SEA DRAGON ENERGY INC.

FORM 51-102F1
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEAR ENDED DECEMBER 31, 2008

The following management's discussion and analysis (the "MD&A") dated April 14, 2009 is a review of results of operations and the liquidity and capital resources of Sea Dragon Energy Inc. (the "Company" or "Sea Dragon") for its year ended December 31, 2008 and December 31, 2007. This MD&A should be read in conjunction with the audited financial statements and the notes thereto for the years ended December 31, 2008 and 2007. The financial statements of the Company are prepared in accordance with Canadian generally accepted accounting principles ("GAAP").

Certain information contained herein is forward-looking and based upon assumptions and anticipated results that are subject to risks, uncertainties and other factors. Should one or more of these uncertainties materialize or should the underlying assumptions prove incorrect, actual results may vary significantly from those expected. See "Forward Looking Information", below.

All financial references in this MD&A are in Canadian Dollars unless otherwise noted.

Additional information related to the Corporation will be filed on SEDAR at www.sedar.com.

Selected annual information *$C 000, except share and per share information*	**2008**	**2007**	**2006**
Unrestricted cash balance (overdraft) at year-end	16,733	4,452	(1)
Working capital (deficiency)	10,096	(2,349)	(581)
Restricted cash	10,081	-	-
Capital expenditures	11,033	2,635	161
Total assets	29,814	8,189	1,634
Shareholders' equity	22,868	1,351	881
Share capital	44,444	1,948	1,237
Common shares outstanding			
Basic	144,509,405	40,747,500	34,632,500
Diluted	158,491,076	65,028,936	37,203,750
Weighted average common shares outstanding			
Basic	95,637,258	39,981,322	33,354,008
Diluted	96,128,549	Not available (1)	Not available (1)
Retained earnings (Deficit)	(23,013)	(1,686)	(737)
Cash flow from operations	(1,832)	(755)	(157)
Funds flow from operations(2)	(1,488)	(672)	(277)
Basic, per share(2)(3)	($0.015)	($0.017)	(0.001)
Net income (loss)	(21,327)	(948)	(737)
Basic, per share(3)	($0.22)	($0.02)	($0.02)

(1) Diluted weighted average number of common shares outstanding, which is calculated with respect to daily stock trading prices not available until the Company's commons shares were listed on the Toronto Venture Exchange and stock prices became publicly available.
(2) See discussion concerning non-GAAP measures
(3) Funds flow from operations per share and Net income per share are not calculated on a diluted basis as they are anti-dilutive.

2008 ACHIEVEMENTS

During the year the company attained the following milestones:

- Completed its Initial Public Offering on July 15 and issued 58,333,334 common shares at $0.60 per share to raise proceeds of $30,924,447 net of share issuance costs.
- Commenced trading on the Toronto Venture Exchange under the stock symbol "SDX" on July 17, 2008.
- Acquired 100% of the common shares of Egypt Oil Holdings Ltd. through a share exchange transaction. This acquisition increased the Company's share from 40% to 75% of the East Wadi Araba concession ("EWA") in Egypt.

- Commenced drilling the 5-X well in the EWA concession, an off-shore well drilled by the Transocean 103 GSF jack-up rig, in partial fulfillment of its obligations under the EWA Concession Agreement.
- Pursued other investment opportunities, the results of which include:
  - entered into a Letter of Understanding on February 17, 2009 to pursue negotiations for the acquisition of the producing Ras El Ush concession in Egypt;
  - the purchase on December 12 of a $300,000 convertible debenture issued by Prevail Energy Inc., a private Canadian corporation with a joint venture interest in the Republic of the Congo.

Forward-Looking Statements

This Management's Discussion and Analysis contains certain forward-looking statements. Some of the statements contained herein including, without limitation, financial and business prospects and financial outlooks of the Company may be forward-looking statements which reflect management's expectations regarding future plans and intentions, growth, results of operations, performance and business prospects and opportunities. Words such as "may", "will", "should", "could", "anticipate", "believe", "expect", "intend", "plan", "potential", "continue", and similar expressions have been used to identify these forward-looking statements. These statements reflect management's current beliefs and are based on information currently available to management. Forward-looking statements involve significant risk and uncertainties. A number of factors could cause actual results to differ materially from the results discussed in the forward-looking statements including, but not limited to, changes in general economic, political and market conditions and other risk factors. Although the forward-looking statements contained herein are based upon what management believes to be reasonable assumptions, management cannot assure that actual results will be consistent with these forward-looking statements. Investors should not place undue reliance on forward-looking statements. These forward-looking statements are made as of the date hereof.

Forward-looking statements and other information contained herein concerning the oil and gas industry and Sea Dragon's general expectations concerning this industry are based on estimates prepared by management using data from publicly available industry sources as well as from reserve reports, market research and industry analysis and on assumptions based on data and knowledge of this industry which the Company believes to be reasonable. However, this data is inherently imprecise, although generally indicative of relative market positions, market shares and performance characteristics. While Sea Dragon is not aware of any misstatements regarding any industry data presented herein, the industry involves risks and uncertainties and is subject to change based on various factors. See "Risk Factors."

Non-GAAP Measures

Funds flow from operations is a non-GAAP measure that 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 believes that funds flow from operations is a useful supplemental measure to analyze the Company's ability to generate cash flow to fund capital investment and working capital requirements. Funds flow from operations may not be comparable to similar measures used by other companies.

MAJOR TRANSACTIONS AFFECTING FINANCIAL RESULTS

Sea Dragon's financial results have been and will continue to be significantly affected by a number of transactions that occurred from the Company's inception to the date of this Management's Discussion and Analysis.

- Through a series of agreements dated (i) August 6, 2005 (the "Dover Farmout Agreement"); (ii) August 7, 2005; (iii) September 29, 2005 (the "September 29th Farmout"); (iv) October 1, 2005,; (v) April 5, 2006 the Company acquired a 40% working interest in the EWA Concession Agreement.
- During July 2007, the company and its joint venture members commenced drilling the 4-X well under the second exploration phase of the Concession Agreement of the East Wadi Araba Area, in the Gulf of Suez. Egypt ("the Concession Agreement"). On September 18, 2007 the Company declared the well uneconomic and, after testing, abandoned the well.

- In November 2007, the Company completed the convertible debenture offering (the "Convertible Debenture Offering") pursuant to which the Company issued convertible debentures in the aggregate principal amount of $7,500,000 (the "Convertible Debentures"). The Convertible Debentures were unsecured and non-interest bearing and were convertible into common shares of the Company at a conversion price of $0.35 per share. Upon closing the IPO, the $7.5 million aggregate principle amount Convertible Debentures automatically converted into 21,428,571 common shares in accordance with the terms of the debentures.

- On March 23, 2008, the Company entered into the share exchange agreement with EOH and shareholders of EOH (the "Vendors") to acquire all of the EOH common shares, thus acquiring EOH's 35% working interest in the Concession Agreement. This transaction closed on April 24, 2008. As consideration for the EOH shares, the Company issued 24,000,000 common shares of the Company to the shareholders of EOH. As a condition of the acquisition, each of the Vendors agreed to enter into a voluntary escrow agreement (the "EOH Voluntary Escrow Agreement"), pursuant to which 90 percent of the Company's common shares acquired by EOH and its shareholders were restricted from sale or transfer except upon the occurrence of certain events, and the occurrence of the earlier of: (i) the Company announcing the drilling results of its second exploratory well drilled on the EWA Concession; and (ii) July 31, 2009. This transaction brought the Company's interest in the EWA Concession Agreement to its present level of 75%. Under the terms of the Joint Operating Agreement, Sea Dragon undertook responsibility for 100% of the costs of the next two wells to be drilled at the concession.

- In accordance with the terms of the Concession Agreement, the Company requested Dover provide an election to EGPC that it would enter the Second Exploration Phase of the Concession Agreement. On January 15, 2008, the Company put in place a letter of guarantee in the amount of $US3,483,114 ($C3,524,215) (the "BMO Letter of Guarantee") in favour of EGPC for this election and the election was granted. On August 19th, 2008, based on the EGPC audit for costs incurred on the EWA 4-X well, the Company subsequently reduced the amount of the BMO Letter of Guarantee to US$1,521,875 (CDN$1,570,575).

- On July 15, 2008, the Company successfully closed its initial public offering ("IPO") of common shares, raising gross proceeds of $35,000,000. A total of 58,333,334 common shares were issued at a price of $0.60 per share. Net proceeds of the offering were $30,924,447, after deduction of the agents' closing costs, legal, accounting and other professional fees of approximately $1,421,742 and the agents' commission of approximately $2,100,000 being 6% of the gross proceeds raised on the offering. Transaction costs also include the 3,500,000 compensation options granted to the agents upon closing of the IPO.

- On July 17, 2008 the shares were listed under the symbol SDX on the TSX Venture Exchange.

- On December 12, 2008 the Company acquired a $300,000 convertible debenture issued by Prevail Energy Inc., ("Prevail") a Canadian private corporation. Prevail owns a 20% interest in a joint venture that will explore and develop the Mengo, Kundji and Bindi fields in the Congo. The other joint venture operators are Societe Nationale des Petroles du Congo, Petro SA and Petroci.

  The debenture carries a stated interest rate of 15% p.a., matures on November 19, 2009 and is convertible into common shares of Prevail at $0.15 per share. If the full debenture plus interest is converted, the Company will acquire 2,300,000 common shares, which will consist of 5.85% of the common shares, calculated on a fully diluted basis. The management believes that this investment allows Sea Dragon to participate in an attractive but speculative operation without incurring the additional risks of a joint venture partner.

- On February 17, 2009 the Company announced that the Dahab North Prospect 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 $20,408,609 being the aggregate 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 Company is of the opinion that this operation completed its obligations under the Concession Agreement.

- 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.

MANAGEMENT STRATEGY AND OUTLOOK FOR 2009

Sea Dragon has developed a strategy to focus on acquiring interests in producing properties or properties that are close to production. It is management's belief that oil assets today are undervalued reflecting the current economic downturn and this presents an opportunity to acquire production assets at favourable prices. This will give Sea Dragon a strong position as the economy turns more favourable. In the meantime the cash flow from producing assets will help to pay the operating costs and provide working capital for the Company. To these ends management has undertaken the following measures:

- Negotiations are underway to complete the acquisition of the Ras El Ush concession in Egypt and to obtain operatorship. This property currently produces from 900 to 1,100 barrels of crude oil per day. 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.
- Management is pursuing other investment opportunities in producing properties, primarily in Egypt. The reputation and experience of our board, executive and supporting consultants has opened discussions with other operators, concession holders and the government of Egypt that could lead to Sea Dragon taking an active role as investor and/or operator of other concessions. Each opportunity is evaluated for its economic potential, risks and Sea Dragon's capacity to undertake the project.
- Some investment projects may require additional sources of financing and the Company is considering all options such as partnership or joint venture financing on a project by project basis, issuance of common shares, or private funding that will allow the Company to move forward without undue dilution of its capital stock.
- Given the new focus on acquiring and developing resource properties, management is reviewing its operating and administrative costs for opportunities to reduce costs and realign them with this strategy.

SHARE CAPITAL

The Company's authorized share capital consists of an unlimited number of common shares and an unlimited number of preference shares, issuable in one or more series.

The following table sets forth the designation and number or principal amount of : (a) each class and series of voting or equity securities of the Company for which there are securities outstanding; (b) each class and series of securities of Sea Dragon for which there are securities outstanding if the securities are convertible into, or exercisable or exchangeable for, voting or equity securities of the Company; and (c) each class and series of voting or equity securities of the Company that are issuable on the conversion, exercise or exchange of outstanding securities the Company.

Designation	Authorized	As at April 14, 2009 *(Unaudited)*	As at December 31, 2008 *(Unaudited)*	As at December 31, 2007 *(Audited)*
Total Common Shares	Unlimited	144,509,405	144,509,405	40,747,500
Total Options and Warrants [(1)]	N/A	13,981,671 (Note 1)	13,981,671 (Note 1)	5,102,582
Convertible Debentures	$7,500,000, convertible into 21,428,571 common shares at $0.35 per share.	-	-	$6,712,599, convertible into 19,178,854 common shares at $0.35 per share.

[(1)] Options and warrants expire as follows: (i) 1,378,921 on January 17, 2010, (ii) 7,902,750 on July 17, 2010 and (iii) 4,700,000 on July 28, 2013.

Dilution Impacts

On July 15, 2008 in connection with the closing of the Company's IPO, options purchase a total of 3,500,000 common shares of the Company were granted to the agent's pursuant to an agency agreement.

On July 28, 2008 options to purchase a total of 4,700,000 common shares of the Company were granted to certain officers, directors and a consultant of the Company.

OPERATING RESULTS

Loss from operations

Selected Audited Financial Information for the Years Ended December 31, 2008 and December 31, 2007

$000	Year ended December 31, 2008	Year ended December 31, 2007
Expenses		
General and administrative		
Wages	508	207
Professional fees	877	301
Travel and promotion	316	105
Letter of guarantee expense	186	-
Other	294	71
	2,181	684
Foreign exchange (gain) loss	(1,859)	15
Accretion of debentures	902	277
Stock based compensation	151	-
Impairment of oil and gas properties	20,409	-
Depreciation and depletion	2	-
Loss before other items	(21,786)	(976)
Interest income	459	27
Total	(21,327)	$949

The Company incurred a net loss of $21,327,277 ($0.22 per share) for 2008 compared to a net loss of $948,926 ($0.02 per share) in 2007. Factors contributing to the net loss include:

Total general and administrative expenses for the year increased to $2,181,505 from $684,075 for 2007. The increase in expenses was due to a number of factors including:

(i) Legal fees, included in Professional fees, increased 391% compared to the prior year primarily due costs associated with the IPO, and legal fees pertaining to a lawsuit initiated by two related shareholders. There were no comparable costs during the same quarter in the prior year;

(ii) Wages increased by 145% to $508,174 from $207,096 in 2007 due to an increase in the number of staff positions, pay increases to key officers of the Company and disbursements for directors' fees;

(iii) Costs for Travel and Promotion increased by 200% from the prior year due to a substantial increase in activity including promotion of the Company in North America and overseas, and more frequent trips to Egypt to monitor operations related to drilling the 5X well, and investigation of other potential development deals;

(iv) Quarterly maintenance fees and application set-up fees related to two Letters of Guarantee required to be put up by the Company amounted to $186,083 in 2008 with no such costs in the prior year; and

(v) Other general expenses increased by $226,157 to $294,792 versus $70,535 in 2007. These costs include filing and transfer agent fees (2008 - $101,404; 2007 - $11,008), telephone and internet charges (2008 - $28,458; 2007 - 13,280), rent (2008 - $55,299; 2007 - $12,000) and other (2008 - $109,631; 2007 - 34,247)

The accretion expense, being the amortization of the costs related to the conversion feature of the $7,500,000 Convertible Debenture, amounted to $902,262 in 2008 as compared to $276,649 in 2007.

During 2008 the Company issued 4,200,000 stock options to employees and 500,000 to consultants with an estimated fair value of $1,141,630. These stock options vest over a three year period and the stock based compensation expense of $151,252 (2007 – Nil) is the portion that was amortized in 2008.

Subsequent to the year end the Company assessed its exploration efforts on the EWA Concession in Egypt. Although hydrocarbons were found they were determined to be uneconomic. Management decided that with little time remaining for exploration no further exploration on the block would be undertaken; as a result a write-down of $20,408,609 has been recorded for impairment of these costs, direct and indirect, associated with the acquisition of and exploration in the EWA concession. These costs were originally capitalized as property and equipment assets under the full cost method of accounting for oil and gas assets. No similar write-downs were recorded in 2007.

During 2008 the company experienced foreign exchange gains on its cash assets held in US currency due to the appreciation of the US$. Of this, $1,625,216 was an unrealized foreign exchange gains primarily due to translating the $US denominated portion of the restricted funds to $C at the closing exchange rate for December 31, 2008 which had increased significantly from the rate in effect when the investments were acquired. Foreign exchange gains and losses are considered to have been realized when the funds are expended or are converted to Canadian funds.

Interest income in 2008 increased to $458,914 from $27,448 in 2007. This was due to significantly more cash balances as a result of the IPO and investments of excess cash in Term Deposits and redeemable GIC's through 2008.

SUMMARY OF QUARTERLY RESULTS *(unaudited)*

$000 except per share amounts	Total Assets	Working Capital	Cash Flow from Operations	Net Income (Loss)	Net Income (Loss) per Share ($0.00)
Quarter ended:					
12/31/2008	29,814	10,096	(1,832)	(21,327)	(0.22)
09/30/2008	42,007	22,697	(978)	(648)	(0.00)
06/30/2008	11,437	(7,856)	(61)	(458)	(0.01)
03/31/2008	7,989	(7,351)	(289)	(1,081)	(0.03)
12/31/2007	8,189	(2,350)	(755)	(949)	(0.02)

Cash Flow and Cash position

Operating

Funds flow from operations was an outflow of $1,488,469 and was comprised of G&A expenses of $2,181,505 (discussed above), offset by interest revenue of $458,914 and a realized foreign exchange gain of $234,122.

Financing

Cash provided from financing activities for the year ended December 31, 2008 was $31,579,885 compared to $7,104,132 in 2007. The large increase in cash in-flows was due to the $31,478,259 in net cash proceeds of the IPO financing of July 15, 2008. The increase in cash also included a net cash inflow of $104,170 being the final funds received from the issuance of the last tranche of the convertible debenture financing.

Investing

Cash used in investing activities for the year ended December 31, 2008 was $17,524,670 compared to cash used of $1,897,562 in 2007. This increase was primarily due to:

(i) Expenditures of $11,032,649 (2007 - $2,635,268) for direct drilling expenses, and indirect, shared and administrative costs on the EWA concession in Egypt;

(ii) Investment of $8,508,576 in $US Guaranteed Investment Certificates and a $C cash deposit which secure letters of guarantee granted by the Company and corporate credit cards described as follows:

a) The letter of credit for $US6,500,000 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 ("EGPC") as security for the financial commitment of Exploration phase of the East Wadi Arba concession in Egypt.
c) Security for corporate credit cards is a minimum cash balance of $C230,000.

The balance of these restricted funds was increased to $C10,080,863 as at December 31, 2008 reflecting an unrealized foreign currency gain of $1,625,216 due to the increase in the exchange rate of the $US at the year-end. At December 31, 2008 these restricted funds consisted of:

	Terms	Amount (*$US000*)	Amount(*$C000*)
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	1,521	2,1869
c)	Minimum cash balance in $C denominated account	188	230
		8,210	10,081

(iii) The cash provided from the non-cash investing working capital consisted of:

	$000	
a)	Amount receivable	($666)
b)	Prepaid expenses, deposits and amounts paid in excess of costs	(2,553)
c)	Change in inventory on hand at the year-end	(1,211)
d)	Change in accounts payable for the EWA concession	6,475
		$2,045

The Company expects to collect the amount receivable of $666,387 and to sell unused inventory for proceeds in excess of $US 1 million in 2009.

(iv) The Company acquired a $300,000 convertible issued by Prevail Energy Inc., ("Prevail") a Canadian private corporation.

(v) Through the acquisition of its wholly owned subsidiary, Egypt Oil Holdings Ltd., the Company acquired a cash balance of $364,769;

(vi) The Company made payments of $93,520 (2007 - $671,256) on behalf of Mogul Energy Ltd., that was reclassified as property and equipment costs in respect of the EWA concession as part of the acquisition of EOH, and eliminated upon consolidation of EOH.

Liquidity

At December 31, 2008 the Company had an unrestricted cash balance of $16,733,423 and working capital of $10,095,771 (December 31, 2007 – working capital deficit of $2,349,707). Subsequent to the year-end, the Company remitted $13,438,000 to its joint venture operator under cash calls, and expended $650,000 in operations net of interest revenue. The Company anticipates remitting an additional amount of approximately $3.75 million to fully fund its obligations under the EWA Joint Operating Agreement. The January cash call remittance was funded by a $C6,645,000 ($US5,860,000) loan in order to take advantage of an anticipated reduction in the $US foreign exchange rate which is secured by funds on deposit.

As of the date of this report the Company had total cash reserves of $19,100,000, of which $18,700,000 is restricted to support the two letters of guarantee and the bank loan. The TransOcean letter of guarantee will be released upon payment of its final invoices and the Company anticipates the EGPC letter of credit will be released by the third quarter of 2009. Upon final payment of invoices to TransOcean and release of the letter of guarantee, the Company's unrestricted funds will increase by approximately $4.5 million.

If the Company were to repay the loan for the January cash call and receive the funds under the EGPC letter of credit, its unrestricted funds available would be approximately $7 million. In addition, the Company has drilling materials at the EWA site that it expects can be sold for $US 1.3 million and a receivable for $US 700,000 that will be realized in 2009.

Capital investment in property & equipment

$000		December 31, 2008 (Unaudited)		Cumulative to December 31, 2007 (Unaudited)
Resource properties, capitalized costs before write-down for impairment of resource costs	$	22,756	$	3,029
Impairment of resource costs		(20,409)		-
Resources properties, net		2,347		3,029
Furniture and equipment		44		-
Property & equipment, net	$	2,391	$	3,029

The capitalized costs for resource properties after the write-down for impairment consist of the following amounts:

$000		**December 31, 2008** (Unaudited)		**December 31, 2008** (Unaudited)
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

The major capital undertaking in 2008 was the drilling of the 5-X well on the EWA concession. Although originally budgeted at a cost of $US 12.5 million, the total costs are estimated to be approximately $US17.5 million. The increase in costs was due to:

- After commencement, the Company revised the program to explore two different target zones, the Micoene and pre-Miocene, by drilling two well bores from the same location. After the first location was reached, a second hole was initiated with a side track from above the first location to the deeper Kareem and Rudheis formations. Although this increased the costs of the well, it enabled the Company to investigate the two locations and meet its obligations under the Concession Agreement to drill two wells by July 2009 at a lesser cost than if the two wells had been drilled from different locations.
- The well encountered technical difficulties at the beginning of the side bore and while drilling and completing the well in the Rudheis zone. The latter costs arose because the Rudheis shale geology required extra casing in order to protect the downhole equipment and reduce the risk of losing the hole.

Significant Acquisitions

Sea Dragon acquired a further 35% interest in the Concession Agreement as a result a share exchange agreement the Company closed on April 24, 2008, pursuant to which the Company acquired all of the outstanding common shares of EOH. The Company satisfied payment of the purchase price by issuing one common share in exchange for each EOH share acquired (being an aggregate of 24,000,000 common shares) for which Sea Dragon acquired a 35% interest in the Concession Agreement. At the date of the transaction, there were no reserves attributable to the Concession Agreement; hence, the acquisition was not accounted for as a business transaction. In addition, the amount receivable of $764,776 which was owed to Sea Dragon by MEII was assumed by EOH upon its acquisition of a 20% interest in the Concession Agreement from MEII. As such it was included in the purchase price of EOH as the receivable eliminated upon consolidation. This transaction resulted in an increase to Exploration and development expenses of $4,080,007.

DEBT INSTRUMENTS AND COMMITMENTS

Convertible Debentures

- The Company completed the Convertible Debenture offering in three tranches on November 26 and 30, 2007 and January 15, 2008 pursuant to which the Company issued Convertible Debentures in the aggregate principal amount of $7,500,000. The Convertible Debentures were unsecured, non-interest bearing and originally matured on March 31, 2008. On July 17, 2008 the Convertible Debentures were automatically converted into 21,428,571 common shares of the Company as a result of the IPO.
- Subsequent to the year-end the Company borrowed $6,645,000 to fund its January cash call of $US5,830,000. The loan is secured by funds on deposit. The loan was taken out as a currency hedge when the exchange rate for the $US had increased and will be repaid when the exchange rate returns to lower levels.

Commitments

- On or about January 15, 2008, the Company obtained and deposited the BMO Letter of Guarantee in the amount of US$3,483,114 ($3,524,215) in connection with the election to proceed into the Second Exploration Phase of the Concession Agreement. On August 29, 2008 the amount of the BMO Letter of Guarantee was reduced to US$1,521,875 (CDN$1,570,575). The Company believes that with the completion of the 5-X well in February 2009 the Company has met these performance and expenditure obligations and it will reclaim the balance of the deposit in 2009.
- On September 30, 2008 the Company deposited an additional Letter of Guarantee for US$6,500,000 (CDN$6,708,000) as required under the Assignment Agreement dated August 28 for the drilling rig in the EWA Concession.
- The company pledged $230,000 as a security deposit held for corporate credit cards issued to various officers and directors to be used strictly for travel and promotion expenses.
- The Company has entered into an agreement to lease office in Calgary, Alberta beginning on November 1, 2008. 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.

CONTINGENCY

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 and Ghareeb Awad (the "Plaintiffs") against the Minister of Petroleum – Egypt, Dover 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 the Company when it concluded that the Plaintiffs did not have a legal right to initiate a court action in respect of a contractual dispute involving the EWA concession in Egypt. This matter accordingly moved to arbitration in Alberta where on April 6, 2009 the arbitration tribunal stayed the proceedings indefinitely 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 them. 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 incur.

Related Party Transactions

An amount receivable was due from Mogul Energy International Inc. ("MEII") (a company with whom a director of the Company is a significant shareholder) representing cash calls MEII was required to make to fulfill its 1/3 working interest in the exploration program on the EWA Concession in fiscal 2007 and to April 23, 2008. These cash calls were provided by the Company on MEII's behalf. The amount receivable is non-interest bearing, unsecured, and has no other specific terms or conditions. Due to the acquisition of MEII's interest in the Concession Agreement by EOH and Company's subsequent acquisition of EOH on April 24, 2008, the receivable, with a balance of $764,776 at that time, became an inter-company balance that was eliminated upon consolidation.

ACCOUNTING POLICIES AND ESTIMATES

Effective January 1, 2008, the Company adopted three new Canadian Institute of Chartered Accountants ("CICA") accounting standards: (a) Handbook Section 1535, *Capital Disclosures*; (b) Handbook Section 3862, *Financial Instruments – Disclosures*; and (c) Handbook Section 3863, *Financial Instruments –Presentation* . The main requirements of these new standards and the resulting financial statement impact are described below.

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 required additional disclosure (Note 4(a) to the audited financial statements as at December 31, 2008) but had no effect on the financial statements of the Company.

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 required additional disclosure (Note 4(b) to the audited financial statements as at December 31, 2008) but had no effect on the financial statements of the Company.

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.

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. 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 these new accounting standards on its financial statements.

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.

INTERNATIONAL FINANCIAL REPORTING STANDARDS

In February 2008, the CICA Accounting Standards Board ("ACSB") confirmed the changeover to International Financial Reporting Standards ("IFRS") from GAAP will be required for publicly accountable enterprises' interim and annual financial statements for fiscal years beginning on or after January 1, 2011. The transition from current GAAP to IFRS is a significant undertaking that may materially affect the Company's reported financial position and operations. The Company has appointed internal staff to lead the IFRS conversion project who began attending CICA and other training program related to the IFRS conversion. At this time Sea Dragon 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.

During 2009, the Company will develop a detailed plan for the implementation and conversion to IFRS. As part of the plan, it will be required to prepare a transition balance sheet as at December 31, 2009 which will be representative of the opening balance sheet as at January 1, 2010, enabling comparative information for financial reporting in 2011.

The following IFRS standards are expected to have the most significant impact on Sea Dragon.

- IFRS 1 – First time adoption of IFRS
- IFRS 2 – Share based payments
- IFRS 6 – Exploration and evaluation of mineral resources
- IFRS 16 – Property, plant and equipment
- ED 9 – Joint arrangements (replacing IAS 31 – Interests in joint ventures)
- IAS 36 – Impairment of assets
- IAS 37 – Provisions, contingent liabilities and contingent assets

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 and deferred exploration costs, ability to continue as a going concern, and stock-based compensation amounts related to granting of finders' fee options and share purchase warrants.

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.

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).

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.

Economic Factors Affecting Sea Dragon

The following economic factors represent both positive and negative changes in global and local economies and more specifically the oil and gas industry in Egypt. Sea Dragon has no direct control over these factors and is subject to the full effect that these factors may have upon the Company and its operations. In several cases, mitigating actions have been taken by Sea Dragon; however, there is no assurance that such actions will have any continuing impact in controlling these factors and their effect on Sea Dragon.

BUSINESS RISK ASSESSMENT

There are a number of inherent business risks associated with oil and gas operations and development. Many of these risks are beyond the control of management. The following outlines some of the principal risks and their potential impact to the Company.

Foreign Investments

All of the Company's oil investments are located outside of Canada. These investments are subject to the risks associated with foreign investment including tax increases, royalty increases, re-negotiation of contracts, currency exchange fluctuations and political uncertainty. The jurisdiction in which the Company operates, Egypt, has a well established fiscal regime and there are some improved fiscal terms to encourage investments. The functional currency in the primary operating area is US dollars. Sea Dragon expects to be paid in US dollars when it commences production.

As operations are primarily carried out in US dollars, the main exposure to currency exchange fluctuations is the conversion to equivalent Canadian funds for reporting purposes.

Competition

The Company operates in the highly competitive areas of oil and gas exploration, development and acquisition with a substantial number of other companies, including U.S.-based and foreign companies doing business in Egypt. The Company faces intense competition from independent, technology-driven companies as well as from both major and other independent oil and gas companies in seeking oil and gas exploration licences and production licences in Egypt; and acquiring desirable producing properties or new leases for future exploration. The Company also faces competition in marketing oil and natural gas production; acquiring exploration leases; hiring skilled industry personnel; and acquiring the equipment and expertise necessary to develop and operate properties.

The Company believes it has significant in-country relationships within the business community and government authorities needed to obtain cooperation to execute projects. The Company also has excellent relationships with its working interest partner in the EWA Concession.

Commodity Price Risk

When the Company has producing resource properties and commences to sell crude oil or natural gas, its revenues will be significantly affected by the prevailing world commodity prices. Although management is bullish about the prices for crude oil and natural gas in the longer term, it views current prices as an opportunity to acquire joint venture interests, concessions, producing properties etc. at costs that will be lower than in recent years. Management is, therefore, seeking out and evaluating investment opportunities that will be congruent with the Company's growth and development strategies.

Lower commodity prices will also be factor in the Company's efforts to raise additional capital. Management takes the availability of investment capital into consideration as it evaluates acquisition opportunities so as to minimize the possibility of becoming illiquid by acquiring assets that may require more capital than the Company can provide.

Disclosure Controls and Procedures

As the Company is classified as a Venture Issuer under applicable Canadian securities legislation, it is required to file basic Chief Executive Officer and Chief Financial Officer certificates, which it has done for the year ended December 31, 2008. The Corporation makes no assessment relating to establishment and maintenance of disclosure controls and procedures as defined under Multilateral Instrument 52-109 as at December 31, 2008.