(Loss) Gain on sale	-	(755)	-
Net (Loss) Income of Discontinued Operation	$ -	$ (298)	$ 434

Effective December 31, 2006, the Company sold 100% of its shares of Oilexco America, Inc. for $65 thousand and recognized a loss on this sale of approximately $755 thousand.

12. INCOME TAXES

The provision for income taxes is as follows:

		2007		2006		2005
Current Income Tax:						
UK	$	**(1,221)**	$	(717)	$	-
Canada		**-**		-		-
		(1,221)		(717)		-
Future Income Tax (Provision) Recovery:						
UK	$	**(40,094)**	$	44,384	$	-
Canada		**-**		-		-
		(40,094)		44,384		-
Total Tax (Provision) Recovery	$	**(41,315)**	$	43,667	$	-

Current income tax of $1.2 million for the year ended December 31, 2007, relates to the 30% UK income tax on non-ring fence activities, which, for the Company, includes interest on cash and bank deposits as well as foreign exchange gains or losses on cash denominated in foreign currencies.

The future income taxes of $40.1 million for the year ended December 31, 2007 relates entirely to the UK operation.

Tax-effected temporary differences on future income tax assets (liabilities) are as follows:

		2007		2006		2005
Oil and Gas Assets	$	**(461,261)**	$	(245,510)	$	(12,996)
Furniture and Equipment		**183**		65		54
Asset Retirement Obligations		**16,910**		3,257		3,371
Stock Option Expense		**4,804**		3,134		-
Share Issue Costs		**3,614**		3,229		5,250
Valuation of Derivatives		**20,172**		2,818		
Income Tax Losses		**430,235**		284,356		18,015
Other		**2,100**		1,029		-
		16,757		52,378		13,694
Valuation Allowance		**(12,468)**		(7,994)		(13,694)
Future Income Tax-Asset	$	**4,289**	$	44,384	$	-

The income tax provision differs from the expected results obtained by applying the statutory tax rate of 32.12% (32.12% in 2006 and 37.62% in 2005) to the loss before income taxes, as summarized below:

	2007	2006	2005
Income (Loss) Before Income Taxes	$ 117,574	$ (57,380)	$ (16,779)
Expected Income Tax Recovery	37,765	(18,430)	(6,312)
Add (Less):			
UK Tax Rate Differential	17,726	(8,971)	(157)
UK Supplemental Loss Claimed	(21,940)	(14,459)	-
Change in Valuation Allowance	4,474	(5,700)	-
Change in Previously Estimated Tax Pools	1,726	(6,648)	-
Non-Deductible Charges	349	226	61
Effect of foreign exchange	(3,392)	8,120	(118)
Stock Based Compensation	3,264	1,855	3,847
Losses Not Recognized	-	-	2,711
Change in Statutory Rates	1,103	439	326
Other	240	(99)	(358)
Income Tax Provision (Recovery)	$ 41,315	$ (43,667)	$ -

The Company has non-capital losses carried forward for Canadian income tax purposes of approximately C$27.2 million which expire from 2008 to 2015. As at December 31, 2007 a full valuation allowance has been taken against the Canadian taxable temporary differences. In addition, the Company has approximately £432.2 million in operating losses for UK income tax purposes which can be carried forward indefinitely and applied against future income.

13. SUPPLEMENTAL INFORMATION

	2007	2006	2005
Cash	$ 64,117	$ 65,236	$ 102,470
Term Deposits as at Year End	17,748	16,715	12,012
Cash and Cash Equivalents	$ 81,865	$ 81,951	$ 114,482
Interest Paid During the Year	$ 24,803	$ 7,598	$ 6
Income taxes Paid During the Year	$ 440	$ 970	$ -

14. COMMITMENTS

	Total	Less than One Year	One to Three Years	Four to Five Years	After Five Years
Drilling Contracts	$ **449,575**	$ 242,995	$ 206,580	$ -	$ -
Floating Production Vessel	**370,000**	54,736	140,160	140,352	34,752
Contractors – Development	**73,937**	65,006	8,931	-	-
UKCS Licences	**45,324**	1,922	6,759	9,955	26,688
Interest in Aircraft	**11,667**	8,375	1,585	1,707	-
Office Leases	**10,293**	1,773	3,001	2,683	2,836
Total Obligations	$ **960,796**	$ 374,807	$ 367,016	$ 154,697	$ 64,276

Drilling Contracts

Oilexco North Sea Limited has in place contracts with Transocean Offshore (North Sea) Ltd. ("Transocean") for the provision of the Sedco 712 semi-submersible drilling unit until March 23, 2010. As at December 31, 2007, the Company's obligations for the next 27 months under these contracts with Transocean amount to approximately $266.9 million.

Oilexco North Sea Limited has in place a contract with Diamond Offshore Drilling ("Diamond") for the provision of Ocean Guardian, a semi-submersible drilling unit until May 2009. As at December 31, 2007, the Company's obligations for the next 17 months under this contract with Diamond amount to approximately $182.7 million.

Floating Production Vessel

On April 27, 2007, the Company signed an agreement with Sevan Production UK (a wholly-owned subsidiary of Sevan Marine ASA) for charter of the floating production vessel "Sevan 3" to be installed in 2008 on the Shelley field. The fixed term of the contract is five years with option to extend for an additional five years. The commitments under the fixed term amount total approximately $370 million and are payable over the next six years to 2013.

Contractors-Development Commitments

The Company's contractor commitments relating to development of Brenda, Nicol and Balmoral fields amounted to approximately $14.8 million as at December 31, 2007.

Contractual commitments related to Shelly and Ptarmigan development work and equipment amounted to approximately $59.1 million as at December 31, 2007.

UKCS Licences

Further to licenses granted to Oilexco North Sea, the Company is committed to pay UK license fees of approximately $45.3 million over the next fifteen years in respect of its share in North Sea Blocks.

Interest in Aircraft

The Company has entered into agreements to purchase a 31.25% undivided interest in a Challenger 605 aircraft for $8.4 million. The Company's ownership is a fractional share managed by FlexJet of the Bombardier Aerospace Corporation and includes management services related to its share of the aircraft's fixed costs for the next five years. The fractional interest was purchased in January 2008.

Office Leases

The Company is committed under operating lease agreements for the rental of office space for approximately $10.3 million that is payable over the next nine years.

15. **FINANCIAL INSTRUMENTS**

Financial instruments are comprised of cash and cash equivalents, accounts receivable, deposits, accounts payable and accrued liabilities, capital lease obligation and bank loans. The fair values of cash and cash equivalents, accounts receivable, deposits and accounts payable and accrued liabilities approximate their carrying values due to the short-term nature of these financial instruments. The fair value of the bank loan sapproximates its carrying value due to their floating interest rates. The capital lease obligation fair value does not differ significantly from its carrying value.

Foreign Exchange Risk

A large portion of the Company's accounts receivable and accounts payable and facility debt are denominated in Pounds Sterling and also in U.S. dollars. The Company records accounts receivable and accounts payable of various source currency transactions and balances using current exchange rates. Since time passes between the recording of the receivable or payable and its collection or payment, the Company is exposed to gains or losses on these foreign currency denominated amounts. The exposure to foreign exchange risk is mitigated partly since financing and receivables are mostly in Pounds Sterling and U.S. dollars.

Interest Rate Risk

The Company uses floating rate debt to finance its operations, particularly the Senior facility for Brenda, Nicol and Balmoral fields and the Pre-Development Facility in respect of the Shelley and Ptarmigan fileds. The floating rate debt obligations expose the Company to changes in interest payments due to fluctuations in interest rates.

Credit Risk

The Company's accounts receivable are with customers in the oil and gas industry and are subject to normal industry credit risks and are unsecured. The carrying value of accounts receivable reflects management's assessment of the credit risk associated with these customers. Management believes the credit risk is mitigated by the size and reputation of the companies to which they extend credit. In the past, the Company has not experienced significant credit loss in the collection of accounts receivable. Amounts receivable from joint venture partners included in accounts receivable are recoverable from production, accordingly, management believes credit risk from these amounts is minimal.

Commodity Price Risk

Commodity price risk related to crude oil prices is one of the Company's most significant market risk exposures. Crude oil prices and quality differentials are influenced by worldwide factors such as OPEC actions, political events and supply and demand fundamentals. To a lesser extent the Company is also exposed to natural gas price movements. Natural gas prices are generally influenced by oil prices, North American supply and demand and local market conditions. The Company's expenditures are subject to the effects of inflation and prices received for the product sold are not readily adjustable to cover any increase in expenses from inflation. The Company may periodically use different types of derivative instruments to manage its exposure to price volatility, thus mitigating fluctuations in commodity-related cash flows and as well as a result of a requirement of the Company's lenders as outlined above in Note 6, *Commodity Contracts.*

Operating Hazards and Other Uncertainties

In general, acquiring, developing and exploring for and producing oil and natural gas involve many risks. These risks include encountering unexpected formations or pressures, premature declines of reservoirs, blow-outs, equipment failures and other accidents, craterings, sour gas releases, uncontrollable flows of oil, natural gas or well fluids, adverse weather conditions and environmental risks. Although the Company maintains insurance in accordance with customary industry practice, it cannot fully insure against all of these risks. Losses resulting from the occurrence of these risks could have a material adverse impact on the Company.

16. RETAINED EARNINGS (DEFICIT) AND ACCUMULATED OTHER COMPREHENSIVE INCOME

The balance of retained earnings (deficit) and accumulated other comprehensive income as at December 31, is comprised of the following items:

		2007		2006
Retained Earnings (Deficit)	$	**24,028**	$	(52,231)
Accumulated Other Comprehensive Income		**94,884**		16,158
	$	**118,912**	$	(36,073)