Sea Dragon Energy Inc.

Sea Dragon Energy Inc.
"An Exploration Stage Corporation"
As at December 31, 2008
(Audited)

Sea Dragon Energy Inc.

MANAGEMENTS' REPORT TO SHAREHOLDERS

The financial statements of Sea Dragon Energy Inc. were prepared by management within the acceptable limits of materiality and are in accordance with accounting principles generally accepted in Canada. Management is responsible for ensuring that the financial and operating information presented in this report is consistent with that shown in the financial statements.

The financial statements have been prepared by management in accordance with the accounting polices as described in the notes to the financial statements. Timely release of financial information sometimes necessitates the use of estimates when transactions affecting the current accounting period cannot be finalized until future periods. When necessary, such estimates are based on informed judgments made by management.

Management has designed and maintains an appropriate system of internal controls to provide reasonable assurance that all assets are safeguarded and financial records properly maintained to facilitate the preparation of financial statements for reporting purposes.

BDO Dunwoody LLP, an independent firm of Chartered Accountants appointed by shareholders, have conducted an examination of the corporate and accounting records in order to express their opinion on the financial statements. The Audit Committee, consisting of non-management directors, have met with the representatives of KPMG and management in order to determine if management has fulfilled its responsibilities in the preparation of the financial statements. The Board of Directors has approved the financial statements on the recommendation of the Audit Committee.

"*David Thompson*"
David Michael Thompson
President and Chief Executive Officer

"Cameron Dow"
Cameron Walter Dow
Chief Financial Officer

BDO Dunwoody LLP
Chartered Accountants

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Auditors' Report

To the Shareholders of
Sea Dragon Energy Inc.

(an Exploration Stage Corporation)

We have audited the Consolidated Balance Sheets of Sea Dragon Energy Inc. (an exploration stage company) as at December 31, 2008 and 2007 and the Consolidated Statements of Loss and Comprehensive Loss, Changes in Shareholders' Equity and Cash Flows for the years then ended and for the period from March 28, 2006 (inception) to December 31, 2008. 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 financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2008 and 2007 and the results of its operations and its cash flows for the years then ended and for the period from March 28, 2006 (inception) to December 31, 2008 in accordance with Canadian generally accepted accounting principles.

(signed) "BDO Dunwoody LLP"

Chartered Accountants
Vancouver, British Columbia

April 14, 2009

Sea Dragon Energy Inc.
"An Exploration Stage Corporation"
Consolidated Balance Sheets
(Expressed in Canadian Dollars)
(Audited)

$000	**December 31, 2008**	December 31, 2007
ASSETS		
Current		
Cash	**$ 16,733**	$ 4,452
Interest receivable	**271**	-
Prepaid expenses and deposits	**38**	-
GST recoverable	**-**	37
	17,042	4,489
Restricted cash (Note 6)	**10,081**	-
Investment (Note 7)	**300**	-
Due from related party (Note 8)	**-**	671
Property and equipment (Note 9)	**2,391**	3,029
	$ 29,814	$ 8,189
LIABILITIES		
Current		
Accounts payable and accrued liabilities	**$ 6,946**	$ 293
Convertible debentures (Note 10)	**-**	5,940
Cash received for debentures to be issued (Note 10)	**-**	605
	6,946	6,838
Commitments and Contingencies (Note 13)		
SHAREHOLDERS' EQUITY		
Common stock (Note 11)	**44,444**	1,948
Contributed surplus (Note 10)	**-**	361
Options and warrants to purchase common stock (Note 11)	**1,437**	667
Warrants to be issued (Note 11)	**-**	61
Deficit accumulated during exploration stage	**(23,013)**	(1,686)
	22,868	1,351
	$ 29,814	$ 8,189

Approved by the Directors:

"David Thompson" (Signed)
David Thompson

"Barry Swan " (Signed)
Barry Swan

The accompanying notes are an integral part of the financial statements

Sea Dragon Energy Inc.
“An Exploration Stage Corporation”
Consolidated Statements of Loss and Comprehensive Loss
(Expressed in Canadian Dollars)
(Audited)

$000	**Year ended December 31, 2008**	Year ended December 31, 2007	Cumulative Period from Inception (March 28, 2006) to December 31, 2008
EXPENSES			
General and administrative	**$ 2,181**	$ 684	$ 3,153
Foreign exchange loss (gain)	**(1,859)**	15	(1,855)
Accretion of debenture (Note 10)	**902**	277	1,179
Stock-based compensation (Note 11)	**151**	-	151
Impairment of oil and gas properties (Note 9)	**20,409**	-	20,409
Depletion and depreciation (Note 9)	**2**	-	2
Loss before other items	**(21,786)**	(976)	(23,039)
OTHER INCOME (EXPENSE)			
Interest and other income	**459**	27	486
Loss on settlement of lawsuit	**-**	-	(460)
	459	27	26
NET LOSS	**$ (21,327)**	$ (949)	$ (23,013)
Basic and diluted loss per share	**$ (0.22)**	$ (0.02)	
Weighted average common shares outstanding	**95,637,258**	39,981,322	

The accompanying notes are an integral part of the financial statements

Sea Dragon Energy Inc.
"An Exploration Stage Corporation"
Consolidated Statements of Changes in Shareholders' Equity
(Expressed in Canadian Dollars)
(Audited)

$000	Year ended December 31, 2008	Year ended December 31, 2007	Cumulative Period from Inception (March 28, 2006) to December 31, 2008
Share capital (Note 11)			
Balance, beginning of period	**$ 1,948**	$ 1,238	$ -
Shares issued for:			
Convertible Debentures (Note 10)	**7,500**	-	7,500
Initial Public Offering (Note 11)	**30,924**	-	30,924
Acquisition of Egypt Oil Holdings (Note 5)	**3,660**	-	3,660
Transferred from Contributed surplus (Note 11)	**412**	-	412
Private placements	**-**	296	712
Settlement of lawsuit	**-**	414	414
For cash	**-**	-	759
Acquisition of 40% interest in EWA Concession	**-**	-	63
Balance, end of period	**$ 44,444**	$ 1,948	$ 44,444
Contributed surplus			
Balance, beginning of period	**$ 361**	$ -	$ -
Convertible debentures (Note 10)	**51**	361	412
Transferred to share capital (Note 11)	**(412)**	-	(412)
Balance, end of period	**$ -**	$ 361	$ -
Options and warrants to purchase common stock			
Balance, beginning of period	**$ 667**	$ 363	$ -
Stock-based compensation (Note 11)	**151**	-	151
Finder's fee options (Note 11)	**554**	35	628
Convertible debentures (Note 10)	**65**	67	132
Private placements (Note 11)	**-**	202	526
Balance, end of period	**$ 1,437**	$ 667	$ 1,437
Warrants to be issued			
Balance, beginning of period	**$ 61**	$ -	$ -
Convertible debentures (Note 10)	**(61)**	61	-
Balance, end of period	**$ -**	$ 61	$ -
Shares to be issued			
Balance, beginning of period	**$ -**	$ 18	$ -
Private placements (Note 11)	**-**	(18)	-
Balance, end of period	**$ -**	$ -	$ -
Deficit Accumulated in the Exploration Stage			
Balance, beginning of period	**$ (1,686)**	$ (737)	$ -
Net loss	**(21,327)**	(949)	**(23,013)**
Balance, end of period	**$ (23,013)**	$ (1,686)	**$ (23,013)**
Total Shareholders' Equity	**$ 22,868**	$ 1,351	**$ 22,868**

The accompanying notes are an integral part of the financial statements

Sea Dragon Energy Inc.
"An Exploration Stage Corporation"
Consolidated Statements of Cash Flows
(Expressed in Canadian Dollars)
(Audited)

$000	Year ended December 31, 2008	Year ended December 31, 2007	Cumulative Period from Inception (March 28, 2006) to December 31, 2008
Cash provided by (used in)			
Operating Activities			
Net loss	$ **(21,327)**	$ (949)	$ (23,013)
Add non-cash items:			
Accretion of debenture	**902**	277	1,179
Stock-based compensation	**151**	-	151
Depletion and depreciation	**2**	-	2
Impairment of oil and gas properties	**20,409**	-	20,409
Unrealized currency gains	**(1,625)**	-	(1,625)
Loss on settlement of lawsuit	**-**	-	461
Changes in non-cash working capital (Note 12)	**(344)**	(83)	(308)
	(1,832)	(755)	(2,744)
Financing Activities			
Proceeds from issuance of shares, net of share issuance costs	**31,478**	515	33,549
Proceeds from issuance of convertible debt, net of issuance costs	**104**	6,758	6,862
Due to related parties	**(2)**	(168)	
Bank overdraft	**-**	(1)	-
	31,580	7,104	40,411
Investing Activities			
Property and equipment expenditures	**(11,033)**	(2,635)	(13,829)
Cash received on acquisition (Note 5)	**365**	-	365
Restricted cash	**(8,509)**	-	(8,509)
Investment – Convertible debenture	**(300)**	-	(300)
Due from related parties	**(94)**	(671)	(765)
Changes in non-cash investing working capital (Note 12)	**2,045**	-	2,045
Cash held in trust	**-**	1,409	-
	(17,526)	(1,897)	(20,993)
Effect of exchange rate changes on cash and cash equivalents held in foreign currencies	**59**	-	59
Net increase in cash	**12,281**	4,452	16,733
Cash, beginning of period	**4,452**	-	-
Cash, end of period	$ **16,733**	$ 4,452	$ 16,733
Supplemental Information			
Interest and taxes paid	$ **-**	$ -	$ -
Supplemental schedule of non-cash transactions			
Common shares issued for resource property (Note 11)	$ **3,660**	$ -	$ 3,722
Resource property acquired by forgiveness of amount due from related party (Notes 5 and 8)	$ **765**	$ -	$ 765
Common shares issued upon exercise of convertible debenture (Note 10)	$ **7,500**	$ -	$ 7,500
Contributed surplus recorded as common share capital upon exercise of convertible debenture (Note 11)	$ **412**	-	$ 412
Stock options issued for financing services	$ **554**	$ -	$ 628

The accompanying notes are an integral part of the financial statements

NOTE 1 – BASIS OF PRESENTATION AND NATURE OF OPERATIONS AND ABILITY TO CONTINUE AS A GOING CONCERN

a. Basis of Presentation

The consolidated financial statements include the accounts of Sea Dragon Energy Inc. ("Sea Dragon" or the "Company") and its subsidiary Egypt Oil Holdings Ltd. ("EOH") at December 31, 2008 and December 31, 2007 and for the years ended December 31, 2008 and 2007 and the cumulative period from March 28, 2006 (inception) through December 31, 2008 and are presented in accordance with Canadian generally accepted accounting principles. All material inter-company transactions have been eliminated upon consolidation. In these consolidated financial statements all dollar amounts are disclosed in Canadian dollars unless otherwise noted.

b. Organization

Sea Dragon was incorporated, under the *Canada Business Corporations Act* on March 28, 2006 to engage in the business of oil and gas exploration. The Company's planned business operations involve acquiring low entry cost exploration prospects, as measured on a dollar per barrel for proven and potential reserves in proximity to producing oil fields, and exploring for oil and gas reserves. Since inception, the Company's business activities have included incorporating and organizing the Company, financing and acquiring a 75% working interest and exploration activities in the East Wadi Araba area of the Gulf of Suez oil and gas concession (the "Concession Agreement" or "Egyptian Concession") (Note 9).

c. Ability to Continue as a Going Concern

These financial statements have been prepared on a going concern basis which contemplates the realization of assets and the payments of liabilities in the ordinary course of business.

For the year ended December 31, 2008 the Company reported a net loss of $21,327,277 and incurred negative cash flow from operating activities of $1,832,239. At December 31, 2008 its working capital was $10,095,771. Subsequent to the year end, the Company determined that the EWA Concession was not economic for further exploration (See Note 15 a.) and it has written-off the costs related to the acquisition of an interest in this concession and the direct and indirect drilling costs related to wells drilled in this concession.

The future of the company is dependent on its ability to successfully acquire, explore, develop and produce economically viable reserves, and when necessary, raise capital. The current credit market crisis, the decline in commodity prices and the global slowdown of economic growth have combined to create a substantially more difficult business environment, resulting in an extremely limited ability to execute capital market transactions. In response, management has restricted capital spending and realigned its investment strategy to focus on the acquisition of oil and gas properties that generate positive cash flows. It has restricted its administrative spending and continues to monitor financing and credit opportunities to fund future prospects and opportunities. Management believes that these courses of action will mitigate the conditions noted above and that the going concern assumption is appropriate.

NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES

a. Financial Statement Presentation

The financial statements presented are for the period from March 28, 2006 (inception) through December 31, 2008. The Company is considered an exploration stage corporation because it has had no revenues from its intended principal business and has not yet achieved commercial production. Amounts included in the financial statements are cumulative since inception.

b. Foreign Currency Transaction

The Company's functional and reporting currency is the Canadian Dollar ("$C"). Foreign currency denominated transactions are translated into $C at the rate of exchange in effect at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies have been translated into $C at the rate of exchange in effect at the balance sheet date. Gains or losses resulting from translation of monetary assets and liabilities are included in the determination of income.

c. Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions based on information available at the time. These estimates and assumptions affect the reported amounts of assets, particularly the recoverability of the resource property acquisition and deferred exploration costs, the recording of liabilities and contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Because of various factors affecting future costs and operations, actual results could differ from management's best estimates. Principal estimates used in the preparation of the financial statements include estimates for the realizable value of resource property acquisition, deferred exploration costs, ability to continue as a going concern, asset retirement obligation and stock-based compensation amounts related to granting of finders' fee options and share purchase warrants.

d. Property and equipment

In accordance with CICA Accounting Guideline 16, the Company accounts for exploration and development activities under the full-cost method. All costs associated with oil and gas property acquisition, exploration and development are capitalized on a country-by-country cost centre basis pending determination of the feasibility of the project. Costs incurred include license acquisition costs, materials and drilling costs for both productive and non-productive wells, geological and geophysical consulting fees and expenses related to exploration activities. If an oil and gas property development project is successful, the related expenditures will be depleted and amortized over the estimated life of the reserves on a unit of production basis. Where a license or deed of assignment is relinquished, a project is abandoned, or is considered to be of no further commercial value to the Company, the related costs will be charged to earnings during the period.

e. Depreciation, Depletion and Impairment

Capitalized costs within each country will be depleted and depreciated on the unit-of-production method based upon estimated proved reserves, before royalties, as determined by an independent engineer. For purposes of the calculation, oil and gas reserves and production will be converted to equivalent volumes of petroleum based upon relative energy content. Depletion and depreciation is calculated using the capitalized costs, including estimated asset retirement costs, plus the estimated future costs to be incurred in developing proved reserves, net of estimated salvage value. Costs of acquiring unproved properties are initially excluded from the full cost pool and are assessed yearly to ascertain whether impairment has occurred.

Furniture and fixtures are depreciated at declining balance rates of 20 to 30 percent.

Once commercial production is achieved, the Company will apply a "ceiling test" to ensure that capitalized costs do not exceed total estimated future net revenues from the production of proved reserves less general and administrative expenses, financing costs, site restoration costs and income taxes related to future production. Any reduction in value as a result of the ceiling test will be charged to operations as additional depletion, depreciation, and amortization. The Company did not apply a ceiling test in 2008 or 2007 because it is in the exploration stage and no proven reserves have been established.

Cost centres in the exploration stage are assessed at each reporting date to determine whether it is likely that the net costs, in aggregate, may be recovered in the future. Costs considered unlikely to be recovered are charged to earnings during the period. For the year ended December 31, 2008 an impairment charge of $20,408,609 (2007 - $nil) was recorded against the EWA Concession (Note 9).

f. Share Issue Costs

Finder's fees and commissions paid to agents and underwriters and share issue costs such as legal, accounting, auditing and printing costs incurred on the issuance of shares are charged directly to share capital.

g. Accounting for Income Taxes

Income taxes are calculated using the asset and liability method of accounting. Temporary differences arising from the difference between the tax basis of an asset or liability and its carrying amount on the balance sheet are used to calculate future income tax assets or liabilities. Future income tax assets and liabilities are measured using tax rates and laws that are expected to apply when the temporary differences are expected to reverse.

Future income tax assets also result from unused loss carry-forwards and other deductions. Future income tax assets are recognized only to the extent that management determines that it is more likely than not that the future income tax assets will be realized. Future income tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment or substantive enactment. The income tax expense or benefit is the income tax payable or refundable for the period plus or minus the change in future income tax assets and liabilities during the period. The valuation of future income tax assets is reviewed annually and adjusted, if necessary, by use of a valuation allowance to reflect the estimated realizable amount.

h. Revenue Recognition

The Company will recognize petroleum and natural gas revenues from its interests in producing wells when title passes from the Company to the customer.

i. Basic and Diluted Loss per Common Share

Basic loss per share is calculated by dividing the net loss applicable to common shares by the weighted–average number of common shares outstanding for the year. Diluted loss per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock.

For the period ended December 31, 2008, potentially dilutive common shares, relating to the share purchase options, convertible debentures, and warrants outstanding at year end, totaling 13,981,671 (2007 - 24,281,436) are not included in the computation of loss per share because their effect was anti-dilutive.

j. Stock-based Compensation

The Company records compensation expense over the vesting period based on fair value of the options granted to employees, directors and consultants. These amounts are recorded as options and warrants to purchase common shares. Any consideration paid by employees, directors or consultants on the exercise of these options is recorded as share capital together with related contributed surplus associated with the exercised options.

The Company measures compensation costs using the fair value based method for employee and non-employee based stock options which is determined at the grant date using the Black-Scholes option pricing model using the assumptions more fully described in note 11(c).

k. Asset Retirement Obligation

The Company recognizes the fair value of obligations associated with the retirement of long-life assets in the period in which it is incurred, with a corresponding increase in the carrying amount of the related asset. The obligations recognized are statutory, contractual or legal obligations. The liability is adjusted over time for changes in the value of the liability through accretion charges which are included in depletion, depreciation and accretion expense. The costs capitalized to the related assets are amortized to earnings in a manner consistent with the depletion and depreciation of the underlying assets. The Company did not have any asset retirement obligations in 2008 and 2007.

l. Financial Instruments

Financial instruments are measured at fair value on initial recognition of the instrument, into one of the following five categories: held-for trading, loans and receivables, held-to-maturity investments, available-for-sale financial assets or other financial liabilities.

Subsequent measurement of financial instruments is based on their initial classification. Held-for-trading financial assets are measured at fair value and changes in fair value are recognized in net earnings. Available-for-sale financial instruments are measured at fair value with changes in fair value recorded in other comprehensive income until the instrument is derecognized or impaired. The remaining categories of financial instruments are recognized at amortized cost using the effective interest rate method.

Cash and restricted cash are classified as held-for-trading and are measured at fair value which equals the carrying value and any gains or losses are recognized in earnings in the period they occur. Accounts receivable are classified as loans and receivables which are measured at amortized costs. Accounts payable and accrued liabilities are classified as other financial liabilities, which are measured at amortized cost. The Investment is classified as held-for-trading which is measured at fair value.

The Company expenses transaction costs related to the acquisition or issuance of held-for-trading financial instruments in the period in which the costs are incurred. The Company adds transaction costs related to the acquisition or issuance of all other categories of financial instruments.

m. Segmented Information

The Company is engaged in the business of oil and gas exploration in Egypt. The Company has determined that it operates in one reporting segment.

NOTE 3 – ADOPTION OF NEW ACCOUNTING PRONOUNCEMENTS AND FUTURE ACCOUNTING CHANGES

a. Capital Disclosures, Section 1535:

This section establishes standards for disclosures about an entity's capital and how it is managed. Under this standard the Company is required to disclose qualitative information about its objectives, policies and processes for managing capital; to disclose quantitative data about what it regards as capital; and to disclose whether an entity has complied with any externally imposed capital requirements and, if not, the consequences of such noncompliance.

The adoption of this standard requires additional disclosure (Note 4(a)) but otherwise had no effect on the financial statements of the Company.

b. Financial Instruments, Disclosure, Section 3862:

This section requires entities to provide disclosure of quantitative and qualitative information in their financial statements that enable users to evaluate (a) the significance of financial instruments for the entity's financial position and performance; and (b) 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 management's objectives, policies and procedures for managing such risks.

The adoption of this standard requires additional disclosure (Note 4(b)) but otherwise had no effect on the financial statements of the Company.

c. Financial Instruments –Presentation, Section 3863:

This Section establishes standards for presentation of financial instruments and non-financial derivatives.

This standard carries forward the former presentation requirements and thus had no effect on the financial statements of the Company.

d. Goodwill and intangible assets, Section 3064:

In February 2008, the CICA issued Section 3064, *Goodwill and intangible assets*, ("Section 3064") replacing Section 3062, *Goodwill and other intangible assets* ("Section 3062") and Section 3450, *Research and development costs*. Various changes have been made to other standards to be consistent with the new Section 3064. Section 3064 will be applicable to financial statements relating to fiscal years beginning on or after October 1, 2008. Accordingly, the Company will adopt the new standards for its fiscal year beginning January 1, 2009.

Section 3064 establishes standards for the recognition, measurement, presentation and disclosure of goodwill and of intangible assets. Standards concerning goodwill are unchanged from the standards included in the previous Section 3062. Also in February 2008, the CICA amended portions of Section 1000, "*Financial Statement Concepts*", which the CICA concluded permitted deferral of costs that did not meet the definition of an asset. The amendments apply to annual and interim financial statements relating to fiscal years beginning on or after October 1, 2008. Upon adoption of S.3064 and the amendments to Section 1000 on January 1, 2009, capitalized amounts that no longer meet the definition of an asset will be expensed retrospectively. The Company is currently assessing the impact of this new accounting standard on its financial statements.

e. Business combinations, Section 1582:

In December 2008 the CICA issued section 1582, *Business Combinations,* replacing section 1581, *Business Combinations*. This standard was amended to require additional use of fair value measurements, recognition of additional assets and liabilities and increased disclosure. Company's adopting section 1582 will also be required to adopt CICA Handbook Sections 1601, *Consolidated Financial Statements*, and 1602, *Non-Controlling Interests*. These standards will require a change in the measurement of non-controlling interest and will require the change to be presented as part of shareholders' equity on the balance sheet. In addition, the income statement of the controlling parent will include 100% of the subsidiary's results and present the allocation between controlling and non-controlling interest. These standards will be effective January 1, 2011 however early adoption is permitted. The changes resulting from adopting section 1582 will be applied prospectively and the changes for adopting sections 1601 and 1602 will be applied retrospectively. The Company has not yet begun to assess the impact of these new accounting standards on its financial statements.

f. International Financial Reporting Standards ("IFRS"):

In 2008 the CICA Accounting Standards Board ("AcSB") confirmed the changeover to IFRS from Canadian GAAP will be required for publicly accountable enterprises effective for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The eventual changeover from current Canadian GAAP to IFRS represents changes due to new accounting standards. The Company is evaluating the impact of the differences between the IFRS and GAAP and assessing the need for amendment to existing accounting policies and reporting controls in order to comply with IFRS. The transition to IFRS is a significant undertaking with the overall impact to the Company's financial statements unknown at this time.

NOTE 4 – FINANCIAL RISK MANAGEMENT

a. Capital Management:

The Company's capital structure consists of shareholders' equity, working capital and long-term debt. The Company's objective when managing its capital is to ensure it has sufficient capital to maintain its ongoing operations, safeguard the Company's ability to continue as a going concern in order to pursue the development of its working interest in the Concession Agreement (Note 9) and to maintain a flexible capital structure which optimizes the costs of capital at an acceptable risk. The Company manages its capital structure and makes adjustments to it, based on the funds available to the Company, in order to support the exploration and development of its interest in the Concession Agreement and to pursue other opportunities.

The Company monitors its capital structure and short-term financing requirements using cash flow from operations and non-GAAP metrics consisting of funds flow from operations, both calculated on most current four rolling quarter basis. Funds flow from operations represents funds generated from operating activities before changes in non-cash working capital. Funds flow from operations should not be considered an alternative to, or more meaningful than, cash flow from operating activities. Management reviews its capital management approach on an ongoing basis and believes that this approach, given the relative size of the Company, is reasonable.

$C000		2008		2007
Cash flow from operations	$	(1,832)	$	(755)
Funds flow from operations	$	(1,488)	$	(672)
Working capital (deficiency)	$	10,096	$	(2,349)

In order to complete planned exploration and development under the Concession Agreement, pay for administrative costs and pursue other exploration and development opportunities, the Company will use some of its existing working capital and may raise additional amounts through a combination of debt and equity financing as needed.

There were no changes in the Company's approach to capital management during the year ended December 31, 2008 compared to the year ended December 31, 2007. The Company is not subject to externally imposed capital requirements.

b. Financial Instruments:

The Company's financial instruments as at December 31, 2008 were comprised of cash, restricted cash, investment and accounts payable and accrued liabilities. Fair value of financial assets and financial liabilities and information related to risk management positions and discussions of risks associated with financial assets and financial liabilities are presented below.

(i) Fair Value

The carrying amount of the Company's accounts payable and accrued liabilities approximates their fair values due to the short terms to maturity. The investment is recorded at its cost which the Company believes was the fair value at the time as the price was negotiated by two unrelated parties acting at arm's length. The fair value of the investment is reviewed on an on-going basis by discussions and reports provided by the development stage issuer so that the Company can assess whether the operating plan upon which the investment decision was made is ongoing as was anticipated. Subsequent to the year-end the Company's management visited the issuer's exploration site, and reviewed and discussed the exploration plans with the issuer's senior management and on-site operating personnel.

(ii) Risks Associated with Financial Assets and Liabilities

Credit Risk

The Company is exposed to credit risk in relation to its cash, restricted cash, investment and amounts receivable and the risk of financial loss if a counterparty to a financial instrument fails to meet its contractual obligations. The Company maintains cash and restricted cash with a Major Canadian Chartered bank and therefore the Company considers cash to have credit risk which reflects the strength of the Company's bank. The Company's amount receivable (See Note 8) was due from a related party and upon the closing of the acquisition of Egypt Oil Holdings Ltd. ("EOH"), the receivable was eliminated as part of the allocation of the purchase price among the fair value of the assets and liabilities acquired (Note 5). Accordingly, the amount receivable has negligible credit risk. The Company's investment is in a debenture in a Prevail Energy Inc. (a Canadian private Company) (Note 7). Since Prevail Energy Inc. is an exploration stage company with no history of cash flow there is a significant credit risk that the Company will not receive the $300,000 in principal and $45,000 in interest owed on the debenture at maturity.

Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due. The Company's approach to managing liquidity is to ensure, as far as possible, that it will have sufficient liquidity to meet its liabilities when due, without incurring unacceptable losses or risking harm to the Company's reputation. The Company monitors cash flows to ensure it has sufficient available funds to meet current and foreseeable financial requirements at a reasonable cost.

Management believes that funds raised from the IPO financing that closed during the year ended December 31, 2008 (Note 11) will be adequate to support these financial liabilities.

Market Risk

Market risk is the risk that changes in market prices including commodity prices, foreign exchange rates and interest rates that will affect the Company' net earnings of the value of its financial instruments. The objective of market risk management is to reduce exposures to acceptable limits while maximizing returns.

Commodity Price Risk

Commodity price risk is the risk that the fair value of financial instruments or future cash flows will fluctuate as a result of a change in commodity prices. The ability of the Company to develop its interest in the Concession Agreement (Note 9) is directly related to the market price of oil and gas. Given that the current oil and gas activities are in the exploration stage and that no oil and gas reserves have been identified, the Company does not use financial derivatives or physical delivery sales contracts and accordingly, commodity price risk is negligible.

Foreign Currency Exchange Rate Risk

The Company transacts business in both Canada and Egypt and purchases goods and services denominated in Canadian and US dollars. As a result, the Company has foreign exchange transaction and translation exposure. US dollar denominated transactions are translated into Canadian dollars at the rate of exchange in effect at the date of the transaction. Monetary assets and liabilities are translated into Canadian dollars using the exchange rates in effect at the balance sheet dates. Translation gains and losses are recognized in income in the current period. The Company advances funds to Dover Investments Limited ("Dover"), the current operator of the Egyptian Concession, to the extent necessary to carry out exploration activities thus monetary assets and liability balances are minimal. As such, the Company has exposure to foreign currency exchange rate fluctuations at this time. The Company has US$8,021,875 cash and restricted cash as at December 31, 2008 (See Note 6, items a) and b)). There are no other foreign denominated financial assets or liabilities as at December 31, 2008.

Sensitivity

The Company estimates a ten percent change in the United States foreign exchange rate would have resulted in unrealized foreign exchange gains impacting the net loss by $1.0 million. A ten percent change in the average United States foreign exchange rate for the year would have impacted the cost of the acquisition of property and equipment by an estimated $1.2 million.

NOTE 5 – SIGNIFICANT ACQUISITION

On March 23, 2008, Sea Dragon entered into a share exchange agreement to acquire all of the outstanding common shares of EOH, a company incorporated under the *Canadian Business Corporations Act* on October 22, 2007. This acquisition closed on April 24, 2008. The purchase consideration reflected in the table below has been calculated using a common share price of $0.1525 per Sea Dragon share, which is the estimated fair value of Sea Dragon's shares based on the most recently completed private placement transactions (less imputed value of warrants using the Black-Scholes option pricing model) prior to the share exchange with EOH.

EOH acquired, through sale and purchase agreements, a 15% interest in the Concession Agreement from Dover, Brokton International Ltd. and Robert Salna for 5,000,000 shares of EOH's common stock and a 20% interest in the Concession Agreement from Mogul Energy International, Inc. ("Mogul" – a company with whom a director of the Company is a significant shareholder) for 4,000,000 shares of EOH common stock, the assumption of certain liabilities (including a $764,776 payable to Sea Dragon (Note 8)) and $C100,000) thereby, giving EOH a 35% interest in the Concession Agreement.

Sea Dragon accounted for the purchase of EOH as a direct acquisition of a 35% interest in the Concession Agreement primarily because the Company considered EOH to be an intermediary as it had incurred minimal costs to acquire its 35% interest in the Concession Agreement for Petroleum Exploration and Exploitation (the "Concession Agreement") between Dover, Arab Republic of Egypt ("ARE") and The Egyptian General Petroleum Corporation ("EGPC") dated July 18, 2002. Furthermore, as there were no reserves attributable to the Concession Agreement at the date of the transaction, the acquisition was not accounted for as a business combination. The purchase of the 20% interest from Mogul is recorded using the exchange value, being the value established and agreed to between the parties and consistent with the value determined for the acquisition of the 15% carried interest.

As described in note 8, a $C764,776 receivable was owed to Sea Dragon by Mogul for cash calls on the Concession Agreement during fiscal 2007 and in fiscal 2008 (to the date of acquisition) that were paid on Mogul's behalf by Sea Dragon. This liability was assumed by EOH upon its acquisition of a 20% interest in the Concession Agreement from Mogul. Since it represents expenditures on the Concession Agreement, and will eliminate upon consolidation, the receivable has been included in the purchase price below.

The allocation of the purchase price is summarized in the table below:

$000 Purchase price	
24,000,000 Sea Dragon common shares @$0.1525 per share	$ 3,660
Amount receivable from Mogul	765
	4,425
Fair value of EOH net assets to be acquired	
Cash	(365)
Accounts payable and accrued liabilities	20
Resource property	$ 4,080

EOH was dissolved on October 10, 2008 and its assets and liabilities were amalgamated into the Company.

NOTE 6 – RESTRICTED CASH

Restricted cash consists of $US denominated term deposits that secure two Letters of Credit, and a minimum cash balance that secures corporate credit cards. These balances are held under the following terms:

$000	Terms	Amount ($US)	Amount($C)
a)	Interest of 0.10% p.a., maturing January 23, 2009	6,500	7,982
b)	Interest of 1.15% p.a., maturing February 3, 2009	1,522	1,869
c)	Minimum cash balance in $C denominated account	188	230
		8,210	10,081

a) The letter of credit for $US6,500,000 which expires on May 28, 2009 was granted as security for the contractor's payment for the Transocean 103 off-shore drilling rig used to drill the East Wadi Araba 5-X well in 2008 and 2009.
b) The letter of credit for $US1,521,875, was provided to the Egyptian General Petroleum Corporation as security for the financial commitment of Exploration phase of the East Wadi Araba concession in Egypt.
c) Security for corporate credit cards is a minimum cash balance of $C230,000.

The term deposits supporting the Letters of Credit will be reinvested in term deposits when they mature. Upon maturity the Letters of Credit will either be released by the holders in full satisfaction of the underlying commitment, extended by Sea Dragon, or called by the holders.

NOTE 7 – INVESTMENT

On December 22, 2008, the Company purchased a $300,000 convertible debenture issued by Prevail Energy Inc., ("Prevail") a private Canadian corporation with a joint venture interest in an oil and gas concession in The Republic of the Congo. The debenture bears interest at 15% per annum and matures on November 19, 2009. Any unpaid amounts of the debenture and accrued interest may be converted into the shares of Prevail at the rate of $C0.15 per share. If the full amount of the debenture and interest is converted, the Company could acquire 3,552,500 common shares of Prevail, representing 8.92% of all of the issued common shares of Prevail on a fully diluted basis. The Company has classified this financial instrument as a security held for trading. The transaction costs associated with the debenture, in the amount of $33,038 have been expensed during the year.

The fair value of the investment at December 31, 2008 equals its purchase price because the Company is not aware of any events that have occurred between the purchase date and the year-end which would have a material effect on the fair value of the investment.

NOTE 8 - DUE FROM RELATED PARTY

An amount receivable from Mogul, a company with whom a director of the Company is a significant shareholder, represented cash calls Mogul was required to pay to fulfill its 1/3 working interest in the exploration program on the Egyptian Concession in fiscal 2007 and to April 23, 2008. These cash calls were paid by Sea Dragon on Mogul's behalf. The amount receivable was non-interest bearing, unsecured, and had no other specific terms or conditions. Upon the acquisition of Mogul's interest in the Concession Agreement by EOH and Sea Dragon's subsequent acquisition of EOH on April 23, 2008 (Note 5), the amount receivable at that date in the amount of $764,776 (2007 - $671,256) became an inter-company balance that was eliminated upon consolidation.

NOTE 9 - PROPERTY AND EQUIPMENT

$000		2008		2007
Furniture and fixtures	$	46	$	-
Accumulated deprecation		(2)		-
Furniture & fixtures, net		44		-
Exploration and development expenses		22,756		3,029
Write-down of EWA Concession costs		(20,409)		-
Oil and gas properties:		2,347		3,029
	$	2,391	$	3,029

The Company is in the exploration stages of its planned principal operations in Egypt. Through a series of agreements it entered into between August 6, 2005 and April 5, 2006 the Company acquired a 40% working interest in the EWA Concession Agreement. On January 24, 2007, Sea Dragon and Mogul, one of the joint venturers, entered into an agreement pursuant to which Sea Dragon and Mogul became jointly liable to the Arab Republic of Egypt ("ARE") and The Egypt General Petroleum Corporation ("EGPC") for the performance obligations under the EWA Concession Agreement, which included incurring exploration costs of US$2 million for one well by July 17, 2007 (subsequently extended to February 17, 2008) and US$4.5 million for two additional wells by July 17, 2009.

On July 12, 2007 the joint venture commenced drilling the EWA-4X deviated well from an onshore surface location to test an offshore structure, targeting light oil in the Raha and Nubia formations. On September 18, 2007 the Company received notification that the well did not contain any economically recoverable hydrocarbons and was subsequently wire-line-logged, plugged and abandoned.

On January 5, 2008, Dover, the current operator on the EWA Concession, entered into the Second Extension for the EWA Concession and the relinquishment of 25% of the original Concession. The extension was granted pursuant to Sea Dragon issuing a letter of guarantee of US$3,483,114 (CDN$3,524,215). The letter of guarantee was subsequently reduced to US$1,521,875 based on the EPGC audit of the costs incurred on the EWA-4X well. (See Note 6).

On March 23, 2008 the Company acquired the shares of EOH (See Note 5) which increased its ownership share in the Concession Agreement to 75%. The Company's deed of assignment for the 75% interest was granted by the ARE and EGPC at the same time. As a result, the Company became responsible for 100% of the costs for the next two wells under the Concession Agreement.

On September 11, 2008 the Company, through its operator, contracted the Jack-Up Rig Transocean 103 GSF to carry out the drilling of the EWA 5-X well subject to a letter of guarantee being placed as security for the rig. The letter of guarantee was established on September 30, 2008 for US$6,500,000 (CDN$7,892,000 – See Note 6). Drilling commenced through 2008 and in February 2009 the Company concluded that the well did not contain commercial quantities of hydrocarbons and, accordingly, it tested, plugged and abandoned the property.

Subsequent to the year-end Management decided that it would not pursue further exploration on the EWA concession. Accordingly, all costs related to the acquisition of the concession, direct drilling and capitalized administrative and other overhead costs totaling $20,408,609 that had been incurred to December 31, 2008 were written off. The costs remaining on the balance sheet are comprised of:

$000		2008		2007
Amount receivable	$	666	$	-
Drilling materials and supplies		273		113
Prepaid expenses, deposits and amounts paid in excess of costs		1,408		10
Direct drilling costs		-		2,263
Administrative and consulting		-		643
	$	2,347	$	3,029

NOTE 10 – CONVERTIBLE DEBENTURES

On November 26, 2007, the Company entered into a non-brokered financing of unsecured convertible debentures (the "Debentures"). The financing closed in three tranches and raised total gross proceeds of $7,500,000. The Debentures were non-interest bearing and were to mature on March 31, 2008. Subject to certain conditions, the lenders were entitled to convert in whole or in part the debentures into common shares of the Company at a conversion price of $0.35 per share. In addition, subject to certain events occurring on or before the maturity date, the outstanding Debentures were automatically convertible into common shares of the Company at the same conversion price.

In connection with the Debenture financing the Company paid the agents a commission equal to 7% of the gross proceeds raised on the financing and granted compensation warrants to purchase 7% of the number of common shares issuable by the Company upon conversion of the debenture. The warrants were exercisable at $0.35 per share and expire 18 months from the date that the Company is listed on the TSX Venture Exchange (the "Exchange").

The first tranche of the financing closed on November 26, 2007 and raised gross proceeds of $5,962,599. The second tranche closed on November 30, 2007 and raised gross proceeds of $750,000.

In accordance with the requirements of CICA handbook S3855, *Financial Instruments – Recognition and Measurement*, the debentures were designated as other liabilities. Furthermore the proceeds raised from the issuance of the debentures were allocated between the liability component (the debenture) and the equity component (the conversion feature) using the residual method whereby the Company determined the fair value of the debentures and allocated the residual to the conversion feature.

The fair value of the first and second tranches of the Debenture financing, being the present value of the repayment obligation, was estimated using a discount factor of 16%. At the date of issuance of the first and second tranches the Company allocated $6,352,000 to the debentures and $360,599 to the conversion feature (with an offsetting credit to contributed surplus). The commission paid to the agent on the issuance of the Debentures, in the amount of $470,182 and legal fees in the amount of $90,315 have been deducted from the value of the proceeds.

A total of 1,342,521 compensation warrants were granted upon closing the first and second tranches of the debenture financing. The fair value of the broker warrants, estimated to be $128,583, was calculated using the Black-Scholes option pricing model using the following assumptions: average risk free rate – 3.95%, expected life – 2.09 years, expected volatility 112% and expected dividend yield of 0.00%. Of the compensation warrants granted, a total of 642,689 compensation warrants with an estimated fair value of $61,560 were not issued at December 31, 2007, and were recorded as warrants to be issued. These warrants were issued on January 15, 2008 and the fair value was reclassified to options and warrants to purchase common shares.

Prior to the closing of the third tranche of the Debenture financing, the Company received gross proceeds of $605,401. As the debentures were not issued prior to December 31, 2007, the cash received was deferred to the balance sheet as "Cash received for debentures to be issued". On January 15, 2008 the third tranche closed and the cash received was reclassified to convertible debentures. The remaining gross proceeds received in the third tranche of the Debenture Financing were $182,000. In connection with the closing of the third tranche, the Company granted an additional 36,400 compensation warrants. The warrants are exercisable at $0.35 per share and expire 18 months from the date the Company is listed on the TSX Venture Exchange.

The fair value of the Debentures issued pursuant to the third tranche of the financing, being the present value of the repayment obligation, was estimated using a discount factor of 16%. At the date of issuance the Company allocated $761,000 to the debentures and $26,401 to the conversion feature (with an offsetting credit to contributed surplus).

The fair value of the additional compensation warrants, estimated to be $3,300, was calculated using the Black-Scholes option pricing model using the following assumptions: average risk free rate – 3.78%, expected life - 1.95 years, expected volatility 112% and expected dividend yield of 0.00%.

The amount allocated to the conversion feature and transaction costs (being legal fees of $19,810, additional cash commission of $54,720, and the fair value of the additional compensation warrants) represent a discount on the Debentures which will be accreted to income over the term of the Debentures using the effective interest rate method.

On March 31, 2008, the maturity date of the Debentures was extended from March 31, 2008 to June 30, 2008 as agreed to by lenders holding at least two thirds of the aggregate principal amount of the outstanding Debentures. All other terms and conditions attached to the debentures remained unchanged. On June 19, 2008, pursuant to a second debenture amending agreement, the convertible debentures were further extended to July 31, 2008 as agreed to by lenders holding at least two thirds of the aggregate principal amount of the outstanding debentures.

In accordance with EIC-88, "Debtor's Accounting for a Modification or Exchange of Debt Instruments" the extensions of the Debentures at March 31 and June 19, 2008 were considered modifications of the debt. The fair value of the repayment obligation, being the present value of the future principal payment was estimated at each extension date using a discount factor of 16% and an additional $25,000 and $nil, respectively, was allocated to the conversion option (with an offsetting credit to contributed surplus) at each extension date.

On July 17, 2008, upon closing of the Company's IPO (Note 11), the Debentures were converted into 21,428,571 common shares of the Company.

The Debentures and debt discount are summarized as follows:

$000	**Face Amount**	**Discount**	**Carrying Value**
Convertible debentures issued	$6,713	$1,050	$5,663
Accretion of debt discount	-	(277)	277
Debentures at December 31, 2007	$6,713	$773	$5,940
Debentures issued	787	104	683
Extension of Debenture to July 31, 2008	-	25	(25)
Accretion of debt discount	-	(902)	902
Conversion to common shares	(7,500)	-	(7,500)
Debentures at December 31, 2008	$ -	$ -	$ -

During the year ended December 31, 2008, the Company recorded an accretion expense of $902,262 (2007 - $276,649) in respect of the discount.

NOTE 11 – SHARE CAPITAL

a) **Authorized**

Unlimited common shares with no-par value.

Unlimited preference shares with no-par value. No preferred shares are issued or outstanding at December 31, 2008 and December 31, 2007.

b) **Issued and outstanding**

Common shares with no-par value *$000, except for number of shares*	Number of Shares		Amount
Balance at December 31, 2006	34,632,500	$	1,238
Shares issued for settlement of lawsuit at $0.138 per share	3,000,000		414
Units issued for cash at $0.20, less $5,818 for estimated value of the share purchase warrants	90,000		12
Units issued for cash at $0.20 less $54,800 in finder's fees, $34,366 in legal fees and $35,532 for finder's fee options and $179,929 for the estimated fair value of the share purchase warrants	2,775,000		251
Units issued for cash at $0.20 less transfer agent costs of $795 and the estimated fair value of $15,988 of the share purchase warrants	250,000		33
Balance, December 31, 2007	40,747,500		1,948
Shares issued to acquire EOH (Note 5)	24,000,000		3,660
Shares issued through Initial Public Offering at $0.60 less offering costs of $4,075,553, which included all costs directly associated with the IPO	58,333,334		30,924
Shares issued upon conversion of the convertible debentures (Note 10)	21,428,571		7,500
Contributed surplus from convertible debentures transferred to common shares upon conversion of the debentures	-		412
Balance, December 31, 2008	144,509,405	$	44,444

On September 29, 2006, 90,000 common shares worth $12,182 and 45,000 share purchase warrants with an estimated value of $5,818 were paid for but not yet issued. These amounts were classified as shares to be issued at December 31, 2006. These units were issued on March 16, 2007 and the amounts were reclassified from shares to be issued to common stock and options and warrants to purchase common stock respectively.

On January 24, 2007 Sea Dragon reached a settlement agreement with respect to a statement of claim made by two related shareholders. Under the terms of the settlement agreement, the Company issued 1,500,000 common shares to each of the complainants. The fair value of the 3,000,000 shares was $414,072, determined using the average fair value of common shares issued during the period ended December 31, 2006. This amount was reclassified from accrued liabilities to share capital during the period ended June 30, 2007. The fair value of common shares used to record this share issuance was estimated by taking the $0.20 unit price less the estimated value of the warrants, resulting in a share component of $0.138 per share.

On March 8, 2007 and March 16, 2007, the Company completed private placements for gross proceeds of $555,000 through the issuance of 2,775,000 units consisting of one common share and one half of a share purchase warrant at CDN$0.20 a unit. Each whole warrant entitles the holder to acquire one share at a price of $0.30 per share, at any time on or before the first business day that is two years after the initial listing date of the shares on the Exchange; provided that, if at any time following the expiration of any hold period on the warrants imposed by the Exchange or by statute, the closing price of the Company's common stock on the Exchange is equal to or greater than $0.45 per share for 20 consecutive trading days, the Company may give notice in writing to the holders of the warrants that the expiry date of the warrants is being shortened to 30 days from the date of such notice. The fair value of the warrants was estimated to be $179,929 using the Black-Scholes option pricing model using the following assumptions: average risk free rate – 4.01%, expected life – 3.30 years, expected volatility 112% and expected dividend yield of 0.00%.

In connection with this issuance, a commission equal to $54,800 of the gross proceeds on the private placement was paid as a finder's fee. In addition, the finder's fee includes 274,000 compensation options entitling the holder to acquire from the issuer 274,000 common shares at any time prior to 4:00 p.m. (Pacific Standard Time) on the date that is two years following the date on which the Company's common shares are listed on the TSX on payment of $0.20 per share, provided that, if at any time following the expiration of any hold period on the shares imposed by the exchange or by statute, the closing price of the Company's common shares on the Exchange equal to or greater than $0.45 per share for 20 consecutive trading days, the Company may give notice in writing to the holder of the options that the expiry date of the options is being shortened to 30 days from the date of such Notice. The fair value was calculated using the Black-Scholes option pricing model using the following assumptions: average risk free rate – 4.01%, expected life – 3.30 years, expected volatility 112% and expected dividend yield of 0.00%.

On April 18, 2007 the Company completed a financing with the issuance of 250,000 units comprising 250,000 common shares worth $50,000 and 125,000 share purchase warrants with an estimated fair value of $15,988 was completed. In connection with subscription additional legal fees of $795 were paid. The fair value of the warrants was calculated using the Black-Scholes option pricing model using the following assumptions: average risk free rate – 4.18%, expected life – 3.20 years, expected volatility 112% and expected dividend yield of 0.00%.

On April 24, 2008 Sea Dragon and EOH, entered into a share exchange agreement whereby Sea Dragon issued to the shareholders of EOH, 24,000,000 common shares of the Company in exchange for all of the issued and outstanding common shares of EOH. EOH is now a wholly-owned subsidiary of the Company upon completion of the acquisition. Upon the execution of all the aforementioned Agreements Sea Dragon is the beneficial holder of a 75% working interest in the Concession Agreement (Note 9).

On July 15, 2008, the Company completed an initial public offering ("the IPO") and issued a total of 58,333,334 common shares for net proceeds of $30,924,447 after deducting $1,317,142 for legal fees, $104,600 of accounting fees and agents' commission of $2,100,000 being 6% of the gross proceeds raised on the offering. Pursuant to the agency agreement, the Company also agreed to grant compensation options to the agents entitling the agents to acquire a number of common shares equal to 6% of the number of common shares sold by the Company under the offering at $0.60 per share for a period of eighteen months after the common shares are listed on the TSX-V,. As a result, the Company has granted 3,500,000 compensation options to the agents upon closing of the IPO. The fair value of the warrants was estimated to be $553,812 using the Black-Scholes option pricing model under the following assumptions: average risk free rate – 3.27%, expected life – 1.5 years, expected volatility 84.24% and expected dividend yield of 0.00%.

Concurrent with the closing of the IPO, the convertible debentures were converted into 21,428,571 common shares at an aggregate value of $7,500,000 and $412,000 was transferred from contributed surplus to the value of the common shares.

As a condition of closing the IPO, the common shares held directly or indirectly by the directors or officers of the Company and the common shares held by shareholders of the Company who purchased or acquired common shares of the Company more than a year prior to the offering ("Seed Shares") were placed into an escrow agreement (the "Directors, Officers and Seed Shareholders Voluntary Escrow Agreement") with an escrow agent. The escrowed shares will be released from escrow on the earlier of: (i) the Company announcing the drilling results of the second exploratory well drilled on the EWA Concession (Note 9); and (ii) July 31, 2009. At December 31, 2008 there are 26,971,498 common shares are held in escrow pursuant to the Directors, Officers and Seed Shareholders Voluntary

Escrow Agreement which includes 11,810,998 common shares held in escrow in accordance with the Canadian Securities Administrators Policy 46-201 and 19,600,000 common shares held in escrow pursuant to the EOH escrow agreement. None of these shares have been released from escrow.

c) **Options**

On March 28, 2008, the board of directors adopted a stock option plan (the "Option Plan"). A number of common shares equal to 10% of the Company's outstanding common shares are reserved for issuance under the Option Plan.

The Option Plan provides for the grant of options to purchase common shares to eligible directors, senior officers, employees and consultants of the Company or any of its affiliates ("Participants"). The exercise periods and vesting periods of options granted under the Option Plan are to be determined by the board of directors. The expiration of any option will be accelerated if the participant's employment or other relationship with the Company terminates. The exercise price of an option is to be set by the board of directors at the time of grant but shall not be lower than the Market Price (as defined in the Option Plan) at the time of grant.

Any amendment to the Option plan would be subject to shareholder and regulatory approval.

Compensatory stock based transactions with directors, officers, employees and outside consultants are recorded at estimated fair value. The Company uses the Black-Scholes option pricing model to estimate the fair value of each stock option at the date of grant. The fair value of stock options, which vest immediately, is recorded at the date of grant; the fair value of options, which vest in future, is recognized over the vesting period. Stock options that vest over time are recorded over the vesting period using the straight line method. Stock options issued to outside consultants that vest over time are valued at the grant date and subsequently re-valued on each vesting date. Stock based compensation is recognized as an expense with a corresponding increase in options and warrants to purchase common stock.

Consideration received on the exercise of stock options together with the related portion previously recorded in options and warrants to purchase common stock is credited to share capital.

On July 28, 2008 the Company granted 4,200,000 stock options under the option plan to certain directors and officers of the Company at an exercise price of $0.60 per share. The stock options vest in equal installments over a 3-year period. The options expire on July 28, 2013. The Company also granted 500,000 stock options under the option plan at an exercise price of $0.60 per share to a third party consultant in exchange for investor relation services. These options vest in equal installments over 3 years, the length of time in which the investor relations services are expected to be provided. These options also expire on July 28, 2013.

These options were ascribed a total fair value of $1,141,630 on the grant date, using the Black-Scholes option pricing model with the following assumptions: average risk free rate – 3.4%, expected life – 5 years, expected volatility 106% and expected dividend yield of 0.00%. Stock-based compensation expense of $151,252 (2007 - $nil) was recorded during the year ended December 31, 2008.

The following share purchase options were outstanding and exercisable at December 31, 2008:

	Year end December 31, 2008		Year ended December 31, 2007	
	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
Outstanding, beginning of year	1,228,832	$0.32	255,000	$0.20
Options granted	8,879,089	$0.58	1,616,521	$0.32
To be issued	-	-	(642,689)	$0.35
Outstanding, end of year	10,107,921	$0.55	1,228,832	$0.32
Exercisable, end of year	5,407,921	$0.48	1,228,832	$0.32

The following summarizes details about the Company's stock option granted as at December 31, 2008:

	Outstanding Options		Vested Options	
Exercise Price	Number of Options	Remaining Contract Life	Number of Options	Remaining Contract Life
$0.20	529,000	1.54 years	529,000	1.54 years
$0.35	1,378,921	1.05 years	1,378,921	1.05 years
$0.60	3,500,000	1.54 years	3,500,000	1.54 years
$0.60	4,700,000	4.58 years	Nil	
	10,107,921		5,407,921	

Unvested options as of December 31, 2008 will vest in accordance with the following schedule:

Exercise Price	Number of Options	Date when vested
$0.60	1,566,667	July 28, 2009
$0.60	1,566,667	July 28, 2010
$0.60	1,566,666	July 28, 2011
	4,700,000	

Warrants

The following share purchase warrants were outstanding at December 31, 2008:

	Number of shares	Exercise Price	Expiry Date
Balance, January 1, 2007	2,316,250	$0.30	July 17, 2010
Issued	1,557,500	$0.30	July 17, 2010
Balance, December 31, 2007 and December 31, 2008	3,873,750	$0.30	July 17, 2010

NOTE 12 – SUPPLEMENTAL CASH FLOW INFORMATION

Changes in operating non-cash working capital consisted of the following:

$000		**2008**		**2007**
Operating activities				
Interest receivable	$	(270)	$	-
GST recoverable		37		(36)
Prepaid expenses		(38)		-
Accounts payable and accrued liabilities		(73)		(47)
	$	(344)	$	(83)
Investing activities				
Amount receivable	$	(666)	$	-
Prepaid expenses, deposits and amounts paid in excess of costs		(2,553)		-
Drilling materials and supplies		(1,211)		-
Accounts payable and accrued liabilities		6,475		-
	$	2,045	$	-

NOTE 13 – COMMITMENTS AND CONTINGENCIES

a. Commitments

- Under the terms of the Concession Agreement for the East Wadi Araba Area in Egypt, the Company committed to drill two wells and spend $US3.5 million on exploration activities. In order to secure the expenditure commitment, the Company issued a Letter of Guarantee for $US3.5 million to the Egyptian General Petroleum Corporation in January 2008. The Letter of Guarantee was subsequently reduced to $1,521,875 by August 2008 after completion of the first well (4-X) (See Note 5).

  The Company is of the opinion that with the completion of the 5-X well in February 2009 (See Note 15) the Company has met these performance and expenditure obligations.

- Subsequent to the year-end, the Company remitted $13,438,000 to the EWA Concession joint venture pursuant to cash calls issued by the joint venture operator to fund drilling operations and administrative expenses incurred in December 2008 and the first quarter of 2009. The Company anticipates remitting an additional amount of approximately $3.75 million to fully fund its obligations under the EWA Joint Operating Agreement.

- The Company has entered into an agreement to lease office space in Calgary, Alberta beginning on November 1, 2008 and ending on January 30, 2011. A payment has been made as a deposit for the first and last month's rent currently booked as deposit. The monthly rent is $13,721.

b. Contingencies

On May 30, 2008 (as amended on June 30, 2008), a statement of claim (the "Claim") was filed in the province of British Columbia by Transpacific Petroleum Corp. and Ghareeb Awad (the "Plaintiffs") against the Minister of Petroleum – Egypt, Dover Investments Limited and the Company (the "Defendants"). The Plaintiffs allege, among other things, that the actions on behalf of the Defendants have resulted in Transpacific not being recognized for a 25% interest in the Concession Agreement. They seek injunctions and damages as compensation.

On November 10, 2008 the British Columbia Supreme Court ruled in favour of an application made by the Company that the Plaintiffs did not have a legal right to initiate a court action in respect of a contractual dispute involving the East Wadi Araba concession in Egypt. This matter was accordingly moved to arbitration in Alberta, and in February 2009 the proceedings were stayed following the failure of the plaintiffs to fund their share of the costs of the arbitration.

The Company strongly believes these Claims to be without merit and will vigorously defend itself against these actions. As an assessment of the likelihood of loss is indeterminable at this time, no provision has been made in these financial statements for this claim. Any such loss will be recognized in the period it becomes likely to occur.

NOTE 14 – INCOME TAXES

a. The provision for income taxes differs from the result that would be obtained by applying the combined current year Federal and provincial income tax rates of 30.72% (2007 – 33.00%) to the net loss. The difference results from the following items:

$000		**2008**		**2007**
Loss before income taxes	$	(21,327)	$	(949)
Tax rate		30.72%		34.12%
Expected income tax (recovery)	$	(6,551)	$	(324)
Accretion of convertible debenture		277		91
Stock-based compensation		46		-
Non-taxable portion of foreign exchange gain		250		-
Non-taxable portion of impairment loss		1,253		
Other non-deductible items		8		9
Tax rate adjustments		694		173
Valuation allowance		4,023		51
Total income taxes (recovery)	$	-	$	-

b. The components of the Company's future income tax assets and liabilities at December 31 are as follows:

$000		**2008**		**2007**
Non-capital losses	$	1,683	$	414
Property & equipment		3,150		-
Share issue costs		792		167
Unrealized foreign exchange (gains) losses		(207)		4
Valuation allowance		(5,418)		(585)
	$	-	$	-

The Company's future tax assets also include approximately $3,046,000 (2007 - $640,000) related to future deductions of share issuance costs for tax purposes in excess of amounts deducted for financial reporting purposes. If and when the valuation allowance related to these amounts is reversed, the Company will recognize the benefit as an adjustment to share capital as opposed to income tax expense in the Statement of Loss and Comprehensive Loss. The valuation allowance as at December 31, 2008 was increased by $810,000 (2007 - $220,000), representing the net tax effect of the share issuance costs incurred in the year.

Management has determined that for financial reporting purposes a 100% valuation allowance is appropriate as the criteria for recognition of the future income tax assets have not been met. The Company evaluates its valuation allowance requirements based on projected future operations. When circumstances change and this causes a change in management's judgment about the recoverability of future tax assets, the impact of the change on the valuation allowance is reflected in current income.

c. At December 31, 2008 the Company had estimated non-capital losses of $6,473,000 (2007 – $1,591,000) which will expire as follows:

Year incurred *$000*		**Non-capital losses**	**Year of expiry**
2006	$	314	2026
2007		1,277	2027
2008		4,882	2028
	$	6,473	

NOTE 15 – SUBSEQUENT EVENTS

a. On February 17, 2009 the Company announced that the Dahab North Prospect well was drilled to a depth of 9,750 feet and was fully evaluated by drilling two well bores from the same surface location in order to test the Miocene and Pre-Miocene targets. Although the well encountered two separate reservoirs in the Kareem and Rudeis formation and hydrocarbons were encountered, the findings were determined to be uneconomic for further exploration or development and the well was plugged and abandoned. The GSF#103 drilling rig was released. As a result the Company has written-off the cost related to the acquisition of an interest in this concession and the direct and indirect drilling costs related to wells drilled in this concession. The Company is of the opinion that this operation completed its obligations under the Concessions Agreement for the West Araba Area of Egypt (See Note 9).

b. On January 12, 2009 the Company incurred a revolving demand loan for up to $US 6 million, bearing interest at the bank base rate plus 1.875%, secured by cash or term deposits held by the Company. The loan was acquired to fund its drilling program and meet cash call requirements payable in US dollars when the Company anticipated a reduction in $US exchange rate for acquiring US funds. $US5,860,000 has been drawn on this facility.

c. On February 17, 2009, the Company entered into a Letter of Intent with Dover Investments Limited ("Dover") to acquire 100% of the participating interest of the Gebel El Zeit Concession in Egypt that is currently owned by Dover. The terms of the acquisition are under negotiation as of the date of these financial statements, however, it is anticipated that the purchase price will not exceed $US2 million, plus or minus an adjustment for working capital items assumed by the Company. The acquisition is subject to the approval by applicable Egyptian government authorities.