



**Arrow Energy Ltd.**

**Q2 2008 Management's Discussion and Analysis**

## Management Discussion and Analysis

This Management Discussion and Analysis (“MD&A”), compared to the results for the six months ended June 30, 2007 is management’s assessment of financial condition and results of operations of Arrow Energy Ltd. (“Arrow” or the “Company”) for the 6-months ended June 30, 2008 and should be read in conjunction with the audited financial statements for the year ended December 31, 2007, and unaudited financial statements for the period ending June 30, 2008. These documents, along with other statutory filings, are available on SEDAR at [www.sedar.com](http://www.sedar.com) and at the Company’s Web site at [www.arrow-energy.com](http://www.arrow-energy.com). This MD&A has been approved by the Board of Directors and has been prepared with the overview of the audit committee, and is dated August 28, 2008.

### Basis of Presentation

The financial data presented in this MD&A has been prepared in accordance with Canadian generally accepted accounting principles (“GAAP”). The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and the disclosure of contingent assets and liabilities, at the date of the financial statements, and the reported amounts of revenues and expenses during the period. Actual results could differ from these estimates.

### Non-GAAP Measurements

This MD&A may contain the term “*funds flow*”, which should not be considered an alternative to, or more meaningful than “*cash flow from operating activities*” as determined in accordance with Canadian GAAP; it is used by Arrow to analyze leverage and liquidity. Funds flow as presented does not have any standardized meaning prescribed by Canadian GAAP and therefore may not be comparable with the calculation of similar measures by other entities. Funds flow from operations per share is calculated using the same weighted average number of shares outstanding used in the calculation of income per share. Funds flow from operations represents cash flow from operating activities expressed before changes in non-cash working capital and asset retirement.

The following table reconciles funds flow to cash flow from operating activities, which is used in the MD&A:

	Q2 2008	Q2 2007	YTD 2008	YTD 2007
Cash flow from operating activities	\$ (502,496)	\$ 46,236	\$ 177,050	\$ 412,058
Changes in non-cash working capital	1,118,961	220,865	176,984	(277,732)
Funds flow	\$ 616,465	\$ 267,101	\$ 354,034	\$ 134,326

Arrow also uses “operating netbacks” as a key performance indicator of field results by commodity. Operating netbacks do not have a standardized meaning prescribed by Canadian GAAP and therefore may not be comparable with the calculation of similar measures by other companies. Operating netbacks are determined by deducting royalties and operating, processing and transportation expenses from petroleum and natural gas sales.

Funds flow and operating netbacks are not intended to represent operating profits, nor should they be viewed as an alternative to cash flow from operating activities, net earnings or other measures of financial performance calculated in accordance with Canadian GAAP.

### Forward Looking Statements

Certain statements contained within the Management’s Discussion and Analysis, and in certain documents incorporated by reference into this document, constitute forward looking statements. These statements relate to future events or our future performance. Some such forward looking statements are: “*The Company is planning to conduct a 3-D seismic survey in the latter part of 2008*”, “*The funds received from dispositions in the third quarter are earmarked for the reduction of the Bank indebtedness*”, and “*For the third quarter, the Company’s working capital, excluding Bank indebtedness, is projected to be a surplus*”. These statements involve known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in such forward looking statements. We believe the expectations reflected in

### Forward Looking Statements - continued

those forward looking statements are reasonable but no assurance can be given that these expectations will prove to be correct and such forward looking statements included in, or incorporated by reference into, this MD&A should not be unduly relied upon. These statements speak only as of the date of this MD&A or as of the date specified in the documents incorporated by reference into this MD&A, as the case may be.

### BOE Presentation

All barrels of oil equivalent ("BOE") conversions are based on the widely used conversion ratio of six thousand cubic feet ("Mcf") of natural gas to one barrel ("bbl") of oil. BOEs may be misleading, particularly if used in isolation. A BOE conversion ratio of 6 Mcf: 1 bbl is based upon an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.

### Description of Business

Arrow Energy Ltd. was incorporated August 21, 2001. On May 3, 2004 Arrow Energy Ltd. amalgamated with 1095862 Alberta Ltd. and then with Red Chip Inc. Throughout these amalgamations, the Company retained the name Arrow Energy Ltd.

Tirmoil Energy Ltd., through a successful takeover bid, succeeded in acquiring control of Arrow Energy Ltd. effective September 1, 2006.

On September 28, 2007, by way of a Plan of Arrangement, Castle Rock Petroleum Ltd. became a wholly owned subsidiary of Arrow Energy Ltd.

Arrow is a Calgary, Alberta based public company engaged in the acquisition, exploration, development and production of petroleum and natural gas reserves in Alberta. The Company's common shares are listed on the TSX Venture Exchange "TSX-V" under the trading symbol "AOF".

### Quarterly Information

The following table summarizes revenue from petroleum and natural gas sales, net of royalties, cash flow from operations and net income for Arrow for the periods indicated.

Quarterly Financial Data (\$)	2008		2007				2006	
	June 30	Mar 31	Dec 31	Sep 30	Jun 30	Mar 31	Dec 31	Sep 30
Production revenue, net of royalties	<b>1,750,701</b>	747,575	555,981	1,179,571	946,886	649,392	402,351	465,293
Pipeline revenue	<b>262,052</b>	272,351	325,252	356,990	383,046	253,017	-	-
Funds flow <sup>1</sup>	<b>616,465</b>	(262,426)	(793,330)	495,472	267,101	(132,776)	(234,800)	(778,474)
Per share basic	<b>\$0.02</b>	(\$0.01)	(\$0.05)	\$0.03	\$0.02	(\$0.01)	(\$0.02)	(\$0.06)
Per share diluted <sup>2</sup>	<b>N/A</b>	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Cash flow from operating activities	<b>(502,496)</b>	679,546	(282,975)	(809,303)	46,236	365,821	(761,669)	(731,700)
Per share basic	<b>(\$0.02)</b>	\$0.02	(\$0.02)	(\$0.06)	\$0.00	\$0.03	(\$0.05)	(\$0.05)
Per share diluted <sup>2</sup>	<b>N/A</b>	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Net income (loss)	<b>(278,875)</b>	(594,676)	(1,140,703)	(428,561)	(273,174)	(592,288)	(630,307)	(806,002)
Per share basic	<b>(\$0.01)</b>	(\$0.02)	(\$0.07)	(\$0.03)	(\$0.03)	(\$0.04)	(\$0.04)	(\$0.06)
Per share diluted <sup>2</sup>	<b>N/A</b>	N/A	N/A	N/A	N/A	N/A	N/A	N/A

(1) *Funds flow* and *funds flow per share* are non-GAAP terms that represent cash generated from operating activities before changes in non-cash working capital and other operating items. Arrow's cash flow from operations may not be comparable to other companies'. Arrow considers cash flow from operations a key measure of performance as it demonstrates Arrow's ability to generate the cash flow necessary to fund future capital investments.

(2) A diluted per-share calculation would be anti-dilutive and is therefore not applicable.

## *Quarterly Information - continued*

### Revenues:

- Pipeline revenues have been in decline since Q2 of 2007 due to decrease in shipper volumes relating to natural declines in the area. Q1 of 2007 contained only 2 months of pipelines revenues.
- Production revenues increased from Q4, 2006 to Q1, 2007 primarily due to the Tirmoil acquisition. Q1 of 2007 contains two months of production. Q2 and Q3 of 2007 saw an increase in production revenues primarily due to a successful work over at our Peavine 16-31-79-16W5 well, stabilized production rates at the well drilled at Peavine 11-32-79-16W5 and the Bluesky gas well drilled on Peavine mid way through Q2, 2007. In Q4 of 2007, revenues decreased as a result of three wells being temporarily shut in due to work-overs and due to adjustments to royalty expense. The increase in Q4 2007 royalty expense is primarily due to the recording of royalty expenses related to joint venture billings remitted on partner operated wells and an adjustment to the GORR expense for a period prior to October 1, 2007. As a result, Management does not consider the Q4 2007 royalty expense to be indicative of performance in future quarters.
- Q1 of 2008 saw a slight recovery as the work over wells in Q4 2007 came back on stream; however, this was partially offset by the shutting in of West Lock 14-01-59-27W/0 by the operator.
- For the second quarter of 2008, production revenues were \$2,178,631 versus \$983,722 for the first quarter of 2008. This increase of 133.7% is due to the Gift Lake acquisition and the resumption of gas production for the month of June from the West Lock 14-01-59-27W/0. In addition, commodity prices received for oil and gas for the quarter ended June 30, 2008, increased 69% and 39% respectively.

### **Corporate Developments**

- On April 2, 2008, Arrow acquired a producing property near its Peavine core area in northern Alberta (Gift Lake area) from a private company for a total consideration of \$4.1 million. As the transaction was made effective October 1, 2007, the cash back to Arrow after adjustments at closing was \$918,731. The acquisition represented development of the Company's asset base in and around another one of Alberta's major Métis Settlements, Gift Lake Métis Settlement.
- On April 2, 2008, Arrow reached an agreement with its lender to extend its credit facility from \$3.5MM to \$6.0MM. On May 29, 2008, the facility was again revised to \$6.5MM.
- On April 16, 2008, Arrow announced the appointment of Richard Edgar, P. Geol. to the position of Executive Chairman, Richard Ballak, CGA to the position of Corporate Controller, and Jorge Aviles to the position of Coordinator of Corporate Affairs.
- On May 2, 2008, the Company entered into an agreement relating to the disposition of certain oil and gas properties within the Hays Grand Forks area. The consideration received after adjustments totaled \$453,701.
- On August 1, 2008, Mr. Richard Edgar was appointed Executive Director overseeing all the affairs of Arrow to replace Mr. Chris Tesarski who resigned as President and Chief Executive Officer of Arrow effective July 31, 2008. On that same date, Mr. Sandford Gauchier, a Director of Arrow, was appointed Vice President of Surface Operations of Arrow. As part of Mr. Gauchier's employment package, he will receive 100,000 stock options to purchase common shares of Arrow at an exercise price of \$0.17 per common share effective August 1st, 2008.

## Results of Operations

\$	Q2 2008	Q2 2007	YTD 2008	YTD 2007
<b>REVENUES</b>				
Petroleum and natural gas revenue	<b>\$2,178,631</b>	\$1,280,783	<b>\$3,162,353</b>	\$2,172,621
Royalties	<b>(427,930)</b>	(333,897)	<b>(664,077)</b>	(576,343)
Pipeline revenue	<b>262,052</b>	383,046	<b>534,403</b>	636,063
Other income	<b>(1,324)</b>	14,439	<b>6,994</b>	23,660
	<b>2,011,429</b>	1,344,371	<b>3,039,673</b>	2,256,001
<b>EXPENSES</b>				
Operating expense	<b>373,351</b>	117,602	<b>839,511</b>	351,672
Transportation expense	<b>5,226</b>	5,512	<b>14,278</b>	18,250
Pipeline expense	<b>223,438</b>	228,013	<b>406,179</b>	410,754
General and administrative expense	<b>665,977</b>	675,965	<b>1,240,729</b>	1,251,446
Depletion, depreciation and accretion expense	<b>773,481</b>	680,647	<b>1,301,537</b>	1,359,487
Interest	<b>126,972</b>	50,178	<b>184,937</b>	89,553
Stock-based compensation expense	<b>190,592</b>	19,790	<b>203,992</b>	39,580
	<b>2,359,037</b>	1,777,707	<b>(4,191,163)</b>	(3,520,742)
Loss from operations	<b>(347,608)</b>	(433,336)	<b>(1,151,490)</b>	(1,264,741)
Net loss before taxes	<b>(347,608)</b>	(433,336)	<b>(1,151,490)</b>	(1,264,741)
Future income tax recovery	<b>(68,733)</b>	(160,162)	<b>(277,939)</b>	(393,279)
Net loss	<b>\$(278,875)</b>	\$(273,174)	<b>\$(873,551)</b>	\$(871,462)
Net loss per share, basic and diluted	<b>\$ (0.01)</b>	\$ (0.03)	<b>\$ (0.03)</b>	\$ (0.07)

## Netbacks

\$	Three months ended June 30		Six months ended June 30	
	2008	2007	2008	2007
Realized price	<b>\$ 93.69</b>	\$ 57.21	<b>\$ 85.12</b>	\$ 56.04
Royalties	<b>18.40</b>	14.92	<b>17.88</b>	14.87
Transportation expense	<b>0.22</b>	0.25	<b>0.38</b>	0.47
Operating expense	<b>16.06</b>	5.25	<b>22.60</b>	9.07
Operating netback	<b>59.01</b>	36.79	<b>44.26</b>	31.63
Other income	<b>0.06</b>	(0.65)	<b>(0.19)</b>	(0.61)
G&A expense	<b>28.64</b>	30.20	<b>33.40</b>	32.28
Interest expense	<b>5.46</b>	2.24	<b>4.98</b>	2.31
Netback (\$/boe)	<b>24.85</b>	5.00	<b>6.07</b>	(2.35)

## Drilling Activity

The following table summarizes the results of the wells that Arrow drilled or participated in drilling for the period ended June 30, 2008 and June 30, 2007:

	Three Months ended June 30, 2008		Six Months ended June 30, 2007	
	Gross	Net	Gross	Net
Natural gas	-	-	3.00	0.86
Oil	-	-	1.00	0.25
Dry & abandoned	-	-	-	-
<b>Total</b>	-	-	<b>4.00</b>	<b>1.11</b>

## Oil and Natural Gas Wells

The following table summarizes Arrow's interest, as at June 30, 2008, in wells that are producing or which Arrow considers to be capable of production:

Producing Oil		Non Producing Oil		Producing Natural Gas		Non Producing Natural Gas	
Gross	Net	Gross	Net	Gross	Net	Gross	Net
14.00	4.57	7.00	0.77	9.00	4.10	9.00	4.10

## Undeveloped Land Holdings

The undeveloped land holdings of Arrow as at June 30, 2008 and 2007, respectively, are set forth in the following table:

	Undeveloped Land			
	Gross Acres		Net Acres	
	2008	2007	2008	2007
Total	<b>32,646</b>	18,240	<b>18,610</b>	10,952

## Production

Arrow's average production for the second quarter of 2008 was 256 BOE/d, compared with 246 BOE/d for Q2 of 2007. Production for the quarter increased 67% from Q1 2008. The Gift Lake acquisition, made effective October 1, 2007 and closed April 2, 2008, averaged 76 BOE/d for the second quarter. The Westlock 14-01-59-27-W4/0 well, which was shut-in from February to June 4 of 2008, averaged 465 Mcf/d for the remainder of June 2008. Arrow's exit production for Q2 of 2008 was 313 BOE/d.

	Three months ended June 30		Six months ended June 30	
	2008	2007	2008	2007
Volumes				
Oil (bbl/d)	<b>150</b>	113	<b>117</b>	97
Natural gas (Mcf/d)	<b>616</b>	804	<b>524</b>	698
<b>Total (BOE/d)</b>	<b>256</b>	246	<b>204</b>	213

## Commodity Prices

For the second quarter, the Company's average realized prices on natural gas increased by 39 percent from the prior-year period from \$7.10/Mcf of natural gas to \$9.86/Mcf. The average natural gas price received year-to-date for 2008 was \$9.12/Mcf compared to \$7.25/Mcf, received for the year-to-date 2007.

The average price per barrel of oil received in Q2 was \$119.57/BOE, compared with \$70.87/BOE in the prior-year period. The West Texas Intermediate ("WTI") oil price per barrel rose to an average of US\$111.14 in 2008 from US\$61.58 for the 6-month period in 2007. Part of this significant year-over-year increase in oil prices, however, was offset by the stronger Canadian dollar.

Arrow's Realized Price	Three months ended June 30		Six months ended June 30	
	2008	2007	2008	2007
Oil (\$/bbl)	<b>\$119.57</b>	\$70.87	<b>\$112.50</b>	\$69.05
Natural gas (\$/Mcf)	<b>9.86</b>	7.10	<b>9.12</b>	7.25
Average (\$/BOE)	<b>93.69</b>	57.21	<b>85.12</b>	56.04
<b>Benchmark Prices</b>				
WTI (US\$/bbl)	<b>\$123.80</b>	64.95	<b>\$111.14</b>	\$61.58
Cdn/US average exchange rate	<b>0.990</b>	0.9111	<b>0.993</b>	0.882
Edmonton Par (\$/BOE)	<b>126.41</b>	72.64	<b>112.26</b>	70.12
Alberta spot (\$/Mcf)	<b>10.08</b>	6.94	<b>8.96</b>	7.10

## Revenue

Revenue from Arrow's oil and natural gas sales increased in the second quarter to \$2,178,631 compared to \$1,280,783 in the same quarter of last year. For the six month period, revenue grew to \$3,162,353 compared to \$2,172,621 in 2007. The revenue increases for both comparable periods are due to the Gift Lake acquisition and the continuation of gas production for the month of June from the Westlock 14-01-59-27W/0 well. In addition, the commodity prices received for oil for the quarter and year-to-date periods ended 2008 increased 69% and 64% respectively. For gas, the increase for the same comparable periods was 39% and 26% respectively.

Petroleum and Natural Gas Sales	Three months ended June 30		Six months ended June 30	
	2008	2007	2008	2007
Natural Gas sales	<b>\$ 572,232</b>	\$ 518,869	<b>\$ 871,550</b>	\$ 916,375
Crude Oil sales	<b>1,582,931</b>	725,265	<b>2,243,038</b>	1,212,210
Natural Gas liquids sales	<b>23,468</b>	36,649	<b>47,765</b>	44,036
Petroleum & Natural Gas revenue	<b>\$2,178,631</b>	\$1,280,783	<b>\$3,162,353</b>	\$2,172,621

Pipeline revenue for the second quarter of 2008 totaled \$262,052 versus \$383,046 for the comparable quarter of 2007. For the six months ended June 30, 2008, revenue was \$534,403 versus \$636,063 for the period February through June 2007.

## Royalties

Q2 2008 royalties averaged 19.6% of revenue compared to 26.1% of revenue in Q2 2007. YTD 2008 royalties averaged 21.0% of revenue compared to 26.1% of revenue for YTD 2007. Royalty rates decreased in 2008 as a percentage of revenues from 2007, as the revenue on which the gross overriding royalties' payables calculated are lower in 2008.

Royalties by Commodity	Three months ended June 30		Six months ended June 30	
	2008	2007	2008	2007
Oil	\$327,619	\$238,729	\$469,286	\$380,367
Natural Gas	87,912	85,580	172,808	181,591
NGLs	12,399	9,588	21,983	14,385
Totals	\$427,930	\$333,897	\$664,077	\$576,343

Royalties by Type	Three months ended June 30		Six months ended June 30	
	2008	2007	2008	2007
Crown	\$375,417	\$260,214	\$553,008	\$482,175
Gross overriding	52,513	73,683	111,069	94,168
Totals	\$427,930	\$333,897	\$664,077	\$576,343
\$/BOE	\$18.40	\$14.92	\$17.88	\$14.87
As a percent of Revenue	19.6%	26.1%	21.0%	26.5%

## Operating and Transportation Expense and Pipeline Costs

The operating cost for the quarter ended June 30, 2008 amounted to \$378,577 or \$16.28/BOE, compared to \$123,114 or \$5.50/BOE during the quarter ending June 30, 2007. For the six months ending June 30, 2008, operating costs were \$853,789 or \$22.98/BOE compared to \$369,922 or \$9.54/BOE for the period ending June 30, 2007. YTD 2008 operating costs include Q1 costs relating to the Hays Grand Forks 9-30-12-14 W4M, which were \$98,462 (\$62.48/BOE) due to hauling and trucking costs associated with its high water cut. This property has since been sold on May 2, 2008.

Transportation costs were \$5,226 (\$0.22/BOE) in Q2 2008, compared with \$5,512 (\$0.25/BOE) in Q2 2007. Year-to-date transportation costs for 2008 are \$14,278 (\$0.38/BOE) versus \$18,250 (\$0.47/BOE) for the comparable period ended June 30, 2007.

	Three months ended June 30		Six months ended June 30	
	2008	2007	2008	2007
Operating costs	\$378,577	\$123,114	\$853,789	\$369,922
per BOE <sup>1</sup>	\$16.28	\$5.50	\$22.98	\$9.54

(1) includes transportation costs

Pipeline expenses were \$223,438 (\$1.66/BOE) for the second quarter of 2008, compared to \$228,013 (\$1.11/BOE) for the second quarter of 2007. For the six months ended June 30, 2008, pipeline expenses were \$406,179 (\$1.42/BOE) compared to \$410,754 (\$1.21/BOE) for the comparable period ended June 30, 2007. This increase in costs per BOE for 2008 is due to a decline in oil production within the Peavine area and field costs remaining fixed.

The pipeline was constructed in March, 2003 and was acquired by Arrow Energy Ltd from Tirmoil energy Ltd. in November of 2006. The pipeline is 8" in diameter and is 24.95 miles in length. This is an non-regulated pipeline. A large oil and gas operator within the Peavine area contracts through Arrow for the delivery of its production. A tariff of \$1.87 per boe is charged by Arrow.

*Operating and Transportation Expense and Pipeline Costs - continued*

	Three months ended June 30		Six months ended June 30	
	2008	2007	2008	2007
Pipeline expenses	<b>\$ 223,438</b>	\$ 228,013	<b>\$ 406,179</b>	\$ 410,754
Through-put in BOE	<b>140,345</b>	205,051	<b>286,201</b>	340,555
Pipeline expenses per BOE	<b>\$ 1.66</b>	\$ 1.11	<b>\$1.42</b>	\$1.21

**General and Administrative (“G&A”) Expense**

The second quarter general and administrative expenses totaled \$665,977 compared to \$675,965 in the second quarter of 2007. The year-to-date general and administrative expenses totaled \$1,240,729 compared to \$1,251,446 for the six-month period ending June 30, 2007.

	Three months ended June 30		Six months ended June 30	
	2008	2007	2008	2007
Salaries & Benefits	<b>\$ 177,701</b>	\$ 266,929	<b>\$ 268,155</b>	\$ 419,016
Office Costs	<b>39,614</b>	27,774	<b>83,869</b>	65,654
Office Rent	<b>108,323</b>	93,100	<b>225,697</b>	170,086
Legal	<b>66,930</b>	81,599	<b>75,293</b>	215,068
Audit	<b>60,976</b>	44,730	<b>61,027</b>	54,730
Consultants	<b>124,388</b>	125,448	<b>348,227</b>	257,746
Shareholder Services	<b>24,995</b>	–	<b>33,755</b>	4,200
Environmental Services	<b>16,000</b>	–	<b>16,000</b>	
Insurance	<b>13,938</b>	10,608	<b>43,987</b>	21,317
Computer Systems	<b>11,828</b>	3,778	<b>31,247</b>	9,496
Travel & Promotions	<b>21,284</b>	21,999	<b>53,472</b>	34,133
	<b>\$ 665,977</b>	\$ 675,965	<b>\$ 1,240,729</b>	\$ 1,251,446
G&A per BOE	<b>\$ 28.63</b>	\$ 30.20	<b>\$ 33.40</b>	\$ 32.28

**Depletion, Depreciation and Accretion (“DD&A”) Expense**

Total depletion and depreciation for the quarter ended June 30, 2008 amounted to \$773,481 compared to \$680,647 for the quarter ended June 30, 2007. Depletion expense during the quarter increased 46.4% due to the acquisition of the Gift Lake properties, however these costs were offset partially by the Hays disposition. Total depletion on a year-to-date basis at June 30, 2008 was \$1,301,537, compared to \$1,359,487 for the six months ended June 30, 2007.

The depletion calculation is based on reserves as updated by the Company’s independent engineers as at March 31, 2008.

	Three months ended June 30		Six months ended June 30	
	2008	2007	2008	2007
DD&A expense, gross	<b>\$ 773,481</b>	\$ 680,647	<b>\$1,301,537</b>	\$ 1,359,487
DD&A expense, per BOE, net	<b>\$ 33.26</b>	\$ 30.41	<b>\$ 35.03</b>	\$ 35.07

## Accretion

Accretion expense represents the increase in the present value of the asset retirement obligation for the current period. During the quarter ended June 30, 2008 accretion expense amounted to \$22,071 (\$43,708 year-to-date), compared to \$6,598 (\$10,599 year-to-date) during the similar period in fiscal 2007.

## Future Income Taxes

The future income tax recovery for the three months ended June 30, 2008 was \$68,733 compared with \$160,162 for the three months ended June 30, 2007. Total future income tax recovery on a year-to-date basis at June 30, 2008 was \$277,939, compared to \$393,279 for the six months ended June 30, 2007.

## Capital Expenditures

	Three months ended June 30		Six months ended June 30	
	2008	2007	2008	2007
Land	\$ 35,530	–	\$ 39,738	\$ 16,791
Geological and geophysical	23,980	–	74,771	–
Drilling and completions	5,185	341,294	304,623	1,057,262
Production equipment & facilities		221,642	5,275	461,701
Property acquisition	3,256,958	(91,692)	3,256,958	893,762
Property disposition	(426,406)	(120,000)	(426,406)	(120,000)
Furniture and Fixtures	(11,541)	–	36,111	–
	\$ 2,883,706	\$ 351,244	\$ 3,291,070	\$ 2,309,516

During the current quarter, the major capital expenditure was the acquisition of the Gift Lake property with a closing date of April 2, 2008. On May 2, 2008, the Company disposed of its interests within the Hays Grand Forks area.

Amounts reported in the table above do not include non-cash capital recorded for asset retirement obligations, which amount to \$ 138,573 in the second quarter of 2008 (\$138,573 year-to-date), and to \$nil in the second quarter of 2007 (\$95,845 year-to-date).

The Company is planning to conduct a 3-D seismic survey in the latter part of 2008, which is expected to be funded with operating cash flows, and funds generated by assets dispositions to take place during Q3 & Q4, 2008. The amount budgeted for this project is \$350,000. The only other Capital Expenditure to be incurred in the second half of 2008 will be related to a work-over for a well within the Dawson area. The Company's budgeted amount for this work-over is \$25,000.

In the letter to the shareholders dated April 29, 2008, the former president announced aggressive plans for 2008; the current management will not be proceeding with these aggressive plans. Management is focusing on resolving the covenant violation on its bank loan relating to its working capital deficiency by reducing cash flows for investing activities in the second half of 2008.

## Share Capital, Contributed Surplus, and Option Activity

### Share Capital

	Number of Shares	Amount
Balance, December 31, 2007	27,233,727	\$ 14,126,407
Share issue costs		(11,978)
Future income taxes on renunciation of flow through shares issued		(147,500)
Balance, June 30, 2008	27,233,727	\$ 13,966,929

The issued and outstanding Common shares for Arrow Energy Ltd. are 27,233,727 as at August 29, 2008.

	Number of Warrants	Amount
Balance, December 31, 2007	5,142,958	\$ 612,276
Expiry of warrants	(2,000,000)	(102,259)
Balance, June 30, 2008	3,142,958	\$ 510,017

### Working Capital, Liquidity, and Capital Resources

At June 30, 2008, the Company had a working capital deficiency of \$ 6,612,318, compared to a working capital deficiency of \$ 3,663,308 at December 31, 2007 and \$ 4,277,462 at June 30, 2007. The Company also continued to be in breach of the working capital covenant contained in the bank loan agreement, for which the bank has provided a waiver until September 30, 2008. The bank loan is classified as a current liability and is due on demand irrespective of the covenant breach. The Company currently would not have the available cash flow to settle the bank loan in the event payment was demanded. It is common in the industry to use demand facilities that are classified as current liabilities as a form of long-term financing as is supported by oil and gas reserve values.

Components of the working capital deficiency are contained in the following table:

	June 30 2008	Dec 31 2007	June 30 2007
Cash and cash equivalents	\$ 29,596	\$ 155,692	\$ 15,273
Accounts receivable	1,743,780	1,765,956	836,520
Deposits and prepaid expenses	229,910	236,566	205,979
Bank indebtedness	(6,303,382)	(3,037,838)	(3,400,000)
Accounts payable and accrued liabilities	(2,312,222)	(2,783,684)	(1,935,234)
Total Working Capital Deficiency	\$ (6,612,318)	\$ (3,663,308)	\$ (4,277,462)

The Company has, in the second quarter, successfully disposed of a non-core property for \$453,701; and identified other non-core assets for potential disposition in Q3. Any funds received from this potential disposition in the third quarter are earmarked for the reduction of the Bank indebtedness. The Company is currently realizing receipts from its commodity sales of approximately \$925,000 per month that are being applied to reducing its payables and fund current operating and other current expenses. For the third quarter, the Company's working capital, excluding Bank indebtedness, is projected to be a surplus.

At December 31, 2007, the Company had established a demand loan facility in the amount of \$3,500,000 with the lender. Interest on this facility is charged monthly at the bank's prime rate plus 50 basis points. The credit facility is secured by a fixed and floating charge on the assets of the Company, which is subject to an annual review. Arrow has recently completed the renegotiation with the lender for an increase in the demand loan facility from \$6,000,000 to \$6,500,000 due to additional reserves as evaluated by the external reserve engineers. The increase in the bank loan was used to finance the acquisition of the Gift Lake Properties.

## **Commitments and Contingencies**

The Company has remaining lease commitments for office space of \$33,163 and \$865,488, which expire on February 28, 2010 and July 1, 2012, respectively.

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

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. As at June 30, 2008, the Company has expended \$148,698 relating to these commitments.

## **Related-Party Transactions**

For the period ended June 30, 2008, Arrow incurred \$80,992 (December 31, 2007 \$13,574) in legal fees with a balance of \$11,729 still payable to Parlee McLaws LLP. Parlee McLaws is legal counsel to Arrow Energy Ltd, and a partner of that firm is also a Director of this company (Arrow Energy Ltd.)

At June 30, 2008 the Company has a payable to the Peavine Métis Settlement in the amount of \$27,427, to the Métis Settlement General Council in Trust for Peavine for \$59,910, and \$24,221 to the Métis Settlement General Council. 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 former 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 stipulates that the promissory note is payable on Demand, and interest is paid at the rate of 8% per annum calculated and compounded semi-annually. The Company believes this loan is collectable as at June 30, 2008.

## **Financial Instruments**

Financial instruments comprise cash and cash equivalents, accounts receivable and accounts payable and accrued liabilities. The fair values of these financial instruments approximate their carrying amounts due to their short-term maturities. The Company's long-term debt bears interest at a floating market rate and accordingly the fair market value approximates the carrying value.

## **Adoption of New Policies**

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.

### *Adoption of New Policies - continued*

- 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.

### **Future Accounting Pronouncements**

- Section 3064 – “Goodwill and Intangible Assets”, will be adopted on January 1, 2009. These sections establish standards for the recognition, measurement, presentation, and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. Standards concerning goodwill are unchanged from the standards included in the previous Section 3062. The Company is currently evaluating the impact of the adoption of this new Section on its financial statements but does not expect that the adoption of this new Section will have a material impact on its financial statements.

### **Recent Pronouncements**

On February 13, 2008, the Canadian Accounting Standards Board confirmed that publicly accountable enterprises will be required to adopt IFRS in place of Canadian Generally Accepted Accounting Principles (GAAP) for interim and annual reporting purposes for fiscal years beginning on or after January 1, 2011. At this time, the impact of our future financial position and results of operations is not reasonably determinable or estimable.

The Company plans to conduct an initial diagnostic phase commencing in the fourth quarter of 2008 after engaging external expertise and upon organizing a cross functional steering committee for monitoring the IFRS project until its completion. Regular reporting will occur to Management and to the Audit Committee.

### **Critical Accounting Estimates**

The Company’s financial and operating results contain estimates made by management in the following areas:

1. capital expenditures are based on estimates on projects in various stages of completion;
2. revenues, royalties and operating costs are based on estimates for which revenue had not yet been received and costs had not yet been realized;
3. depletion, depreciation and accretion are based on estimates of oil and natural gas reserves that the Company expects to recover in the future;
4. asset retirement obligations are based on estimates of future costs and timing of expenditures; and
5. the future recoverable value of capital assets is also based on estimates that the Company expects to realize in the future.

Management’s assumptions are based on factors that, in management’s opinion, are relevant and appropriate. Management’s assumptions may change over time as operating conditions change.

### Oil and Natural Gas Reserves Determination

The process of estimating reserves is complex. It requires significant judgments and decisions based on available geological, geophysical, engineering and economic data. Reserve estimates are based on current production forecasts, prices and economic conditions. These estimates may change substantially as additional data from ongoing development and production activities becomes available and as economic conditions impact oil and natural gas prices and costs.

### Depletion Expense

The Company uses the full-cost method of accounting for exploration and development activities. In accordance with this method of accounting, all costs associated with exploration and development activities, whether successful or not, are capitalized. The aggregate of net capitalized costs (less costs of unproved properties) and estimated future development costs (less estimated salvage values) is amortized using the unit-of-production method based on estimated proved oil and natural gas reserves. An increase in estimated proved oil and natural gas reserves or a decrease in estimated future development costs would each result in a corresponding reduction in depletion and depreciation expense.

### Impairment of Petroleum and Natural Gas Assets

The Company is required to review the carrying value of all petroleum and natural gas assets for potential impairment. Impairment is indicated if the carrying amount of the oil and natural gas property and equipment is not recoverable by the future undiscounted funds flows. If impairment is indicated, the amount by which the carrying value exceeds the estimated fair value of the property and equipment is charged to earnings. The assessment of impairment is dependent on estimates of reserves, production rates, prices, future costs and other relevant assumptions.

### Stock-Based Compensation

Under the fair-value method of accounting for stock options, compensation expense is determined on the date of grant using the Black-Scholes option pricing model. The Black-Scholes option pricing model was developed for use in estimating the fair value of traded options that are fully transferable and have no vesting restrictions. Arrow's stock options are not transferable, cannot be traded and are subject to vesting restrictions that would tend to reduce value. The Black-Scholes model requires the input of several variables including estimated volatility of Arrow's stock price over the life of the option, estimated forfeitures and the estimated life of the option. Changes in these estimates would alter the option's fair value and the related expense as determined by the Black-Scholes model.

### Asset Retirement Obligations

The Company is required to provide for future removal and restoration costs. The Company must estimate these costs in accordance with existing laws, contracts or other policies. The fair value of the liability for the Company's asset retirement obligations is recorded in the period in which it is expected to be incurred, discounted to its present value using the Company's risk-adjusted interest rate and the expected inflation rate. The offset to the liability is recorded in the carrying amount of property and equipment. The liability amount is increased each reporting period due to the passage of time, and the amount of accretion is charged to earnings in the period. Revisions to the estimated timing of cash flows or to the original estimated undiscounted cost could also result in an increase or decrease to the obligation. Actual costs incurred upon settlement of the retirement obligation are charged against the obligation to the extent of the liability recorded.

### Income Tax Accounting

The determination of the Company's income and other tax liabilities requires interpretation of complex laws and regulations. All tax filings are subject to audit and potential re-assessment after the lapse of considerable time. Accordingly, the actual income tax liability may differ significantly from that estimated and recorded by management.

### Internal Control Reporting

Effective for periods ending on or after December 31, 2007, CSA issued blanket orders or similar allowing venture issuers to file "Venture Issuer Basic Certificates."

On April 18, 2008, the CSA published the proposed new rule N52-109 that is intended to become effective December 15, 2008. Under this proposed new rule, venture issuers will not be required to certify the design or effectiveness of disclosure controls or internal control over financial reporting.

### Risk Factors

There are a number of risk factors facing companies that participate in the Canadian oil and gas industry. A summary of certain risk factors relating to our business is provided in the following list:

Exploration, Development and Production Risks: Oil and natural gas operations involve many risks that even a combination of experience, knowledge and careful evaluation may not be able to overcome. Our long-term commercial success depends on our ability to find, acquire, develop and commercially produce oil and natural gas reserves. Without the continual addition of new reserves, any existing reserves we may have at any particular time, and the production therefrom will decline over time as such existing reserves are exploited. A future increase in our reserves will depend not only on our ability to explore and develop any properties we may have from time to time, but also

### *Risk Factors - continued*

on our ability to select and acquire suitable producing properties or prospects. No assurance can be given that we will be able to continue to locate satisfactory properties for acquisition or participation. Moreover, if such acquisitions or participations are identified, our management may determine that current markets, terms of acquisition and participation or pricing conditions make such acquisitions or participations uneconomic. There is no assurance that further commercial quantities of oil and natural gas will be discovered or acquired by us.

Future oil and natural gas exploration may involve unprofitable efforts, not only from dry wells, but also from wells that are productive but do not produce sufficient petroleum substances to return a profit after drilling, operating and other costs. Completion of a well does not ensure a profit on the investment or recovery of drilling, completion and operating costs. In addition, drilling hazards or environmental damage could greatly increase the cost of operations, and various field operating conditions may adversely affect the production from successful wells. These conditions include delays in obtaining governmental approvals or consents; shut ins of connected wells resulting from extreme weather conditions, insufficient storage or transportation capacity or other geological and mechanical conditions.

While diligent well supervision and effective maintenance operations can contribute to maximizing production rates over time, production delays and declines from normal field operating conditions cannot be eliminated and can be expected to adversely affect revenue and cash flow levels to varying degrees.

Oil and natural gas exploration, development and production operations are subject to all the risks and hazards typically associated with such operations, including hazards such as fire, explosion, blowouts, cratering, sour gas releases and spills, each of which could result in substantial damage to oil and natural gas wells, production facilities, other property and the environment or personal injury. In particular, we may explore for and produce sour natural gas in certain areas. An unintentional leak of sour natural gas could result in personal injury, loss of life or damage to property and may necessitate an evacuation of populated areas, all of which could result in liability to us.

In accordance with industry practice, we are not fully insured against all of these risks, nor are all such risks insurable. Although we maintain liability insurance in an amount that we consider consistent with industry practice, the nature of these risks is such that liabilities could exceed policy limits, in which event we could incur significant costs that could have a material adverse effect upon our financial condition. Oil and natural gas production operations are also subject to all the risks typically associated with such operations, including encountering unexpected formations or pressures, premature decline of reservoirs and the invasion of water into producing formations. Losses resulting from the occurrence of any of these risks could have a material adverse effect on us.

### Additional Information

Additional information regarding the Company is available on SEDAR at [www.sedar.com](http://www.sedar.com) or can be obtained by contacting Arrow Energy Ltd., Suite 350, 703 – 6th Avenue SW, Calgary, AB T2P 0T9 or on the Company's Web site at [www.arrow-energy.com](http://www.arrow-energy.com).