



**Arrow Energy Ltd.**

**Q1 2008 Consolidated Financial Statement**

## Consolidated Balance Sheets

	March 31/08	December 31/07
<b>ASSETS</b>		
Current:		
Cash	\$ 10,980	\$ 155,692
Accounts receivable	1,265,028	1,765,956
Deposits and prepaid expenses	476,831	236,566
	<u>1,752,839</u>	<u>2,158,214</u>
Capital assets (Note 4)	19,982,731	20,081,782
	<u>\$ 21,735,570</u>	<u>\$ 22,239,996</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>LIABILITIES:</b>		
Current:		
Accounts payable and accrued liabilities	\$ 3,831,394	\$ 2,783,684
Bank loan (Note 7)	2,254,547	3,037,838
	<u>6,085,941</u>	<u>5,821,522</u>
Future income taxes (Note 8)	115,284	324,490
Asset retirement obligation (Note 5)	1,103,514	1,081,877
	<u>7,304,739</u>	<u>7,227,889</u>
<b>SHAREHOLDERS' EQUITY:</b>		
Share capital (Note 6)	14,738,683	14,738,683
Contributed surplus (Note 6(b))	6,320,227	6,306,827
Deficit	(6,628,079)	(6,033,403)
	<u>14,430,831</u>	<u>15,012,107</u>
	<u>\$ 21,735,570</u>	<u>\$ 22,239,996</u>

Commitments and contingencies (Note 9)  
Subsequent events (Note 12)  
Basis of Presentation – Going concern (Note 1)

### APPROVED ON BEHALF OF THE BOARD:

*(signed) "Richard Edgar", Director*

*(signed) "Jason Pack", Director*

See accompanying notes to the financial statements

## Consolidated Statements of Operations, Comprehensive Loss & Deficit

For the three-month period ended March 31

	2008	2007
<b>Revenue</b>		
Petroleum and natural gas sales	\$ 983,722	\$ 891,838
Royalties	(236,147)	(242,446)
	747,575	649,392
Pipeline revenue	272,351	253,017
Other income	8,318	9,220
	1,028,244	911,629
<b>Expenses</b>		
Production and transportation	475,212	318,290
Pipeline	182,741	111,259
General and administrative	574,752	575,481
Interest	57,965	39,375
Stock based compensation (Note 6a)	13,400	19,790
Depletion, depreciation and accretion (Notes 4 and 5)	528,056	678,840
	1,832,126	1,743,035
<b>Loss from operations</b>	(803,882)	(831,406)
<b>Loss before income taxes</b>	(803,882)	(831,406)
<b>Income tax recovery</b>		
Future	(209,206)	(233,118)
	(594,676)	(598,288)
<b>Net loss and comprehensive loss</b>	(594,676)	(598,288)
<b>Deficit, beginning of period</b>	(6,033,403)	(3,598,677)
<b>Deficit, end of period</b>	(6,628,079)	(4,196,965)
<b>Net loss per share</b>		
Basic and diluted	(0.02)	(0.04)
<b>Weighted average common shares outstanding</b>		
Basic and diluted	27,233,727	14,088,914

See accompanying notes to the financial statements.

## Consolidated Statements Cash Flows

For the three-month period ended March 31

	2008	2007
<b>CASH FLOWS RELATED TO THE FOLLOWING ACTIVITIES</b>		
<b>OPERATING:</b>		
Net loss	\$ (594,676)	\$ (598,288)
Items not involving cash:		
Depletion, depreciation and accretion	528,056	678,840
Stock compensation expense	13,400	19,790
Future income tax recovery	(209,206)	(233,118)
	<u>(262,426)</u>	<u>(132,776)</u>
Changes in non-cash working capital (Note 10)	941,972	498,597
	<u>679,546</u>	<u>365,821</u>
<b>FINANCING:</b>		
Increase / (Decrease) in bank loan	(783,291)	999,468
	<u>(783,291)</u>	<u>999,468</u>
<b>INVESTING:</b>		
Additions to capital assets	(407,364)	(852,816)
Acquisition of oil & gas assets	-	(985,454)
Changes in non-cash working capital (Note 10)	366,397	472,981
	<u>(40,967)</u>	<u>(1,365,289)</u>
<b>Net decrease in cash</b>	<b>(144,712)</b>	<b>-</b>
<b>Cash, beginning of period</b>	<b>155,692</b>	<b>-</b>
<b>Cash, end of period</b>	<b>\$ 10,980</b>	<b>\$ 155,692</b>

See accompanying notes to the financial statements

# Notes to Financial Statements

For the periods ended March 31, 2008 and 2007  
Unaudited

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## 1. Description of Business and Basis of Presentation

The principal business of Arrow Energy Ltd. (the “Company” or “Arrow”) is the exploration for, exploitation, development and production of oil and natural gas reserves. All activity is conducted in Western Canada and comprises a single business segment.

The interim financial statements of the Company have been prepared by management, in accordance with Canadian generally accepted accounting principles and are unaudited. The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. The interim financial statements have been prepared following the same accounting policies and methods of computation as the audited financial statements for the year ended December 31, 2007. These interim financial statements do not include all the note disclosures required for annual financial statements and therefore they should be read in conjunction with the Company’s audited financial statements for the year ended December 31, 2007.

The Company’s financial statements as at and for the interim period ended March 31, 2008 have been prepared on a going concern basis, which contemplates the realization of assets and the settlement of liabilities and commitments in the normal course of business. The ability of the Company to continue as a going concern is dependent upon the Company’s ability to generate future profitable operations and obtaining additional equity or debt financing.

## 2. Adoption of New Policies

### Financial Instruments

The Company adopted the following new CICA Handbook Sections, which were effective beginning January 1, 2008:

- Section 3862 – “Financial Instruments – Disclosures”, describes the required disclosure for the assessment of the significance of financial instruments for an entity’s financial position and performance and of the nature and extent of risks arising from financial instruments to which the entity is exposed and how the entity manages those risks. This section and Section 3863, “Financial Instruments – Presentation” replaced Section 3861, “Financial Instruments – Disclosure and Presentation”.
- Section 3863 – “Financial Instruments – Presentation”, establishes standards for presentation of financial instruments and non-financial derivatives.
- Section 1535 – “Capital Disclosures”, establishes standards for disclosing information about an entity’s capital and how it is managed. It describes the disclosure requirements of the entity’s objectives, policies, and processes for managing capital, the quantitative data relating to what the entity regards as capital, whether the entity has complied with capital requirements, and, if it has not complied, the consequences of such non-compliance.
- Section 3031 – “Inventories”, which replaces Section 3031. This section is harmonized with International Accounting Standards and provides additional guidance on the measurement and disclosure requirements for inventories. This new standard did not have an impact on the Company’s financial statements.
- The CICA has amended Section 1400, “General Standards of Financial Statement Presentation”, which include requirements to assess and disclose the Company’s ability to continue as a going concern. The adoption of this new section did not have an impact on the financial statements.

### 3. Financial Risk and Capital Management

All Financial instruments are initially recognized at fair value on the balance sheet. The Company has classified each financial instrument into one of the following categories: held-for-trading (assets and liabilities), loans and receivables, financial assets available-for-sale, financial assets held-to-maturity, and other financial liabilities. Subsequent measurement of financial instruments is based on their classification.

Financial assets and liabilities “held-for-trading” are subsequently measured at fair value with changes in those fair values recognized in net earnings. Financial assets “available-for-sale” are subsequently measured at fair value with changes in fair value recognized in other comprehensive income, net of tax.

Financial assets “held-to-maturity”, “loans and receivables”, and “other financial liabilities” are subsequently measured at amortized cost using the effective interest method.

Cash is classified as “held-for-trading”. Accounts receivable is classified as “loans and receivables”. Accounts payable and accrued liabilities and bank revolving credit facility are designated as “other financial liabilities”. The carrying values of these financial instruments approximate their fair values due to their relatively short periods to maturity.

The Company is exposed to financial risk in a range of financial instruments including accounts receivable, accounts payable, and a bank revolving credit facility. The Company manages its exposure to financial risks by operating a manner that minimizes its exposure to the extent practical. The main financial risks affecting the Company are discussed below:

#### **Credit Risk**

Credit risk arises when a failure by counter parties to discharge their obligation could reduce the amount of future cash inflows from financial assets on hand at the balance sheet date. A majority of the Company’s financial assets at the balance sheet date arise from crude oil, natural gas liquids, and natural gas sales. Industry standard dictates that commodity sales are settled on the 25<sup>th</sup> day of the month following the month of production. The Company markets its oil and natural gas to several marketers so that the exposure to any one entity is minimized. In addition, when joint operations are conducted on behalf of a joint venture partner relating to capital expenditures, costs of such operations are paid for in advance to the Company by way of a cash call by the partner of the operation being conducted.

The Company assesses quarterly if there has been any impairment of the financial assets of the Company. During the three month period ended March 31, 2008 there was no impairment provision required on any of the financial assets of the Company due to historical success of collecting receivables. The Company does not have any significant credit risk exposure to any single counterparty or any group of counterparties having similar characteristics.

The carrying value of accounts receivable approximates their fair value due to the relatively short periods to maturity on this instrument. The maximum exposure to credit risk is represented by the carrying amount on the balance sheet. There are no material financial assets that the Company considers past due.

## **Market Risk**

### *Interest Rate Risk*

Interest rate risk refers to the risk that the value of a financial instrument or cash flows associated with the instrument will fluctuate due to changes in market interest rates. The Company is exposed to interest rate risk as it borrows funds at floating interest rates as disclosed in Note 4. The Company currently does not use interest rate hedges or fixed interest rate contracts to manage the Company's exposure to interest rate fluctuations.

Assuming all other variables remain constant, a 1% increase or decrease in interest rates would have impacted the cash flows of the Company during the three month period ended March 31, 2008 by approximately \$4,931. The Company considers this risk to be limited and therefore does not hedge its interest rate risk.

### **Liquidity Risk**

Liquidity risk includes the risk that, as a result of the Company's operational liquidity requirements:

- The Company will not have sufficient funds to settle a transaction on the due date;
- The Company will be forced to sell financial assets at a value which is less than what they are worth; or
- The Company may be unable to settle or recover a financial asset at all.

The Company's operating cash requirements, including amounts projected to complete the Company's existing capital expenditure program, are continuously monitored and adjusted as input variables change. These variables include, but are not limited to, available bank lines, oil and natural gas production from existing wells, results from new wells drilled, commodity prices, cost overruns on capital projects, and regulations relating to prices, taxes, royalties, land tenure, allowable production, and availability of markets. As these variables change, liquidity risks may require the Company to conduct equity issues or obtain project debt financing. The Company also mitigates liquidity risk by maintaining an insurance program to minimize exposure to insurable losses. Currently, the Company's maturities of financial liabilities as at March 31, 2008 are within one year for accounts payable, accrued liabilities, and the credit facility. Given the balances are due in the next twelve months there is a risk, as discussed in note 1, that the Company may not be able to meet its obligations as they come due.

### **Capital Risk Management**

The Company's objective when managing capital is to safeguard its ability to continue as a going concern, so that it can continue to provide returns to shareholders and benefits for other stakeholders. The Company manages its capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying assets. The Company's objective is met by retaining adequate equity to guard against the possibility that cash flows from assets will not be sufficient to meet future cash flow requirements. The Board of Directors does not establish quantitative return on capital criteria for management; but rather promotes year over year sustainable and growth in net income and funds flow. The Company defines capital as total equity plus cash and debt.

The Company is not subject to any externally imposed cash flow requirements other than covenants on its operating credit facility with its lender to maintain its working capital ratio at a 1 to 1 level, as defined in the credit agreement. At March 31, 2008, the Company's working capital ratio was 0.77:1. The lender has acknowledged that Arrow Energy Ltd. was in default and has waived this breach.

### **Commodity Price Risk**

The Company is exposed to fluctuations in commodity prices for crude oil, natural gas and natural gas liquids. Commodity prices are affected by many factors including supply and demand. The Company monitors these risks and when appropriate, utilizes financial instruments to manage its exposure to these risks. The Company currently does not use financial hedges to manage the Company's exposure to commodity price fluctuations and therefore has no related financial instruments.

#### 4. Capital Assets

	March 31, 2008		
	Cost	Accumulated Depletion and Depreciation	Net Book Value
Petroleum and natural gas properties	\$ 23,392,281	\$ 7,121,953	\$ 16,270,328
Pipeline	3,740,798	149,632	3,591,166
Office equipment and furniture	168,697	47,460	121,237
	<b>\$ 27,301,776</b>	<b>\$ 7,319,045</b>	<b>\$ 19,982,731</b>

  

	December 31, 2007		
	Cost	Accumulated Depletion and Depreciation	Net Book Value
Petroleum and natural gas properties	\$23,032,566	\$6,663,254	\$16,369,312
Pipeline	3,740,798	112,225	3,628,573
Office equipment and furniture	121,045	37,148	83,897
	<b>\$26,894,409</b>	<b>\$6,812,627</b>	<b>\$20,081,782</b>

Petroleum and natural gas properties as at March 31, 2008 include costs of \$2,356,113 (December 31, 2007 - \$2,353,420) relating to undeveloped land, which has been excluded from the amounts subject to depletion.

The pipeline, which is not included in the full-cost pool, is amortized on a straight-line basis over 25 years.

#### 5. Asset Retirement Obligation

The total future asset retirement obligation was estimated by management based on the Company's net ownership interest in all wells and facilities, estimated costs to reclaim and abandon the wells and facilities, and the estimated timing of the costs to be incurred in future periods. The Company has estimated the net present value of its total asset retirement obligation to be \$1,103,514 as at March 31, 2008 (December 31, 2007 - \$1,081,877) based on a total future liability of \$4,855,639 (December 31, 2007 - \$4,855,639). These payments are expected over the next 20 years with the majority of costs incurred between 2010 and 2026. The Company's credit adjusted risk free rate of 8.0% and an inflation rate of 2.0% were used to calculate the present value of the asset retirement obligation.

(Asset Retirement Obligation – continued)

A reconciliation of the asset retirement obligation is provided below:

	<b>March 31, 2008</b>	December 31, 2007
Carrying amount, beginning of period	<b>\$ 1,081,877</b>	\$ 234,050
Increase in obligations	-	223,615
Pipeline	-	563,666
Accretion expense	<b>21,637</b>	60,546
Carrying amount, end of period	<b>\$ 1,103,514</b>	\$ 1,081,877

## 6. Share Capital

	<b>Number of Shares</b>	<b>Amount</b>
Balance, December 31, 2007	27,223,727	\$ 14,126,407
Balance, March 31, 2008	27,223,727	\$ 14,126,407

<b>March 31, 2008</b>		
	<b>Number of Warrants</b>	<b>Amount</b>
Balance, December 31, 2007	5,142,958	\$ 612,276
Balance, March 31, 2008	5,142,958	\$ 612,276

### (a) Stock Options

Under the Company's stock option plan, options may be granted in such numbers and with such vesting provisions as the Board of Directors may determine. At the time an option is granted, the Board will determine the exercise price of the option. The aggregate number of shares that may be available for issuance, from time to time, under the plan shall not exceed 20% of outstanding shares. In addition, the aggregate number of shares so available for issuance under the plan to any one person in any 12 month period shall not exceed 5% of the issued shares calculated at the time of grant of the option.

The Company incurred stock-based compensation expense of \$13,400 for Q1, 2008, (\$19,790 – Q1, 2007).

	Number of Options	Weighted average exercise price
Balance at December 31, 2007	2,190,178	\$ 0.40
Forfeited during the period	-	-
Granted during the period	-	-
Broker options issued	-	-
Balance at March 31, 2008	2,190,178	\$ 0.40

(Share Capital – continued)

The following table summarizes information about stock options outstanding as at March 31, 2008:

Exercise Price	Options Outstanding	Exercisable	Weighted Average Years to Expiry
\$0.45	893,750	657,813	3.85
\$0.38	725,000	725,000	4.26
\$0.35	571,428	571,428	1.50
Total	2,190,178	1,954,241	3.37

The total stock options exercisable at March 31, 2008 was 1,954,241 (2007 – 1,902,678) at a weighted average exercise price of \$0.39 (2007 - \$0.39).

(b) *Contributed Surplus*

A summary of the change in the Company's contributed surplus balance for the year ended December 31, 2007 is as follows:

	March 31, 2008	Dec. 31, 2007
Balance, beginning of period	\$ 6,306,827	\$ 482,368
Acquisition of oil and gas assets	-	5,389,125
Cancellation of shares	-	34,500
Stock-based compensation expense	13,400	288,833
Fair value of common shares included in broker units	-	112,001
Balance, end of period	\$ 6,320,227	\$ 6,306,827

## 7. Operating Line

At March 31, 2008, Arrow was not in compliance with its debt covenants relating to working capital. However, the lender has acknowledged that Arrow Energy Ltd. was in default of the established working capital covenant with a ratio of 0.77:1 and has waived this breach until June 30, 2008.

On April 2, 2008, the facility was increased from \$3,500,000 to \$6,000,000. This increase reflects the recognition by the lender of the Company's higher reserve base at December 31, 2007. On May 15, 2008, the Facility was again renegotiated and revised from \$6,000,000 to \$6,500,000, due to additional reserves as evaluated by the external reserve engineers.

## 8. Income Taxes

The major components of the future income tax liability at March 31, 2008 and December 31, 2007 using the combined federal and provincial income tax rates of 25.00% based on reversal of the future income tax liability (2007 – 25.00%) are as follows:

	March 31, 2008	December 31, 2007
Property and equipment	\$ (825,327)	\$ (953,054)
Share issue costs deductible for tax purposes	58,165	65,580
Asset retirement obligation	275,879	270,469
Non-capital losses carried forward	375,999	292,515
	\$ (115,284)	\$ (324,490)

## 9. Commitments and Contingencies

(a) The Company has remaining lease commitments for office space of \$80,000, and \$919,581 which expire on August 31, 2008, and July 1, 2012 respectively.

(b) The Company is involved in a legal claim associated with the normal course of business. At this time, in the opinion of management, this matter is not reasonably expected to result in a material adverse effect on the Company's financial position.

(c) In 2007, the Company committed to renounce \$500,000 of exploration expenses pursuant to a flow-through share issue completed December 31, 2007. Arrow has until December 31, 2008 to incur these exploration expenditures. The Company will be subject to a Part XII.6 tax based on the prescribed rate and the balance of exploration expenditures not yet incurred. As at March 31, 2008, the Company expended \$148,698 relating to these commitments.

## 10. Supplementary Cash Flow Information

The following table details the components of non-cash working capital provided by (used in) operations.

	March 31, 2008	March 31, 2007
Accounts receivable	\$ 500,928	\$ (426,039)
Deposits and prepaid expenses	(240,265)	(43,820)
Accounts payable and accrued liabilities	1,047,706	1,441,438
	<b>1,308,369</b>	971,579
Operating	<b>(1,066,849)</b>	(498,597)
Investing	\$ 241,520	\$ 472,981

## 11. Related-Party Transactions

For the period ended March 31, 2008, Arrow included \$27,171 (December 31, 2007: \$13,574) in legal fees and accounts payable to Parlee McLaws LLP of which a director of Arrow is a partner. Parlee McLaws is legal counsel to Arrow Energy Ltd.

At March 31, 2008 the Company has a payable to the Peavine Métis Settlement in the amount of \$73,219, to the Métis Settlement General Council in Trust for Peavine for \$193,159 and \$128,239 to Tirmoil Energy Ltd. These payables relate to revenues earned on land from participation in joint ventures. The Peavine Métis Settlement owns 100% of Tirmoil Energy Ltd. Tirmoil Energy Ltd. is the significant shareholder of Arrow Energy Ltd.

At December 31, 2007, the Company entered into a loan agreement with the President of the Company to provide a loan in the amount of \$100,000 for the purchase of flow-through shares of the Company. The loan agreement is secured by 250,000 common shares of the Company.

## 12. Subsequent Events

Arrow has entered into an agreement to acquire from a private oil and gas company, producing properties in northern Alberta. The purchase price for these fixed assets was \$4,100,000 and closed on April 1, 2008.

Subject to the approval of TSX Venture Exchange and the shareholders, the Company has granted incentive stock options to certain directors, officers, and employees of the Company to procure up to 1,480,000 common shares in the capital stock of the Company. The options have a term of five (5) years and are exercisable at an exercise price of 22¢ per share. The stock option agreement was dated April 24<sup>th</sup>, 2008.

On May 2, 2008, the Company entered into an agreement for the disposition of certain oil and gas properties within the Hayes Grand Forks area. The consideration received after adjustments totaled \$453,701.