BAYOU BEND PETROLEUM LTD.

CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2008 AND 2007

To our shareholders:

Bayou Bend was originally established to take advantage of some high potential, high risk prospects in the shallow water Gulf of Mexico using state of the art 3D seismic processing and interpretation. We were able to assemble a large portfolio of relatively high risk exploration projects and drilled 8 exploration wells with a success rate of 50%. Although we did find commercial gas deposits, the net size of the discoveries was smaller than anticipated and the remaining exploration portfolio was of insufficient scope to grow the Company at the rates originally anticipated. Combining this with a major downturn in gas prices associated with the economic downturn, the management and board of the Company concluded that continuing the Gulf of Mexico exploration strategy was not in the best interests of the shareholders.

To this end, late in the year, the Company engaged Canaccord Adams Inc. as an investment advisor to assist the Company with its current review of the strategic and financial alternatives available to it.

As a result, the Company signed a definitive agreement in respect of the sale of substantially all of its U.S. assets to Dynamic Offshore Resources, LLC., a private company based in Houston, Texas. The purchase price for the transaction is US $12.5 million, payable in cash upon closing of the transaction. In addition, a deferred payment of up to US $8.0 million may be made on April 1, 2011, based upon the increase in proved oil and gas reserves attributable to the purchased interests as at December 31, 2010 above a specified threshold, at a rate of US $0.20 per Mcfe.

In addition, the Company is currently finalizing an agreement with a separate arms length party for the sale of a property excluded from the above transaction in the amount of approximately US $550,000.

Bayou Bend plans to hold a special meeting of shareholders to approve the transaction and related matters on May 22, 2009. Upon receipt of all approvals, the transaction is expected to close by the end of May 2009, with an effective date of April 1, 2009.

Upon closing of the transaction, the Company will have a very strong cash balance exceeding Cdn $60 million. This represents a clear advantage for Bayou Bend in these currently challenging markets and allows the Company to pursue the wealth of distressed, undervalued resource opportunities available today.

The Company looks forward to a successful year ahead.

On Behalf of the Board

Keith C. Hill
President and CEO

April 16, 2009

BAYOU BEND PETROLEUM LTD.

MANAGEMENT DISCUSSION AND ANALYSIS
(Amounts in United States Dollars unless otherwise indicated)
Years Ended December 31, 2008 and 2007

Management's discussion and analysis ("MD&A") of Bayou Bend Petroleum Ltd.'s (the "Company" or "Bayou Bend") financial condition and results of operations should be read in conjunction with the audited consolidated financial statements for the years ended December 31, 2008 and 2007 and related notes thereto, prepared in accordance with Canadian generally accepted accounting principles. The effective date of the MD&A is April 16, 2009. Additional information related to the Company is available on SEDAR at www.sedar.com and on the Company's web-site at www.bayoubendpetroleum.com.

Background

Bayou Bend is a Canadian-based oil and gas company that currently holds various interests in oil and gas exploration and development properties in the USA. Prior to February 9, 2007, the Company operated under the name Kit Resources Ltd. and traded on the TSX Venture Exchange under the symbol "KIT". On February 9, 2007, the Company changed its name to Bayou Bend Petroleum Ltd. and started trading under the symbol "BBP".

Prior to December 31, 2006, the Company was a resource based company engaged in the continued search for new and viable opportunities in the mineral sector. During the three months ended March 31, 2007, the Company began its transition into an oil and gas exploration and development company and completed several significant acquisitions.

Effective April 1, 2007, the Company's reporting currency was changed from Canadian dollars to U.S. dollars. The Company anticipates that its future sales will be earned in U.S. dollars and significant expenditures of the Company costs will be incurred in U.S. dollars. The comparative financial statements from prior periods have been restated to reflect this change.

Summary

During the year ended December 31, 2008, the Company's major accomplishments and other significant events were as follows:

- In June 2008 the Company commenced drilling its Mt. Moran North well, located in Eugene Island Block 10. The prospect was drilled to a total vertical depth (TVD) of 17,004 feet and encountered 98 feet TVD net effective gas pay in three separate gas bearing sands. The well was jointly drilled with Contango Operators, Incorporated ("Contango") through the Company's Joint Exploration Agreement. The well has been completed and tied-in to Contango's Eugene Island Block 11 production facility for processing and sales. Production commenced in early

December and is currently producing at 3 million standard cubic feet per day ("MMCF/D") and 230 barrels of condensate per day. Bayou Bend has a 12.453525% working interest in this well.

- In June 2008 a well in Eugene Island Block 164, which is operated by PetroQuest Energy, LLC, was spud. The well was drilled to a total depth of 15,538 feet TVD and fully evaluated. The Company held a 10% working interest position in this well that was drilled in the Federal waters off of the Louisiana coast. The well discovered a non-commercial gas accumulation in the upper objective of the Tex X lower sand. The main objective, the Big A-4 sand, came in as expected in terms of depth and thickness but log analysis indicated the sand was wet. The wellbore was subsequently plugged and abandoned.

- In May 2008 the Company announced that it had made a gas condensate discovery on its Eagle's Nest prospect in the Marsh Island project in Eugene Island Block 6, and had the discovery on production 10 weeks later. The Eagle's Nest prospect was drilled to a total depth of 16,000 feet true vertical depth ("TVD") and encountered 56 feet TVD net effective gas pay. The well was jointly drilled with Contango Operators, Inc. and has been tied into Contango's Eugene Island Block 11 production facility for processing and sales. In July 2008 Eagle's Nest came on production. First production occurred on July 24, 2008 and is currently flowing at 29.6 MMCF/D and 705 barrels of condensate per day. Bayou Bend has a 12.453525% working interest in this prospect.

- In August 2008 the Company entered into a Participation Agreement with Mariner Energy, Inc. ("Mariner") and Apache Corporation to jointly drill and develop the Smoothe Prospect located in the South Timbalier Area, Block 49. In early December 2008, the exploratory well reached its objective depth of 18,426 feet TVD. After reaching its objective depth, drilling continued in an effort to reach a lower zone. Due to excessive cost overruns in this further deepening process, in January 2009, the Company recommended plugging and abandoning the well based on the relative value of the existing logged pay and the potential risk associated with the deepening operations. At that time Mariner informed the Company that they would continue in their attempt to reach total depth, at which point the Company non-consented to the continued operations. The Company holds a 33.33% working interest in the lease and in this well, subject to non-participation clauses in the joint operating agreement. (For financial statement purposes, the Company considers this well a dry hole as of December 31, 2008.)

- In June 2008 the Company commenced drilling a well in the Marsh Island Project Area on its Haystack prospect. The Company had a 45.6275% working interest in this well. The well was completed on July 2, 2008, at a total depth of 11,028 feet MD. Based on log correlations, the expected Tex W3 sand was present in the well bore but log analysis indicated that the sand was wet. The well was subsequently plugged and abandoned.

- The 3-D seismic data super merge project over Marsh Island which consisted of the reprocessing of two proprietary and two multi-client 3D surveys was completed. This integrated, improved data will greatly assist with enhancing the Company's ongoing exploration success in the Marsh Island area.

- In October 2008 the Company was the successful bidder on two blocks in Louisiana State waters in the Marsh Island Project Area. With these blocks, the total gross acreage held by the Company is 115,125 acres.

Oil and Gas Acquisitions

On February 20, 2007, the Company acquired 100% of the membership interests in Summit (the "Summit Acquisition") and Summit became a wholly-owned subsidiary of the Company. The assets acquired included an 18.1634% interest in a portfolio of assets onshore and offshore Marsh Island in the Gulf of Mexico, together with an 18.1634% interest in a 40 MMcfgpd production facility tied into the existing regional pipeline infrastructure. The acquisition costs for this operating company totaled $45,847,000.

On March 8, 2007, the Company exercised its option under the Summit purchase agreement to acquire two additional properties for the issuance of 1,222,604 common shares with a deemed value of $1,712,000.

Also in February 2007, the Company closed on the purchase of an additional 17.4175% participating interest in the Phase I Area of the Marsh Island project bringing its total working interest to 35.5809% and its net revenue interest to 25.2124%. The acquisition costs totaled $28,601,000.

Selected Quarterly Information

The following is a summary of selected financial information for the Company for the quarters indicated:

($000s, except per share data)	Dec 31 2008	Sep 30 2008	Jun 30 2008	Mar 31 2008	Dec 31 2007	Sep 30 2007	Jun 30 2007	Mar 31 2007
Revenue - oil & gas sales, net	$1,663	$1,583	$798	$965	$1,181	$1,077	$299	$172
Net income (loss)	($72,156)	($16,154)	($5,793)	($3,947)	($46,870)	($13,292)	$6,025	($4,335)
Net income (loss) per share - basic	($0.24)	($0.05)	($0.02)	($0.01)	($0.15)	($0.04)	$0.02	($0.02)
Net income (loss) per share - diluted	($0.24)	($0.05)	($0.02)	($0.01)	($0.15)	($0.04)	$0.02	($0.02)
Exploration & development expenditures	$10,959	$4,146	$5,442	$256	$28,127	$8,631	$4,189	$57,248
Total assets	$63,594	$134,245	$150,203	$152,988	$166,841	$221,632	$228,730	$186,398
Working capital surplus	$41,595	$59,031	$66,621	$76,465	$80,120	$99,432	$117,577	$114,796
Shareholders' equity	$54,466	$126,544	$142,560	$147,857	$151,665	$198,344	$211,542	$180,698
Common shares outstanding	308,756	308,756	308,756	308,756	308,256	308,256	308,256	298,056

Prior to December 31, 2006, the Company was a mineral exploration company and had limited operational activities. During the first three months of 2007, the Company changed its strategic direction to become an oil and gas exploration and development company by acquiring a variety of oil and gas interests in the USA.

In February 2009, the Company entered into a Letter of Intent with a third party to sell substantially all of the Company's Gulf of Mexico properties. On April 16, 2009, the Company entered into a definitive purchase and sale agreement with a third party to sell substantially all of its oil and gas properties, including related asset retirement obligations, for $12,500,000 in cash and a deferred, contingent payment of up to $8,000,000 based on proved reserves, as defined, as December 31, 2010. The transaction is expected to close prior to the end of May 2009. As a result of the Company's decision to exit the Gulf of Mexico, the Company recorded an impairment expense of $56,300,000 in the fourth quarter 2008 primarily related to unproved properties to reflect the estimated market value of the properties.

The Company follows the successful efforts method of accounting for its oil and gas properties.

Production

	For the Quarter Ended							
	Dec 31 2008	Sep 30 2008	Jun 30 2008	Mar 31 2008	Dec 31 2007	Sep 30 2007	Jun 30 2007	Mar 31 2007
Oil & gas sales, net ($000's)	$ 1,663	$ 1,583	$ 798	$ 965	$ 1,181	$ 1,077	$ 299	$ 172
Oil (net bop/d)	68	48	27	30	32	24	16	16
Natural gas (net mcf/d)	1,927	1,277	362	835	1,572	1,457	499	211
Total (net mcfe/d)*	2,337	1,565	524	1,016	1,766	1,601	593	306
Average selling price, net:								
Oil - per bbl	$ 69.14	$ 124.58	$ 123.21	$ 91.52	$ 91.52	$ 77.37	$ 66.79	$ 60.73
Gas - per mcf	$ 8.02	$ 8.71	$ 9.69	$ 9.13	$ 6.16	$ 5.85	$ 7.05	$ 7.66

* Production information is commonly reported in units of barrel of oil equivalent ("boe"), or if primarily a producer of natural gas in units of thousand cubic feet equivalent ("mcfe"), which may be misleading, particularly if used in isolation. For purposes of computing such units, thousand cubic feet of natural gas equivalent units have been calculated using an energy equivalence conversion rate of six thousand cubic feet of natural gas to one barrel of oil (6:1). The conversion ratio of 6:1 is based on an energy equivalency conversion method, which is primarily applicable at the burner tip and does not represent value equivalence at the wellhead.

On July 24, 2008, the Company commenced production on its Eagle's Nest well. The well is currently producing 29.6 MMCF/D on an 8/8th basis. The well, in which the Company holds a 12.453525% working interest and an 8.935404% net revenue interest, is tied into Contango's Eugene Island Block 11 production facility.

Production from the Company's Greylock well was stopped on August 30, 2008 due to Hurricanes Gustav and Ike and did not recommence due to damage to Marathon's Burns Point plant until December 4, 2008. Production from the Company's Eagle's Nest well was also stopped on August 30, 2008 due to the hurricanes. When production recommenced on September 29, 2008, the production rate per day was approximately 50% of the pre-storm rate due to transportation pipeline damage. These pipeline damages were repaired by the transport operator in late December 2008 with full production being achieved in late March 2009.

Results of Operations

	For the Quarter Ended (in $000s)							
	Dec 31 2008	Sep 30 2008	Jun 30 2008	Mar 31 2008	Dec 31 2007	Sep 30 2007	Jun 30 2007	Mar 31 2007
Oil and gas sales	$ 2,241	$ 2,068	$ 1,121	$ 1,293	$ 1,614	$ 1,414	$ 432	$ 201
Royalties	$ (578)	(485)	(323)	(328)	(433)	(337)	(133)	(29)
Oil and gas sales, net	$ 1,663	1,583	798	965	1,181	1,077	299	172
Operating	$ (876)	(630)	(230)	(466)	(397)	(351)	(152)	(45)
Exploration	$ (3,312)	(2,365)	(2,102)	(2,721)	(1,916)	(525)	(1,530)	(845)
Dry hole	$ (7,748)	(1,711)	(3,257)	-	(35,753)	(9,397)	-	-
Impairment of properties	$ (56,972)	(11,584)	-	-	(11,333)	(10,998)	-	(1,603)
Accretion	$ (16)	(11)	(15)	(13)	(11)	(13)	(13)	-
Depletion, deprec. & amort.	$ (543)	(414)	(525)	(430)	(2,248)	(759)	(174)	(78)
General and administrative	$ (966)	(526)	(943)	(928)	(3)	(888)	(1,687)	(457)
Stock-based compensation	$ (78)	(138)	(496)	(89)	(191)	(91)	(37)	(1,904)
Foreign exchange gain (loss)	$ (3,575)	(806)	450	(1,079)	2,627	7,264	8,125	-
Interest income	$ 267	448	527	814	1,174	1,389	1,194	425
Net income (loss)	$ (72,156)	$ (16,154)	$ (5,793)	$ (3,947)	$ (46,870)	$ (13,292)	$ 6,025	$ (4,335)

The Company had a consolidated net loss of $98,050,000 for the year ended December 31, 2008 compared to a net loss of $58,472,000 for 2007. The increased net loss in 2008 is primarily due to the impairment expense of $68,556,000 recorded during the year.

The production volume and proven reserve base at this early stage of exploration result in higher costs per mcfe than would be the case for a later stage exploration company, particularly operating and general and administrative costs.

Certain prior quarterly expenses, in the quarterly presentation above, have been reclassified to conform to the current quarter's presentation. None of these reclassifications impacted net income.

The various income and expenses categories are explained below in more detail.

<u>Oil and Gas Sales</u>
The Company had oil and gas sales, net of royalties, of $5,009,000 and $2,729,000 for the years ended December 31, 2008 and 2007, respectively.

Oil and gas sales for the last four months of 2008 were negatively impacted by Hurricanes Gustav and Ike. As noted earlier in this report, production from the Company's Greylock and Eagle's Nest wells was essentially halted during the entire month of September due to third-party infrastructure damage from the hurricanes. After September, production from both wells continued to be negatively impacted by the infrastructure damage.

The increases in oil and gas sales compared to the prior year are due to the Greylock well commencing production on June 8, 2007, the Eagle's Nest well commencing production on July 24, 2008, and average higher prices for oil and natural gas in 2008.

Operating Costs

The Company had operating costs of $2,202,000 for the year ended December 31, 2008 ($0.004 per mcfe), compared to $945,000 for the prior year ($0.002 per mcfe). Operating costs during the periods are primarily related to the Company's Greylock, Jefferson Island and Eagle's Nest properties. In 2008 operating expenses increased due to the Eagle's Nest well commencement of production on July 24, 2008.

Exploration Costs

The Company incurred exploration costs of $10,500,000 for the year ended December 31, 2008 and $4,816,000 for the 2007. During the three months ended September 30, 2008, the Company incurred $1,340,000 of additional unplanned expenses from Hurricanes Gustav and Ike from its South Timbalier 49 well that was in the process of being drilled. These costs were primarily related to the re-spudding of the well after the drilling rig was moved off location by the hurricanes.

Dry Hole Costs

For the year ended December 31, 2008, dry hole costs were $12,716,000. The comparable costs in 2007 were $45,150,000.

Impairment of Properties

Impairment costs were $68,556,000 for the year ended December 31, 2008, compared to $23,934,000 in 2007. The impairments in 2008 were due to additional seismic information and the results from wells drilled in the surrounding areas. In April 2009, the Company entered into a Purchase and Sale Agreement with a third party to sell substantially all of the Company's Gulf of Mexico properties. As a result, the Company recorded an additional impairment expense of $56,300,000 in the fourth quarter of 2008, primarily related to unproved properties.

Depletion, Depreciation and Amortization

Depletion, depreciation and amortization ("DD&A") was $1,912,000 for the year ended December 31, 2008. For the previous year the comparable amount was $3,259,000. DD&A primarily results from production in the Greylock, Jefferson Island and Eagle's Nest properties.

General and Administrative Expenses

General and administrative expenses were $3,363,000 for the year ended December 31, 2008. In the prior year the comparable amount was $3,035,000.

The general and administrative expenses for the year ended December 31, 2008 include $666,000 for legal, accounting and audit costs, $1,619,000 for salaries and benefits, $437,000 for management and consulting fees, and $232,000 for travel and entertainment expenses.

The general and administrative expenses for the year ended December 31, 2007 include $1,370,000 for legal, accounting and audit costs, $863,000 for salaries and benefits,

$470,000 for management and consulting fees, and $332,000 for travel and entertainment expenses.

<u>Stock-Based Compensation</u>
Stock-based compensation was $801,000 for the year ended December 31, 2008. The comparable amount in 2007 was $2,223,000. The stock-based compensation expense in 2008 results primarily from the issuance of 3,660,000 stock options and the vesting of stock options that were granted in 2007. The Company uses the fair value method of accounting for stock options granted to directors, officers, employees and consultants whereby the fair value of all stock options granted is recorded as a charge to operations. The fair value of common share options granted is estimated on the date of grant using the Black-Scholes option pricing model.

<u>Foreign Exchange (Gain) Loss</u>
Foreign exchange loss was $5,010,000 for the year ended December 31, 2008. The Company had a foreign exchange gain of $18,016,000 during 2007. There was no foreign exchange gain or loss during the first three months of 2007 due to the Company's reporting currency being the Canadian dollar at that time and the Company holding Canadian dollar cash. The Company changed its reporting currency to the U.S. dollar effective April 1, 2007. The year-to-date loss in 2008 results from the strengthening of the United States dollar against the Canadian dollar.

<u>Interest Income</u>
For the year ended December 31, 2008 and 2007, interest income was $2,056,000 and $4,182,000, respectively. Interest income represents bank interest earned on excess cash and investments in marketable securities. The decrease in interest income in 2008 results from a decrease in invested cash and investments and a decrease in yield on those investments from the prior year.

Other Comprehensive Income

Other comprehensive income represents changes in shareholders' equity during a period arising from transactions and other events and circumstances from non-owner sources and, during the first quarter of 2007, includes unrealized foreign currency translation gains and losses.

The Company's operations in the United States are denominated in U.S. dollars and are considered integrated. Effective April 1, 2007, the Company changed its reporting currency from the Canadian dollar to the United States dollar.

As of December 31, 2008, the Company had approximately $44,000,000 Canadian dollars in its cash accounts, with the balance in United States dollars. The Company does not have any exposure to asset-backed commercial paper.

Financial Condition

At December 31, 2008, the Company had total assets of $63,594,000 compared to $166,841,000 at December 31, 2007. The decrease in total assets from the prior year is primarily due to the impairment recorded during 2008 on unproved properties as previously described.

Liquidity and Capital Resources

Working capital at December 31, 2008, totaled $41,595,000, compared to $80,120,000 at December 31, 2007.

Funds used by operations were $24,517,000 for the year ended December 31, 2008 compared to funds provided by operations of $16,240,000 for the year 2007. The primary use of the funds during 2008 was for exploration activities.

Net cash provided from financing activities for the year ended December 31, 2008 was $50,000 compared to $166,767,000 for 2007. During the three months ended March 31, 2007 the Company issued 214,817,538 common shares at an average price of Cdn $0.97 per share.

Net cash provided by investing activities was $11,174,000 for the year ended December 31, 2008, compared to funds used in investing activities of $130,251,000 in 2007. During the three months ended March 31, 2007, the Company used cash to add to its oil and gas operations through the acquisition of leases and exploration and development activities.

Net cash used for exploration and development was $20,803,000 for the year ended December 31, 2008, compared to $98,195,000 in 2007.

Contributed surplus increased $787,000 for the year ended December 31, 2008, compared to $671,000 in 2007. The increase is due to stock-based compensation for the year offset by the exercise of warrants. When options are granted, the Black-Scholes option value method is used to calculate a value for the stock options. The offset to the amount that is recorded as stock compensation expense is a credit to contributed surplus. When the options are exercised, the applicable amounts of contributed surplus are transferred to share capital. During the three month period ended March 31, 2007, 750,000 stock options were exercised. No other stock options were exercised during 2007 or 2008.

The Company does not currently generate sufficient cash flow from its oil and gas operations to fund the entire oil and gas exploration, development and acquisition activities. The Company has relied upon the issuance of common shares to assist with financing its ongoing oil and gas exploration, development and acquisition activities to the extent that sufficient cash flow from oil and gas assets or farming out interests in oil and gas properties is not sufficient to finance its operations. Notwithstanding that the Company has sufficient financial resources to fund operations through the 2009 fiscal year, continuing operations are dependent on discovery of economic oil and gas reserves and ultimately on the attainment of profitable operations. As previously stated, on April 16, 2009, the Company entered into a definitive purchase and sale agreement to sell substantially all of its oil and gas properties.

Financial Instruments

The Company's financial instruments consist of cash, cash equivalents, investments, accounts receivable, accounts payable, accrued expenses and advances from joint interest holders.

Cash, cash equivalents and investments are designated as held for trading and therefore carried at fair value, with unrealized gain or loss recorded in interest income.

The fair values of cash, cash equivalents, accounts receivable, accounts payable, accrued expenses and advances from joint interest holders approximate carrying values because of the short-term nature of these instruments. The fair values of investments are determined directly by reference to quoted market prices.

The Company is exposed in varying degrees to a variety of financial instrument related risks.

Credit Risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations. The Company manages its credit risk through its counterparty ratings and credit limits. The Company is mainly exposed to credit risk on its bank accounts and accounts receivable. Bank accounts are with banks that have a minimum credit rating of R-1 (mid) or better (as measured by Dominion Bond Rate Services) or the equivalent thereof according to a recognized bond rating service.

Accounts receivable are primarily with natural gas marketers and joint venture partners in the oil and gas industry and are subject to normal industry credit risks. As of December 31, 2008, the Company's receivables consist of $996,000 from joint venture partners and other trade receivables and $916,000 of revenue accruals and other receivables from natural gas marketers.

Joint venture receivables are typically collected within one to two months of the joint venture bill being issued to the partner. The Company mitigates the risk from joint venture receivables by obtaining partner approval of capital expenditures prior to starting a project

Receivables from natural gas marketers are typically collected on the end of the month following production. The Company's policy to mitigate credit risk associated with these balances is to establish marketing relationships with established marketers. The Company has not experienced any collection issues with its natural gas marketers.

Liquidity Risk

Liquidity risk is the risk that the Company will incur difficulties meeting its financial obligations as they are due. The Company's approach to managing liquidity is to ensure, as far as possible, that it will have sufficient liquidity to meet its liabilities when due, without incurring unacceptable losses or risk harm to the Company's reputation.

The Company prepares annual capital expenditure budgets, which are regularly monitored and updated as considered necessary. The Company uses authorizations for expenditures on both operating and non-operating projects to further manage capital expenditures.

Market Risk

Market risk is the risk that changes in market prices, such as foreign exchange rates, commodity prices and interest rates, will affect the Company's net earnings or the value of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable limits, while maximizing returns.

The significant market risk exposures to which the Company is exposed are foreign currency, commodity price and interest rate risks.

Foreign currency risk – The Company maintains a portion of its cash in Canadian dollars. The Company's operations are conducted in U.S. dollars. The Company's operating results and cash flows are affected to varying degrees by the changes in the Canadian dollar vis-à-vis the U.S. dollar. Company expenditures are incurred predominately in U.S. dollars. The Company has not entered into any agreements or purchased any instruments to hedge possible currency risks.

At December 31, 2008, the Company had $36,287,000 denominated in Canadian dollars. As of December 31, 2008, with other variables unchanged, a 1% strengthening of the U.S. dollar against the Canadian dollar would decrease the net loss by $363,000 due to this financial asset.

Commodity price risk – The prices that the Company receives for its crude oil and natural gas production may have a significant impact on its revenue and cash provided by operating activities. Any significant price decline in commodity prices would adversely affect the amount of funds available for capital reinvestment purposes. At this time the Company does not use derivative financial instruments to manage its exposure to this risk.

Interest rate risk – The Company's bank accounts earn interest income at variable rates. The Company's future interest income is exposed to changes in short-term rates.

Off-Balance Sheet Arrangements

The Company has no off-balance sheet arrangements.

Outstanding Share Data

As of March 31, 2009, the Company had 308,756,088 shares outstanding, 3,935,000 stock options outstanding under its stock-based compensation plan and zero warrants outstanding.

Related Party Transactions

Namdo Management Services Ltd. (Namdo) provides administrative support to the Company under an agreement which commenced April 1, 2007. The amount paid to Namdo was $264,000 and $187,000 during the years ended December 31, 2008 and 2007, respectively. Namdo is a private corporation owned by a shareholder of the Company.

During the year ended December 31, 2008, the Company incurred legal fees of $18,000 with a law firm in which an officer of the Company is a partner. The comparable amount was $251,000 in 2007.

During the year ended December 31, 2008, the Company incurred geological and geophysical (G&G) costs of $469,000 with a G&G firm in which an officer of the Company is a managing partner. The comparable costs in 2007 were $134,000.

Changes to Management

On December 1, 2008, Clinton W. Coldren resigned as the Company's President and Chief Executive Officer and as a Board member. Keith C. Hill was appointed Acting President by the Board of Directors.

Accounting Policies and Critical Accounting Estimates

Use of Estimates

The consolidated financial statements of the Company have been prepared by management in accordance with accounting principles generally accepted in Canada. In preparing financial statements, management makes informed judgments and estimates that affect the reported amounts of assets and liabilities as of the date of the financial statements and affect the reported amounts of revenues and expenses during the reported period. Specifically, estimates were utilized in calculating depletion, asset retirement obligations, stock-based compensation, amortization and impairment write-downs. Actual results could differ from these estimates and the differences could be material.

New Accounting Standards Adopted

Effective January 1, 2008, the Company adopted the new Canadian Institute of Chartered Accountants ("CICA") Handbook Sections 3862 "Financial Instruments – Disclosures", 3863 "Financial Instruments – Presentation", 1535 "Capital Disclosures", and 3031 "Inventories." The adoption of these standards has had no material impact on the Company's net loss or cash flows. Additional information on the implementation of these new standards can be found in Note 2 to the Audited Consolidated Financial Statements for the Years Ended December 31, 2008 and 2007.

Accounting for Oil and Gas Operations

Due to the Company's transition into the oil and gas exploration and development industry, effective in 2007, the Company has followed the successful efforts method of accounting for its oil and gas operations. Under this method, acquisition costs of oil and gas properties, costs to drill and equip exploratory wells that find proved reserves and costs of drilling and equipping development wells are capitalized and subject to quarterly impairment testing.

Exploration well costs are initially capitalized and, if subsequently determined to have not found sufficient reserves to justify commercial production, are charged to exploration expense. Exploration well costs that have found sufficient reserves to justify commercial production, but whose reserves cannot be classified as proved, continue to be capitalized as long as sufficient progress is being made to assess the reserves and economic viability of the well and or related project. All other exploration costs, including geological and geophysical costs, are charged to exploration expense when incurred.

Capitalized costs of proved oil and gas properties are depleted using the unit of production method based on estimated gross proved reserves of petroleum and natural gas as determined by independent engineers. Successful exploratory wells, development costs and acquired resource properties are depleted over proved developed reserves. Acquisition costs of unproved reserves are not depleted or amortized while under active evaluation for commercial reserves.

Costs associated with significant development projects are depleted once commercial production commences.

A revision to the estimate of proved reserves can have a significant impact on earnings as they are a key component in the calculation of depreciation, depletion and accretion.

Producing properties and significant unproved properties are assessed annually, or more frequently as economic events dictate, for potential impairment. The impairment test is initially based on undiscounted future cash flows from proved and risk adjusted probable reserves. If an impairment is identified, fair value is calculated as the present value of estimated expected discounted cash flows from proved and risk-adjusted probable reserves. Any impairment loss is the difference between the carrying value of the oil and gas property and its fair value. If it is determined that the estimated fair value is less than the net carrying amount, a write-down to the oil and gas property's fair value is recognized during the period, with a charge to earnings.

Estimates of future cash flows used in the evaluation of impairment of assets are performed based on risk assessments on field and reservoir performance and include judgment assumptions regarding commodity prices, discount rates and future costs.

A substantial portion of the Company's exploration and development activities are conducted jointly with others. The financial statements reflect only the Company's proportionate interests in such activities.

The Company engaged Netherland, Sewell and Associates, Inc., an independent geoscience consultancy firm, to evaluate 100% of the Company's proved and probable oil and gas reserves at December 31, 2008. The estimation of reserves is subjective. Forecasts are based on engineering data, future prices, expected future rates of production and the timing of capital expenditures, all of which are subject to uncertainties and interpretations. Reserves will be revised upward or downward based on the results of future drilling, testing and production levels.

International Financial Reporting Standards

In January 2006, the CICA Accounting Standards Board ("AcSB") adopted a strategic plan for the direction of accounting standards in Canada. As part of that plan, the AcSB confirmed in February 2008 that the International Reporting Standards ("IFRS") will replace Canadian GAAP for profit-oriented Canadian publicly accountable enterprises in 2011.

The Company has commenced the process to transition from current Canadian GAAP to IFRS. There are three phases in the process: diagnostic, detailed assessment and design and implementation. The Company is currently performing a review of the major differences between the current Canadian GAAP and IFRS. In 2009 the Company will commence the detailed assessment and design phase of the project.

During the implementation phase, the Company will execute the required changes to business processes, financial systems, accounting policies, disclosure controls and internal controls over financial reporting. At this time, the impact on financial statements is not reasonably determinable.

Risks and Uncertainties

The Company is exposed to a number of risks and uncertainties inherent in exploring for, developing and producing crude oil and natural gas. These risks and uncertainties include, but are not limited to, the following: economic risk of finding and producing reserves at a reasonable cost; cost of capital risk associated with securing the needed capital to carry out the Company's operations; commodity price risk; risk of fluctuating currency exchange rates; risk of carrying out operations with minimal environmental impact; risk of weather, including hurricanes and other storms; risk of governmental policies, social instability or other political, economic or diplomatic developments in the US operations; market risk associated with investing the Company's cash reserves in interest bearing depository instruments; and environmental risks related to its oil and gas and mineral properties. Many of the previously mentioned risks are beyond the Company's control, and it is impossible to ensure that any exploration drilling program will result in commercial operations. The Company does not currently utilize derivative instruments to hedge its foreign currency exchange or interest rate risks.

Outlook

On November 6, 2008, the Company announced that it had engaged an investment advisor to assist the Company with its current review of the strategic and financial alternatives available to it. In February 2009, the Company decided to sell its Gulf of Mexico properties and entered into a Letter of Intent with a third party. On April 16, 2009, the Company entered into a definitive Purchase and Sale Agreement with a third party to sell substantially all of its oil and gas properties, including related asset retirement obligations, for $12,500,000 in cash and a deferred, contingent payment of up to $8,000,000 based on proved reserves, as defined, at December 31, 2010. The transaction is expected to close prior to the end of May 2009.

Considering the Company's favorable cash position and the business opportunities that are routinely presented to members of the Company's Board of Directors, the potential exists for the Company to enter into a new business that may provide greater opportunity for the creation of value than the Company's existing oil and gas business.

Forward-Looking Statements

This report contains forward-looking statements concerning anticipated developments on the Company's operations; the adequacy of the Company's financial resources; financial projections, including, but not limited to, estimates of capital and operating costs, production rates, commodity prices, exchange rates, net present values; and other events and conditions that may occur in the future. Forward-looking statements are frequently, but not always, identified by the words such as "expects," "anticipates," "believes," "intends," "estimates," "potential," "possible," "budget" and similar expressions, or statements that events, conditions or results "will," "may," "could," or "should" occur or be achieved. Information concerning the interpretation of drill results and reserve estimates also may be deemed to be forward-looking statements, as such information constitutes a prediction of what might be found to be present if and when a project is actually developed. Forward-looking statements are statements about the future and are inherently uncertain, and actual achievements of the Company or other future events or conditions may differ materially from those reflected in the forward-looking statements due to a variety of risks, uncertainties and other factors, including, without limitation, those described in this MD&A.

The Company’s forward-looking statements are based on the beliefs, expectations and opinions of management on the date the statements are made and the Company assumes no obligation to update such forward-looking statements in the future. For the reasons set forth above, investors should not place undue reliance on forward-looking statements.

MANAGEMENT'S REPORT

The accompanying Consolidated Financial Statements of Bayou Bend Petroleum Ltd and related financial information presented in this annual report are the responsibility of Management and have been approved by the Board of Directors. The Consolidated Financial Statements have been prepared in accordance with Canadian generally accepted accounting principles. The Consolidated Financial Statements and related financial information reflect amounts which must, of necessity, be based upon informed estimates and judgments of Management with appropriate consideration to materiality. All financial information contained in the annual report is consistent, where appropriate, with that contained in the Consolidated Financial Statements.

The Company has developed and maintains systems of internal controls, policies and procedures in order to provide reasonable assurance as to the reliability of the financial records and the safeguard of assets.

KPMG LLP, independent external auditors appointed by the shareholders of the Company, has audited the Consolidated Financial Statements in accordance with the auditing standards generally accepted in Canada on behalf of the shareholders. Their report is included with the Consolidated Financial Statements.

The Board of Directors has established an Audit Committee. The Audit Committee reviews with Management and the external auditors any significant financial reporting issues, the financial statements, and any other matters of relevance to the parties. The Audit Committee meets quarterly to review and approve the interim consolidated financial statements prior to their release, as well as annually to review the Company's annual consolidated financial statements and Management's discussion and analysis, and to recommend their approval to the Board of Directors. The external auditors have unrestricted access to the Company, the Audit Committee and the Board of Directors.

"Keith C. Hill"

Keith C. Hill
President and Chairman

"William D. Hoffman"

William D. Hoffman
Chief Financial Officer

April 16, 2009

KPMG LLP
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AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the consolidated balance sheets of Bayou Bend Petroleum Ltd. as at December 31, 2008 and 2007 and the consolidated statements of operations and deficit, comprehensive loss and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2008 and 2007 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP (signed)

Chartered Accountants

Vancouver, Canada

April 15, 2009, except as to note 15
which is as of April 16, 2009

BAYOU BEND PETROLEUM LTD.
Consolidated Balance Sheets
Expressed in Thousands of United States Dollars

	December 31, 2008	December 31, 2007
ASSETS		
Current assets		
Cash and cash equivalents	$ 45,282	$ 58,575
Investments	79	32,056
Accounts receivable	1,912	3,109
Prepaid expenses	1,546	629
	48,819	94,369
Petroleum and natural gas properties	19,946	75,731
Accumulated depletion, depreciation & amortization	(5,171)	(3,259)
Net properties	14,775	72,472
	$ 63,594	$ 166,841
LIABILITIES		
Current liabilities		
Accounts payable and accrued expenses	$ 5,636	$ 12,868
Advances from joint interest holders	231	394
Asset retirement obligation	1,357	987
	7,224	14,249
Asset retirement obligation	1,904	927
	9,128	15,176
SHAREHOLDERS' EQUITY		
Share capital	250,899	250,835
Contributed surplus	3,024	2,237
Accumulated other comprehensive income	3,282	3,282
Deficit	(202,739)	(104,689)
	54,466	151,665
	$ 63,594	$ 166,841

Commitments (note 14)
Subsequent event (note 15)

See accompanying notes to the consolidated financial statements.

BAYOU BEND PETROLEUM LTD.
Consolidated Statements of Operations and Deficit
Expressed in Thousands of United States Dollars except Per Share Amounts

	For the Year Ended December 31	
	2008	**2007**
Revenues		
Oil and gas sales	$ 6,723	$ 3,661
Royalties	(1,714)	(932)
	5,009	2,729
Costs and Expenses		
Operating	2,202	945
Exploration	10,500	4,816
Dry hole costs	12,716	45,150
Impairment of properties	68,556	23,934
Accretion	55	37
Depletion, depreciation and amortization	1,912	3,259
General and administrative	3,363	3,035
Stock-based compensation	801	2,223
Foreign exchange (gain) loss	5,010	(18,016)
	105,115	65,383
Other income		
Interest income	2,056	4,182
	2,056	4,182
Net loss	(98,050)	(58,472)
Deficit, beginning of year	(104,689)	(46,217)
Deficit, end of year	$ (202,739)	$ (104,689)
Basic loss per share	$ (0.32)	$ (0.21)
Diluted loss per share	$ (0.32)	$ (0.21)
Weighted average number of common shares used in computing earnings per share (in thousands):		
Basic	308,745	278,017
Diluted	308,745	278,017

See accompanying notes to the consolidated financial statements.

BAYOU BEND PETROLEUM LTD.
Consolidated Statements of Other Comprehensive Income
Expressed in Thousands of United States Dollars

	For the Year Ended December 31	
	2008	**2007**
Net loss for the year	$ (98,050)	$ (58,472)
Other comprehensive income:		
Unrealized gains on adoption of U.S. functional currency	-	3,284
Comprehensive loss for the year	$ (98,050)	$ (55,188)

See accompanying notes to the consolidated financial statements.

BAYOU BEND PETROLEUM LTD.
Consolidated Statements of Cash Flows
Expressed in Thousands of United States Dollars

	For the Year Ended December 31	
	2008	**2007**
Operating activities		
Net loss	$ (98,050)	$ (58,472)
Adjustments for non-cash and non-operating transactions:		
Depletion, depreciation and amortization	1,912	3,259
Impairment of properties	68,556	23,934
Dry hole costs	12,716	45,150
Accretion	55	37
Stock-based compensation	801	2,223
Changes in non-cash operating working capital:		
Accounts receivable	1,197	(3,098)
Prepaid expenses	(917)	(616)
Accounts payable and accrued expenses	(11,916)	2,715
Advances from joint interest holders	(163)	394
Asset retirement obligation	1,292	714
	(24,517)	16,240
Financing activities		
Issuance of share capital	50	166,785
Repayment of related party loans	-	(18)
	50	166,767
Investing activities		
Exploration and development expenditures	(20,803)	(98,195)
Investments, net	31,977	(32,056)
	11,174	(130,251)
Effect of exchange rate changes in cash	-	3,284
Net increase (decrease) in cash and cash equivalents	(13,293)	56,040
Cash and cash equivalents - beginning of year	58,575	2,535
Cash and cash equivalents - end of year	$ 45,282	$ 58,575
Supplemental disclosures of non-cash financing and investing activities:		
Acquisition of Summit Energy Company, L.L.C. and related property interests through the issuance of common stock	$ -	$ 10,593
Acquisition of GOM assets through the issuance of common stock	-	24,764
	$ -	$ 35,357

See accompanying notes to the consolidated financial statements.

1. NATURE OF OPERATIONS

Bayou Bend Petroleum Ltd. (the "Company") is incorporated under the British Columbia Business Corporations Act. The Company is engaged in the business of oil and gas exploration and development in the United States in the Gulf of Mexico.

On February 7, 2007, the Company received regulatory approval to change its name to Bayou Bend Petroleum Ltd. from Kit Resources Ltd. with an effective date of February 9, 2007. The Company's shares trade on the TSX Venture Exchange under the symbol of "BBP".

On February 20, 2007, the Company purchased 100% of the outstanding membership interests in Summit Energy Company, L.L.C. ("Summit").

Notwithstanding that the Company has sufficient financial resources to fund operations through the 2009 fiscal year, continuing operations are dependent on discovery of economic oil and gas reserves and ultimately on the attainment of profitable operations. See Note 15, Subsequent Event.

2. SIGNIFICANT ACCOUNTING POLICIES

a) Basis of Presentation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries Bayou Bend Petroleum U.S.A., Ltd., Summit Energy Company, L.L.C. and Bayou Bend Offshore, Ltd.

These consolidated financial statements are prepared in accordance with generally accepted accounting principles in Canada. The significant accounting policies followed by the Company have been applied consistently in the preparation of these consolidated financial statements. These accounting policies are summarized below.

b) Cash and Cash Equivalents

For purposes of reporting cash flows, the Company considers cash and cash equivalents to include amounts held in banks and highly liquid investments with remaining maturities at point of purchase of 90 days or less. The Company places its cash and cash equivalents with institutions of high-credit worthiness.

c) Investments

Investments are accounted for at fair market value and consist of securities backed by the full credit of the United States Government with maturities of less than one year.

d) Petroleum and Natural Gas Properties

The Company uses the successful efforts method to account for its oil and gas exploration and development costs. Exploration well costs are initially capitalized and, if subsequently determined to have not found sufficient reserves to justify commercial production, are charged to dry hole expense. Exploration well costs that have found sufficient reserves to justify commercial production, but those reserves cannot be classified as proved, continue to be capitalized as long as sufficient progress is being made to assess the reserves and economic viability of the well or related project. All other exploration costs, including geological and geophysical costs and annual lease rentals, are charged to exploration expense when incurred.

Producing properties and significant unproved properties are assessed annually, or more frequently as economic events dictate, for potential impairment. Any impairment loss is the difference between the carrying value of the asset and its fair value. Fair value is calculated as the present value of estimated expected future cash flows from proved, probable and, as appropriate, possible reserves.

The Company engages independent engineers in order to determine its share of reserves.

e) Depreciation, Depletion and Amortization (DD&A)

Capitalized costs of proved oil and gas properties are depleted using the unit of production method. For purposes of these calculations, productions and reserves of oil are converted to cubic feet of natural gas on an energy equivalent basis at a ratio of one barrel (bbl) of oil to six thousand cubic feet (mcf) of natural gas.

Successful exploratory wells and development costs are depleted over proved developed reserves. However, to the extent significant development costs are incurred in connection with proved undeveloped reserves, such costs are excluded from depletion until the reserves are developed. Acquired resource properties with proved reserves, including offshore platform costs, are depleted over proved reserves. Acquisition costs of probable reserves are not depleted or amortized while under active evaluation for commercial reserves. Costs are transferred to depletable costs as proved reserves are recognized. Costs associated with significant development projects are not depleted until commercial production commences.

Corporate assets are depreciated using the straight-line method at annual rates of 20% to 25%.

f) Asset Retirement Obligations

The fair value of the statutory, contractual or legal liability associated with the retirement and reclamation of oil and gas properties is recorded when incurred, with a corresponding increase to the carrying amount of the related oil and gas properties. The increase to capitalized costs is depleted to earnings on a unit of production basis over the life of the proved reserves for each property. Subsequent changes in the estimated fair value of the asset retirement obligation (ARO) are capitalized and depleted over the remaining useful life of the underlying oil and gas properties.

The ARO liabilities are carried at their discounted present value and are accreted over time for the change in their present value. Actual expenditures incurred are charged against the accumulated obligation.

g) Revenue Recognition

Revenues from the sale of petroleum and natural gas are recorded when title passes to an external party and collection is reasonably assured.

h) Income Taxes

The Company follows the asset and liability method of accounting for income taxes. Under this method current income taxes are recognized for the estimated income taxes payable for the current year. Future income taxes are recognized for temporary differences between the tax and accounting basis of assets and liabilities and for the benefit of losses available to be carried forward for tax purposes that are likely to be realized.

Future tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect of future tax assets and liabilities of a change in tax rates is recognized in income in the period that included the date of enactment or substantive enactment.

i) Stock-Based Compensation

All stock-based awards made to employees and non-employees are measured and recognized using a fair value based method. Accordingly, the fair value of the options at the date of the grant is determined and charged to operations, with the offsetting credit to contributed surplus, on a straight-line basis over the vesting period. If and when the stock options are ultimately exercised, the applicable amounts of contributed surplus are transferred to share capital.

j) Loss per Share

Basic earnings per share is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding during the year. The computation of diluted earnings per share assumes the conversion, exercise or contingent issuance of securities only when such conversion, exercise or issuance would have a dilutive effect on earnings per share. The dilutive effect of outstanding options and warrants and their equivalents is reflected in diluted earnings per share by application of the treasury stock method. The treasury stock method assumes that the proceeds received from the exercise of in-the-money stock options are used to repurchase common shares at the average market price for the reporting period.

k) Joint Interests

Substantially all of the Company's exploration and development activities are conducted jointly with others. Accordingly, the financial statements reflect only the Company's proportionate interest in such activities.

l) New Accounting Standards

Effective January 1, 2008, the Company adopted the Canadian Institute of Chartered Accountants ("CICA") section 3862, *"Financial Instruments – Disclosures"* and CICA section 3863, *"Financial Instruments – Presentation,"* which replaced CICA section 3861, *"Financial Instruments – Disclosure and Presentation."* Section 3862 outlines the disclosure requirements for financial instruments and non-financial derivatives. This guidance prescribes an increased importance on risk disclosures associated with recognized and unrecognized financial instruments and how such risks are managed. Specifically, section 3862 requires disclosure of the significance of financial instruments on the Company's financial position. In addition, the guidance outlines revised requirements for the disclosure of qualitative and quantitative information regarding exposure to risks arising from financial instruments. The presentation requirements under section 3863 are relatively unchanged from the former presentation requirements under section 3861. Please refer to Note 12, "Financial Instruments and Risk Management" for additional disclosures under section 3862.

Effective January 1, 2008, the Company adopted CICA section 1535, *"Capital Disclosures."* Section 1535 requires disclosure about the Company's objectives, policies and processes for managing capital. These disclosures include a description of what the Company manages as capital, the nature of any externally imposed capital requirements, how the requirements are incorporated into the Company's management of capital, whether the requirements have been complied with or consequences of non-compliance and an explanation of how the Company is meeting its objectives for managing capital. In addition, quantitative disclosures regarding capital are required. Please refer to Note 13, "Capital Disclosures."

Effective January 1, 2008, the Company adopted CICA section 3031, *"Inventories,"* which replaced CICA section 3030 of the same name. The new guidance provides additional measurement and disclosure requirements. While this standard has been adopted, it has no financial statement impact on the Company.

m) Use of Estimates

The preparation of consolidated financial statements in accordance with Canadian GAAP requires that management make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. These estimates are subject to measurement uncertainty. Actual results could differ from and affect the results reported in these consolidated financial statements.

In the accounting for oil and gas interests, amounts recorded for depletion and amounts used for impairment test calculations are based on estimates of oil and gas reserves and future cash flows, including development costs. By their nature, the estimates of reserves and the related future cash flows are subject to measurement uncertainty and the impact on the consolidated financial statements of future periods could be material.

n) Foreign Currency Translation

Effective April 1, 2007, the Company's reporting currency was changed from Canadian dollars to U.S. dollars. The Company anticipates that its future sales will be earned in U.S. dollars and significant expenditures of the Company costs will be incurred in U.S. dollars. The comparative financial statements from prior periods have been restated to reflect this change.

For the restatement, the Company followed the method prescribed by the CICA Emerging Issues Committee ("EIC") in release number EIC-130. All prior year financial statements were translated using the current rate method. This method of translation resulted in the financial statements of prior years being translated as if the U.S. dollar reporting currency had been used in those years. The resulting exchange gains and losses were recorded as a cumulative translation adjustment in shareholders' equity.

Prospectively, activities denominated in currencies other than the U.S. dollar are translated using the temporal method. Under this method, monetary assets and liabilities denominated in other currencies are translated into U.S. dollars at the exchange rate in effect at the balance sheet date. Non-monetary assets and liabilities denominated in other currencies are translated at rates in effect on the dates the assets were acquired or liabilities were assumed. Revenues and expenses are translated at rates approximating exchange rates in effect at the time of the transactions. Gains and losses on translation are reflected in the Statement of Operations and Deficit.

3. INTERNATIONAL FINANCIAL REPORTING STANDARDS

In January 2006, the AcSB announced its decision to replace Canadian GAAP with International Financial Reporting Standards ("IFRS") for all Canadian Publicly Accountable Enterprises ("PAE"). On February 13, 2008, the AcSB confirmed January 1, 2011 as the official change-over date for PAE's to commence reporting under IFRS. Although IFRS is principles-based and uses a conceptual framework similar to Canadian GAAP, there are significant differences and choices in accounting policies, as well as increased disclosure requirements under IFRS. The Company continues to monitor and assess the impact of IFRS on its financial statements.

Expressed in United States Dollars Unless Otherwise Noted
(Tabular Amounts in Thousands, except Share and Per Share Amounts)

4. ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

The following table reconciles the changes in accumulated other comprehensive income (loss) for the years ended December 31, 2008 and 2007.

	For the Year Ended December 31	
	2008	2007
Accumulated other comprehensive income (loss), beginning of year	$ 3,282	$ (2)
Other comprehensive income:		
Unrealized gains on adoption of U.S. functional currency	$ -	$ 3,284
Accumulated other comprehensive income, end of year	$ 3,282	$ 3,282

5. ACQUISITIONS

On February 20, 2007, the Company acquired all of the issued and outstanding membership interests of Summit for cash consideration of $34,043,000. The assets acquired included an 18.1634% interest in a portfolio of assets onshore and offshore Marsh Island in the Gulf of Mexico, together with an 18.1634% interest in a 40 million cubic feet of gas per day (MMcfgpd) production facility tied into the existing regional pipeline infrastructure.

On March 8, 2007, the Company exercised its option under the Summit Purchase Agreement to acquire two additional properties for the issuance of 1,222,604 shares of stock with a value of $1,458,000.

The Company also acquired from certain other participants an additional 17.4175% interest in the Marsh Island project for consideration of $21,263,000. The consideration paid included the issuance of 393,267 shares of stock with a value of $474,000.

In connection with the above transactions and the private placement described in Note 7(a), the Company issued 2.2 million shares of stock as a finders' fee to third parties. An additional 5 million shares of stock were issued under the terms of certain assignment agreements pursuant to which the Company was granted the opportunity to acquire Summit. The value of the 7.2 million shares issued was $8,661,000.

Expressed in United States Dollars Unless Otherwise Noted
(Tabular Amounts in Thousands, except Share and Per Share Amounts)

The total consideration, including other related properties and transaction costs, for the above acquisitions was $65,425,000. The allocation of the purchase price is as follows:

Petroleum and natural gas properties	$	63,881
Working capital	$	2,707
Asset retirement obligation	$	(1,163)
	$	65,425

On May 8, 2007, the Company closed on the acquisition of the Gulf of Mexico Assets from Pearl Exploration and Production Ltd., an affiliated company. The Gulf of Mexico Assets were acquired in exchange for 10 million common shares with a value of $24,764,000.

6. PETROLEUM AND NATURAL GAS PROPERTIES

	December 31, 2008					
		Cost		Accumulated Depletion		Net
Petroleum and natural gas	$	19,717	$	(5,108)	$	14,609
Office equipment		229		(63)	$	166
	$	19,946	$	(5,171)	$	14,775

	December 31, 2007					
		Cost		Accumulated Depletion		Net
Petroleum and natural gas	$	75,627	$	(3,239)	$	72,388
Office equipment		104		(20)	$	84
	$	75,731	$	(3,259)	$	72,472

Producing properties include the Eagle's Nest, Mt. Moran North, Greylock, Eugene Island Block 7 and Jefferson Island properties.

As of September 30, 2008, the Company reviewed its portfolio of unproved properties. Based on that review, the Company recorded an impairment expense of $11,584,000 during the quarter ended September 30, 2008. Of that amount, $10,516,000 related to leases in the Marsh Island Area and $1,068,000 related to leases in Federal waters. In 2007, the Company recorded an impairment expense of $23,934,000. These impairments resulted from the evaluation of drilling activities and new seismic data.

In February 2009, the Company made the decision to sell its Gulf of Mexico properties (see Note 15, Subsequent Event). As a result of that decision, the Company reviewed its portfolio of unproved properties at December 31, 2008.

Expressed in United States Dollars Unless Otherwise Noted
(Tabular Amounts in Thousands, except Share and Per Share Amounts)

Based on that review, the Company recorded an additional impairment expense of $56,300,000 as of December 31, 2008.

7. SHARE CAPITAL

a) Details are as follows:

	Number of Shares		Share Capital		Contributed Surplus
Authorized:					
Unlimited common shares without par value					
Issued and fully paid:					
Balance - December 31, 2006	83,238,550	$	47,141	$	1,566
Issued for cash:					
- private placement	166,666,667		163,114		-
- property acquisition	10,000,000		24,764		
- warrants exercised	38,785,000		4,433		(1,120)
- stock options exercised	750,000		790		(432)
Issued during the year:					
- Summit acquisitions	8,815,871		10,593		
- stock options granted	-		-		2,223
Balance - December 31, 2007	308,256,088		250,835		2,237
Issued for cash:					
- warrants exercised	500,000		50		-
Warrants exercised	-		14		(14)
Issued during the year:					
- stock options granted					801
Balance - December 31, 2008	308,756,088	$	250,899	$	3,024

During the first quarter of 2007, the Company closed a private placement of 166,666,667 shares at a price of Cdn$1.20 per share. Gross proceeds of the offering were Cdn$200,000,000 (Cdn$190,796,000 net of filing fees). During the second quarter of 2007 the Company finalized the acquisition of the Gulf of Mexico Assets in exchange for 10 million common shares of the Company.

b) Share Options

The Company has an established share purchase option plan whereby a committee of the Company's board of directors may, from time to time, grant up to a total of 10% of the issued share capital to directors, officers, employees or consultants. The number of shares under option at any specific time to any one optionee shall not exceed 5% of the issued and outstanding common shares of the Company. The term of any options granted under the plan will be fixed by the Board of Directors and may not exceed five years from the date of grant. All options granted are subject to a four month hold period from the date of granting. Vesting terms are at the discretion of the Board of Directors. All issued stock options have terms of three to five years and vest over periods of up to three years. The exercise price of an option is not less than the closing price on the TSX Venture Exchange ("the Exchange") on the last trading day preceding the grant date, less the applicable discount, provided that the exercise price will not be less than Cdn $0.10 per share.

Expressed in United States Dollars Unless Otherwise Noted
(Tabular Amounts in Thousands, except Share and Per Share Amounts)

The continuity of incentive stock options issued and outstanding is as follows:

Stock Option Continuity

	Number of Options	**Weighted Average Exercise Price**
Outstanding at December 31, 2006	1,000,000	Cdn $0.61
Granted	3,165,000	Cdn $1.47
Exercised	(750,000)	Cdn $0.56
Cancelled/Forfeited	(200,000)	Cdn $2.20
Outstanding at December 31, 2007	3,215,000	Cdn $1.37
Granted	3,660,000	Cdn $0.48
Expired	(250,000)	Cdn $0.75
Cancelled/Forfeited	(5,000)	Cdn $2.15
Outstanding at December 31, 2008	6,620,000	Cdn $0.90

At December 31, 2008, 4,179,996 options are exercisable at an average exercise price of Cdn $1.14 per share with a weighted average remaining life of 2.5 years.

Stock Based Compensation

The Company recognizes compensation expense on stock options granted to both employees and non-employees using the fair value method at the date of grant, which the Company records as an expense. The stock option compensation expense is calculated using the Black-Scholes Option Pricing Model. The weighted average fair value of options granted and the assumptions used in their determination are as follows.

Expressed in United States Dollars Unless Otherwise Noted
(Tabular Amounts in Thousands, except Share and Per Share Amounts)

	2008	2007
Expected dividend yield	0%	0%
Risk-free interest rate (weighted average)	3.06%	4.07%
Expected stock price volatility (weighted average)	94.24%	68.94%
Expected option life in years (weighted average)	3.00	4.36

Stock option compensation expense for the year ended December 31, 2008 and 2007 were $801,000 and $2,223,000, respectively.

Option pricing models require the input of highly subjective assumptions including the expected price volatility. Changes in the subjective input assumptions can materially affect the fair value estimate, and therefore the existing models do not necessarily provide a reliable single measure of the fair value of the Company's stock options.

c) Warrants

As of December 31, 2006, the Company had share purchase warrants outstanding to purchase 39,285,000 shares at Cdn $0.10 per share, exercisable by January 9, 2008. These warrants were outstanding pursuant to the private placement of 40,000,000 units that closed during 2006. During the first three months ended March 31, 2007, 38,585,000 shares were issued at Cdn $0.10 per share, pursuant to these warrants. During the second three months ended June 30, 2007, 200,000 shares were issued at Cdn $0.10 per share. At September 30, 2007, the Company had share purchase warrants outstanding to purchase 500,000 shares at Cdn $0.10 per share, exercisable by January 9, 2008. These warrants were subsequently exercised on January 8, 2008.

8. ASSET RETIREMENT OBLIGATION

The total future asset retirement obligation was estimated based on the Company's net ownership interest in all wells and facilities, the estimated costs to abandon and reclaim the wells and facilities and the estimated timing of the costs to be incurred in future periods. The total undiscounted amount of the estimated cash flows required to settle the asset retirement obligations is approximately $3,600,000, which will be incurred over the next 20 years with 40% of the costs incurred between 2009 and 2012. An accretion factor of 2% was used to calculate the fair value of the asset retirement obligation.

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Changes to the asset retirement obligation were as follows:

	2008	2007
Balance, beginning of year	$ 1,914	-
Liabilities acquired through acquisitions	-	1,163
Liabilities incurred during the year	753	825
Revisions of estimated cash flows	673	-
Liabilities settled during the year	(134)	(111)
Accretion	55	37
Balance, end of year	$ 3,261	1,914

9. INCOME TAXES

a. Future income tax expense:

The provision for income taxes reflects an effective tax rate which differs from Federal and Provincial statutory tax rates. The main differences are as follows:

		Years Ended December 31,	
		2008	2007
Loss before income taxes	$	(98,050)	(58,472)
Corporate income tax rate		31.0%	34.1%
Computed income tax recovery		(30,396)	(19,939)
Increase (decrease) resulting from:			
Non-taxable foreign exchange gain		1,553	(6,143)
Share issuance costs charged to share capital		-	(2,819)
Non-deductible compensation expense		248	758
Foreign tax rate difference		(3,910)	(524)
Effect of change in tax rates		188	216
Change in valuation allowance		31,570	28,813
Effect of change in Foreign exchange rates		483	
Other		264	(362)
Income tax expense	$	-	-

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b. The components of the future income tax assets are as follows:

		December 31, 2008	December 31, 2007
Future income tax assets:	$		
Non-capital losses		24,045	18,887
Share issue costs carried forward		1,311	2,257
Properties - tax basis over carrying value		35,544	7,996
Exploration expenses		685	875
Future income tax assets		61,585	30,015
Valuation allowance		(61,585)	(30,015)
Future income tax asset	$	-	-

c. The Company has available to carry-forward the following:

		December 31, 2008	December 31, 2007
Canadian losses from operations	$	1,527	796
Canadian exploration expenses		2,636	3,240
Canadian unamortized share issue costs		4,545	7,460
U.S. Federal losses from operations		67,565	53,349
U.S. Federal - tax basis over carrying values of properties		101,556	22,846

The Canadian losses from operations may be used to offset future Canadian taxable income and will expire over the period from 2014 to 2028. The Canadian exploration expenses may be carried forward indefinitely to offset future taxable Canadian income. Canadian unamortized share issue costs may offset future taxable Canadian income of years 2009 to 2011. The U.S. Federal losses are available to offset future taxable income in the United States through 2028.

10. SIGNIFICANT CUSTOMERS

The Company has oil and natural gas sales to customers accounting for 52%, 23% and 22%, respectively, of total oil and natural gas revenues for the year ended December 31, 2008. Comparable amounts for 2007 were 0%, 69% and 27%, respectively.

11. RELATED PARTY TRANSACTIONS

Namdo Management Services Ltd. (Namdo) provides administrative support to the Company under an agreement which commenced April 1, 2007. The amounts paid to Namdo during the years ended December 31, 2008 and 2007 were $264,000 and $187,000, respectively. Namdo is a private corporation owned by a shareholder of the Company.

During the year ended December 31, 2008, the Company incurred legal fees of $18,000 with a law firm in which an officer of the Company is a partner. In 2007, the comparable amount was $251,000.

During the years ended December 31, 2008 and 2007, the Company incurred geological and geophysical (G&G) costs of $469,000 and $134,000, respectively, with a G&G firm in which an officer of the Company is a managing partner.

12. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

The Company's financial instruments consist of cash, cash equivalents, investments, accounts receivable, accounts payable, accrued expenses and advances from joint interest holders.

Cash, cash equivalents and investments are designated as held for trading and therefore carried at fair value, with unrealized gain or loss recorded in interest income.

The fair values of cash, cash equivalents, accounts receivable, accounts payable, accrued expenses and advances from joint interest holders approximate carrying values because of the short-term nature of these instruments. The fair values of investments are determined directly by reference to quoted market prices.

The Company is exposed in varying degrees to a variety of financial instrument related risks.

Credit Risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations. The Company manages its credit risk through its counterparty ratings and credit limits. The Company is mainly exposed to credit risk on its bank accounts and accounts receivable. Bank accounts are with banks that have a minimum credit rating of R-1 (mid) or better (as measured by Dominion Bond Rate Services) or the equivalent thereof according to a recognized bond rating service.

Accounts receivable are primarily with natural gas marketers and joint venture partners in the oil and gas industry and are subject to normal industry credit risks. As of December 31, 2008, the Company's receivables consist of $996,000 from joint venture partners and other trade receivables and $916,000 of revenue accruals and other receivables from natural gas marketers.

Joint venture receivables are typically collected within one to two months of the joint venture bill being issued to the partner. The Company mitigates the risk from joint venture receivables by obtaining partner approval of capital expenditures prior to starting a project

Receivables from natural gas marketers are typically collected on the end of the month following production. The Company's policy to mitigate credit risk associated with these balances is to establish marketing relationships with established marketers. The Company has not experienced any collection issues with its natural gas marketers.

Liquidity Risk

Liquidity risk is the risk that the Company will incur difficulties meeting its financial obligations as they are due. The Company's approach to managing liquidity is to ensure, as far as possible, that it will have sufficient liquidity to meet its liabilities when due, without incurring unacceptable losses or risk harm to the Company's reputation.

The Company prepares annual capital expenditure budgets, which are regularly monitored and updated as considered necessary. The Company uses authorizations for expenditures on both operating and non-operating projects to further manage capital expenditures.

Market Risk

Market risk is the risk that changes in market prices, such as foreign exchange rates, commodity prices and interest rates, will affect the Company's net earnings or the value of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable limits, while maximizing returns.

The significant market risk exposures to which the Company is exposed are foreign currency, commodity price and interest rate risks.

Foreign currency risk – The Company maintains a portion of its cash in Canadian dollars. The Company's operations are conducted in U.S. dollars. The Company's operating results and cash flows are affected to varying degrees by the changes in the Canadian dollar vis-à-vis the U.S. dollar. Company expenditures are incurred predominately in U.S. dollars. The Company has not entered into any agreements or purchased any instruments to hedge possible currency risks.

At December 31, 2008, the Company had $36,287,000 denominated in Canadian dollars. As of December 31, 2008, with other variables unchanged, a 1% strengthening of the U.S. dollar against the Canadian dollar would decrease the net loss by $363,000 due to this financial asset.

Commodity price risk – The prices that the Company receives for its crude oil and natural gas production may have a significant impact on its revenue and cash provided by operating activities. Any significant price decline in commodity prices would adversely affect the amount of funds available for capital reinvestment purposes. At this time the Company does not use derivative financial instruments to manage its exposure to this risk.

Interest rate risk – The Company's bank accounts earn interest income at variable rates. The Company's future interest income is exposed to changes in short-term rates.

13. CAPITAL DISCLOSURE

The Company's objective when managing capital is to safeguard the Company's ability to continue as a going concern such that it can provide returns for shareholders and benefits for other stakeholders.

The Company considers its capital structure to include shareholders' equity and working capital. The Company manages the capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of the underlying assets. In order to maintain or adjust its capital structure, the Company may issue new shares or sell assets to settle liabilities. The Company is not subject to externally imposed capital requirements.

14. COMMITMENTS

The Company enters into commitments and contractual obligations in the normal course of business, including the purchase of services, farm-in agreements, seismic data acquisition agreements and lease agreements.

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The Company has operating leases for office space which expire on various dates through 2011. Future minimum commitments as of December 31, 2008 under these operating leases are as follows:

2009	$	117,000
2010		92,000
2011		8,000
	$	217,000

Expenses related to operating leases for office space were $39,000 and $7,000 in 2008 and 2007, respectively.

15. SUBSEQUENT EVENT

In February 2009, the Company decided to sell its Gulf of Mexico properties and entered into a Letter of Intent with a third party. On April 16, 2009, the Company entered into a definitive purchase and sale agreement with a third party to sell substantially all of its oil and gas properties, including related asset retirement obligations, for $12,500,000 in cash and a deferred, contingent payment of up to $8,000,000 based on proved reserves, as defined, at December 31, 2010. The transaction is expected to close prior to the end of May 2009.

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