



**Eaglewood Energy Inc.**

**Consolidated interim financial statements and notes**

**As at June 30, 2012 and for the three and six months ended June 30, 2012 and 2011  
(unaudited)**

**The auditor of Eaglewood Energy Inc. has not performed a review of the unaudited interim financial statements for the three and six months ended June 30, 2012 and 2011.**

**Eaglewood Energy Inc.**  
**Consolidated Balance Sheets**  
Canadian Dollars

| As at   | June 30, 2012        | December 31, 2011    |
|---|----------------------|----------------------|
| <b>ASSETS</b>                                     |                      |                      |
| <b>Current Assets</b>                             |                      |                      |
| Cash and cash equivalents                         | \$ 10,519,671        | \$ 6,586,499         |
| Accounts receivable                               | 326,331              | 169,951              |
| Prepaid expenses                                  | 13,560               | 13,560               |
|   | 10,859,562           | 6,770,010            |
| Property, plant and equipment                     | 229,504              | 260,674              |
| Exploration and evaluation assets (note 5)        | 50,505,083           | 57,274,782           |
| <b>TOTAL ASSETS</b>                               | <b>\$ 61,594,149</b> | <b>\$ 64,305,466</b> |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>       |                      |                      |
| <b>Current Liabilities</b>                        |                      |                      |
| Accounts payable and accrued liabilities          | \$ 1,994,642         | \$ 4,026,553         |
|   | 1,994,642            | 4,026,553            |
| Asset retirement obligation (note 6)              | 1,882,262            | 1,799,739            |
| <b>TOTAL LIABILITIES</b>                          | <b>3,876,904</b>     | <b>5,826,292</b>     |
| <b>Shareholders' Equity</b>                       |                      |                      |
| Share capital                                     | 72,502,272           | 72,117,067           |
| Contributed surplus                               | 4,634,052            | 4,327,461            |
| Accumulated other comprehensive income            | 167,720              | 332,115              |
| Deficit   | (19,586,799)         | (18,297,469)         |
| <b>TOTAL SHAREHOLDERS' EQUITY</b>                 | <b>57,717,245</b>    | <b>58,479,174</b>    |
| <b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b> | <b>\$ 61,594,149</b> | <b>\$ 64,305,466</b> |

Going concern (note 1)

Contingencies and commitments (note 13)

*The accompanying notes are an integral part of these consolidated financial statements*

**Eaglewood Energy Inc.**  
**Consolidated Statements of Loss and Comprehensive Loss**  
Canadian Dollars

|  | For the three months ended, |                       | For the six months ended, |                       |
|--|-----------------------------|-----------------------|---------------------------|-----------------------|
|  | June 30,<br>2012            | June 30,<br>2011      | June 30,<br>2012          | June 30,<br>2011      |
| <b>Revenue</b>   |                             |                       |                           |                       |
| Operating revenue  | \$ 18,080                   | \$ -                  | \$ 18,080                 | \$ -                  |
| <b>Expenses</b>  |                             |                       |                           |                       |
| General and administrative expenses                        | 639,651                     | 970,839               | 1,385,511                 | 1,628,628             |
| Operating expenses   | 28,601                      | -                     | 37,121                    | -                     |
| Depletion, depreciation and amortization                   | 45,629                      | 39,968                | 91,745                    | 78,887                |
| Gain on sale of exploration and evaluation assets (note 5) | -                           | -                     | (208,458)                 | -                     |
| Impairment of exploration and evaluation assets            | -                           | 1,402,317             | -                         | 1,402,317             |
| Total expenses   | 713,881                     | 2,413,124             | 1,305,919                 | 3,109,832             |
| Results from operating activities                          | (695,801)                   | (2,413,124)           | (1,287,839)               | (3,109,832)           |
| Finance income   | 2,197                       | (85,596)              | 5,560                     | 20,724                |
| Finance expense  | 20,416                      | (77,978)              | (7,051)                   | (119,199)             |
| Net finance (expense) income (note 8)                      | 22,613                      | (163,574)             | (1,491)                   | (98,475)              |
| <b>Loss for the period</b>                                 | <b>(673,188)</b>            | <b>(2,576,698)</b>    | <b>(1,289,330)</b>        | <b>(3,208,307)</b>    |
| <b>Other comprehensive income</b>                          |                             |                       |                           |                       |
| Foreign currency translation adjustment                    | (519,975)                   | 92,513                | (164,395)                 | 448,627               |
| <b>Total comprehensive loss for the period</b>             | <b>\$ (1,193,163)</b>       | <b>\$ (2,484,185)</b> | <b>\$ (1,453,725)</b>     | <b>\$ (2,759,680)</b> |
| Loss per share – basic and diluted                         | \$ (0.01)                   | \$ (0.03)             | \$ (0.01)                 | \$ (0.04)             |
| Weighted average common shares – basic and diluted         | 87,368,942                  | 87,148,942            | 87,320,151                | 87,013,638            |

*The accompanying notes are an integral part of these consolidated financial statements*

**Eaglewood Energy Inc.**  
**Consolidated Statements of Changes in Equity**  
Canadian Dollars

|  | Number of<br>common<br>shares | Share<br>capital | Contributed<br>Surplus | Accumulated<br>other<br>comprehensive<br>income | Deficit         | Total equity  |
|--|-------------------------------|------------------|------------------------|---|-----------------|---------------|
| Balance at January 1, 2012                                   | 87,248,942                    | \$ 72,117,067    | \$ 4,327,461           | \$ 332,115                                      | \$ (18,297,469) | \$ 58,479,174 |
| <b>Total comprehensive loss for the period:</b>              |                               |                  |                        |   |                 |               |
| Loss for the period  |                               |                  |                        |   | (1,289,330)     | (1,289,330)   |
| <i>Other comprehensive income:</i>                           |                               |                  |                        |   |                 |               |
| Foreign currency translation                                 |                               |                  |                        | (164,395)                                       |                 | (164,395)     |
| <b>Total comprehensive income (loss) for the period</b>      |                               | -                | -                      | (164,395)                                       | (1,289,330)     | (1,453,725)   |
| <b>Transactions with owners, recorded directly in equity</b> |                               |                  |                        |   |                 |               |
| Share based payments   |                               |                  | 292,490                |   |                 | 292,490       |
| Options exercised  | 120,000                       | 22,349           | (10,349)               |   |                 | 12,000        |
| <b>Total transactions with owners</b>                        | 120,000                       | 22,349           | 282,141                | -   | -               | 304,490       |
| <b>Translation differences</b>                               |                               | 362,856          | 24,450                 |   |                 | 387,306       |
| Balance at June 30, 2012                                     | 87,368,942                    | \$ 72,502,272    | \$ 4,634,052           | \$ 167,720                                      | \$ (19,586,799) | \$ 57,717,245 |

*The accompanying notes are an integral part of these consolidated financial statements*

Eaglewood Energy Inc.  
**Consolidated Statements of Changes in Equity**  
Canadian Dollars

|  | Number of<br>common<br>shares | Share<br>capital | Contributed<br>Surplus | Accumulated<br>other<br>comprehensive<br>income | Deficit         | Total equity  |
|--|-------------------------------|------------------|------------------------|---|-----------------|---------------|
| Balance at January 1, 2011                                   | 86,238,942                    | \$ 70,174,886    | \$ 3,175,660           | \$ 593,516                                      | \$ (13,360,082) | \$ 60,583,980 |
| <b>Total comprehensive loss for the period:</b>              |                               |                  |                        |   |                 |               |
| Loss for the period  |                               |                  |                        |   | (3,208,307)     | (3,208,307)   |
| <i>Other comprehensive income:</i>                           |                               |                  |                        |   |                 |               |
| Foreign currency translation                                 |                               |                  |                        | 448,627   |                 | 448,627       |
| <b>Total comprehensive income (loss) for the period</b>      |                               | -                | -                      | 448,627   | (3,208,307)     | (2,759,680)   |
| <b>Transactions with owners, recorded directly in equity</b> |                               |                  |                        |   |                 |               |
| Issue of common shares                                       | 710,000                       | 532,500          |                        |   |                 | 532,500       |
| Share issue costs  |                               | (54,364)         |                        |   |                 | (54,364)      |
| Share based payments   |                               |                  | 725,267                |   |                 | 725,267       |
| Options exercised  | 200,000                       | 30,698           | (10,698)               |   |                 | 20,000        |
| <b>Total transactions with owners</b>                        | 910,000                       | 508,834          | 714,569                | -   | -               | 1,223,403     |
| <b>Translation differences</b>                               |                               | (1,641,573)      | (71,704)               | -   | -               | (1,713,277)   |
| Balance at June 30, 2011                                     | 87,148,942                    | \$ 69,042,147    | \$ 3,818,525           | \$ 1,042,143                                    | \$ (16,568,389) | \$ 57,334,426 |

*The accompanying notes are an integral part of these consolidated financial statements*

**Eaglewood Energy Inc.**  
**Consolidated Statements of Cash Flow**  
Canadian Dollars

|   | <b>For the six months ended,</b> |                      |
|---|----------------------------------|----------------------|
|   | <b>June 30, 2012</b>             | <b>June 30, 2011</b> |
| <b>Cash flows related to the following activities:</b>      |                                  |                      |
| <b>Operating activities</b>                                 |                                  |                      |
| Net loss  | \$ (1,289,330)                   | \$ (3,208,307)       |
| Adjustments for:  |                                  |                      |
| Gain on sale of exploration and evaluation assets           | (208,458)                        | -                    |
| Stock-based payments  | 197,619                          | 529,858              |
| Depletion, depreciation and amortization                    | 91,745                           | 78,887               |
| Change in discount rate for asset retirement obligation     | -                                | 26,764               |
| Finance income  | (5,560)                          | (20,724)             |
| Accretion of asset retirement obligation                    | (1,780)                          | 26,602               |
| Impairment of exploration and evaluation assets             | -                                | 1,402,317            |
|   | <b>(1,215,764)</b>               | <b>(1,164,603)</b>   |
| Changes in non-cash working capital (note 9)                | <b>(2,188,294)</b>               | <b>1,309,115</b>     |
|   | <b>(3,404,058)</b>               | <b>144,512</b>       |
| <b>Investing activities</b>                                 |                                  |                      |
| Additions to exploration and evaluation assets              | (2,171,855)                      | (9,476,207)          |
| Additions to property, plant and equipment                  | (2,945)                          | (21,742)             |
| Proceeds from farm-out                                      | 9,326,057                        | -                    |
| Release of letter of credit                                 | -                                | 1,284,595            |
| Finance income  | 5,560                            | 20,724               |
|   | <b>7,156,817</b>                 | <b>(8,192,630)</b>   |
| <b>Financing activities</b>                                 |                                  |                      |
| Issue of common shares                                      | 12,000                           | 552,500              |
| Share issue costs   | -                                | (54,364)             |
|   | <b>12,000</b>                    | <b>498,136</b>       |
| Net (decrease) increase in cash                             | <b>3,764,759</b>                 | <b>(7,549,982)</b>   |
| Cash and cash equivalents, beginning of period              | <b>6,586,499</b>                 | <b>12,858,739</b>    |
| Effect of exchange rate change on cash and cash equivalents | <b>168,413</b>                   | <b>(261,693)</b>     |
| Cash and cash equivalents, end of period                    | <b>\$ 10,519,671</b>             | <b>\$ 5,047,064</b>  |

*The accompanying notes are an integral part of these consolidated financial statements*

**Eaglewood Energy Inc.**

**Notes to the Consolidated Interim Financial Statements**

For the three and six months ended June 30, 2012 and 2011

Canadian dollars unless otherwise stated

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**1. Nature of operations and going concern**

Eaglewood Energy Inc. (collectively with its subsidiary, the “Company” or “Eaglewood”) is a development stage enterprise whose primary activity is exploration of its Papua New Guinea (“PNG”) licenses. Eaglewood is incorporated and domiciled in Canada. The address of its registered office is Suite 602, 304 – 8 Ave. SW, Calgary, Alberta. The Company has commenced exploration drilling activities but does not have any production revenue at this time.

The consolidated interim financial statements include the accounts of the Company and its wholly owned subsidiary, Eaglewood Energy (BVI) Ltd., which was incorporated on July 4, 2007.

The Company’s consolidated interim financial statements have been prepared using International Financial Reporting Standards applicable to a going concern which assumes that the Company will be able to realize its assets and discharge its liabilities in the normal course of operations. The Company has not generated any petroleum revenue to date and for the three and six months ended June 30, 2012, the Company reported a net loss of approximately \$0.7 million and \$1.3 million respectively. At June 30, 2012, the Company had an accumulated deficit of approximately \$19.6 million and net working capital of approximately \$8.9 million. In addition to its ongoing working capital requirements, the Company must secure sufficient funding for the financial commitments related to its PNG licenses as described in note 13. These conditions indicate the existence of material uncertainties that may cast significant doubt on the Company’s ability to continue as a going concern and accordingly, the appropriateness of the use of accounting policies applicable to a going concern.

The Company’s ability to continue as a going concern is dependent upon its ability to raise equity financing and/or enter into and complete joint venture or farm-out arrangements as work commitments become due. Management believes there is the opportunity for the Company to raise additional equity and/or enter into and complete further farm-out or joint venture arrangements as required and therefore continue as a going concern. However, there are no assurances that the Company will be successful in achieving these objectives. These consolidated financial statements do not reflect the adjustments to the carrying values of assets and liabilities, including any impairment in the property, plant and equipment and exploration and evaluation assets, and the reported expenses and balance sheet classifications that would be necessary if the Company is unable to continue as a going concern, and such adjustments could be material.

The consolidated annual financial statements of the Company as at and for the year ended December 31, 2011 are available at [www.sedar.com](http://www.sedar.com).

**2. Basis of preparation**

These consolidated interim financial statements have been prepared in accordance with International Accounting Standard (“IAS”) 34, *Interim Financial Reporting* as issued by the International Accounting Standards Board (“IASB”). Certain information and disclosures required to be included in notes to Consolidated Annual Financial Statements prepared in accordance with International Financial Reporting Standards (“IFRS”) and interpretations of the International Financial Reporting Interpretations Committee (“IFRIC”), as issued by the IASB, have been condensed or omitted.

The consolidated interim financial statements should be read in conjunction with the audited consolidated annual financial statements as at and for the year ended December 31, 2011.

**Eaglewood Energy Inc.****Notes to the Consolidated Interim Financial Statements**

For the three and six months ended June 30, 2012 and 2011

Canadian dollars unless otherwise stated

**3. Significant accounting policies**

The consolidated interim financial statements have been prepared following the same accounting policies as the consolidated annual financial statements as at and for the year ended December 31, 2011.

**4. New and amended accounting standards**

The Company continues to assess the impact of adopting the pronouncements from the IASB as described in the consolidated annual financial statements as at and for the year ended December 31, 2011.

**5. Exploration and evaluation assets****Cost:**

|                                 |           |                   |
|---------------------------------|-----------|-------------------|
| Balance at January 1, 2011      | \$        | 46,136,943        |
| Additions                       |           | 11,274,945        |
| Foreign currency translation    |           | 1,347,266         |
| Balance at December 31, 2011    |           | 58,759,154        |
| Additions                       |           | 2,339,049         |
| Foreign currency translation    |           | 239,523           |
| <b>Balance at June 30, 2012</b> | <b>\$</b> | <b>61,337,726</b> |

**Disposals, amortization and impairment losses:**

|                                 |           |                   |
|---------------------------------|-----------|-------------------|
| Balance at January 1, 2011      | \$        | -                 |
| Impairment                      |           | 1,402,317         |
| Amortization                    |           | 82,055            |
| Balance at December 31, 2011    | \$        | 1,484,372         |
| Disposals                       |           | 9,291,418         |
| Amortization                    |           | 56,853            |
| <b>Balance at June 30, 2012</b> | <b>\$</b> | <b>10,832,643</b> |

**Carrying amounts:**

|                         |           |                   |
|-------------------------|-----------|-------------------|
| At January 1, 2011      | \$        | 46,136,943        |
| At December 31, 2011    | \$        | 57,274,782        |
| <b>At June 30, 2012</b> | <b>\$</b> | <b>50,505,083</b> |

On March 14, 2012, the Company announced the completion of the farm-out agreement for 20% of its 30% participating interest in PPL 260. The proceeds of this sale were \$7.1 million, which resulted in a gain on the sale of these exploration and evaluation assets of \$208,458. In August 2012, the Company completed the sale of its final 10% participating interest in PPL 260.

On April 11, 2012, the Company announced the completion of the farm-out agreement for 25% of its 90% participating interest in PPL 259, which included reimbursement of \$2.3 million in sunk costs.



**Eaglewood Energy Inc.****Notes to the Consolidated Interim Financial Statements**

For the three and six months ended June 30, 2012 and 2011

Canadian dollars unless otherwise stated

**6. Asset retirement obligation**

|                                     |           |                  |
|-------------------------------------|-----------|------------------|
| Balance at December 31, 2011        | \$        | 1,799,739        |
| Change in risk-free rate            |           | 72,324           |
| Accretion                           |           | (1,780)          |
| Total before translation difference |           | 1,870,283        |
| Translation difference              |           | 11,979           |
| <b>Balance at June 30, 2012</b>     | <b>\$</b> | <b>1,882,262</b> |

The Company's asset retirement obligations result from its ownership interest in petroleum and natural gas properties. The total asset retirement obligation is estimated based on the Company's net ownership interest in all wells and facilities, estimated costs to reclaim and abandon these wells and facilities and the estimated timing of the costs to be incurred in future years. The Company has estimated the net present value of the asset retirement obligations to be \$1,882,262 as at June 30, 2012 (December 31, 2011 - \$1,799,739) based on an undiscounted total future liability of \$2,696,865 (December 31, 2011 - \$2,696,865). These payments are expected to occur in 2027 or 2028. The discount factor, being the risk-free rate, is 2.60% at June 30, 2012 (December 31, 2011 - 2.70%).

**7. Share capital****(a) Authorized**

The Company is authorized to issue an unlimited number of common shares and preferred shares.

**(b) Stock options**

The Company has a stock option plan for directors, officers, employees and consultants. Under the Company's stock option plan, the Company may grant options of up to 10% of the issued and outstanding common shares. The plan is administered by the Board of Directors. In accordance with the policies of the TSX Venture Exchange, the option exercise price, when granted, is based on the last closing price of the Company's shares on the TSX-V prior to the grant, subject to a permitted discount. Options granted under the plan have an exercise period not exceeding ten years. The vesting period is determined at the time of grant at the discretion of the Board of Directors.

The Company had stock options outstanding to acquire common shares as follows:

|                                   | Weighted<br>average<br>remaining life<br>(years) | Number of<br>options | Weighted<br>average<br>exercise<br>price |
|-----------------------------------|--|----------------------|--|
| <b>Balance, January 1, 2011</b>   | <b>3.26</b>                                      | <b>5,946,000</b>     | <b>\$ 0.77</b>                           |
| Granted                           |  | 950,000              | 0.26                                     |
| Exercised                         |  | (300,000)            | 0.10                                     |
| Cancelled                         |  | (150,000)            | 1.36                                     |
| Forfeited                         |  | (650,000)            | 1.24                                     |
| <b>Balance, December 31, 2011</b> | <b>2.76</b>                                      | <b>5,796,000</b>     | <b>\$ 0.66</b>                           |
| Granted                           |  | 2,850,000            | 0.30                                     |
| Exercised                         |  | (120,000)            | 0.10                                     |
| <b>Balance, June 30, 2012</b>     | <b>3.11</b>                                      | <b>8,526,000</b>     | <b>\$ 0.55</b>                           |

**Eaglewood Energy Inc.****Notes to the Consolidated Interim Financial Statements**

For the three and six months ended June 30, 2012 and 2011

Canadian dollars unless otherwise stated

The following table summarizes the stock options outstanding at June 30, 2012:

| Range of exercise prices | Options outstanding | Weighted average exercise price | Options exercisable | Weighted average remaining life (years) |
|--------------------------|---------------------|---------------------------------|---------------------|---|
| \$0.10 - \$0.50          | 5,186,000           | 0.24                            | 1,436,000           | 3.82                                    |
| \$0.51 - \$1.00          | 1,865,000           | 0.78                            | 1,370,000           | 2.04                                    |
| \$1.01 - \$1.50          | 1,100,000           | 1.21                            | 1,100,000           | 1.64                                    |
| \$1.50 - \$1.64          | 375,000             | 1.64                            | 375,000             | 2.83                                    |
|                          | <b>8,526,000</b>    | <b>0.55</b>                     | <b>4,281,000</b>    | <b>3.11</b>                             |

The fair value of the stock options granted during the six months ended June 30, 2012 for which the exercise price was equal to the share's market price was estimated at \$687,508 (June 30, 2011 - \$42,410). These amounts will be recognized as stock based compensation expense over the vesting period of the options.

## (c) Performance warrants

In 2008, the Company granted performance warrants to certain employees. The performance warrants entitle the employees to purchase an equivalent number of common shares of the Company if the common shares close at or above pre-determined prices for specified periods of time. The performance warrants vest in four equal tranches over a two year period and expire three years from the date of grant. Certain of these warrants have been extended for a further two years and will expire in November 2013. The exercise price of the performance warrants escalates with each tranche and ranges from \$0.75 to \$1.75.

|   | Number of warrants | Weighted average exercise price |
|---|--------------------|---------------------------------|
| <b>Balance, January 1, 2011</b>                     | <b>7,800,000</b>   | <b>\$ 1.19</b>                  |
| Expired   | (1,600,000)        | 1.19                            |
| <b>Balance, December 31, 2011 and June 30, 2012</b> | <b>6,200,000</b>   | <b>\$ 1.19</b>                  |

| Exercise price | Warrants outstanding | Warrants exercisable |
|----------------|----------------------|----------------------|
| \$0.75         | 1,550,000            | 1,550,000            |
| \$1.00         | 1,550,000            | 1,550,000            |
| \$1.25         | 1,550,000            | 1,550,000            |
| \$1.75         | 1,550,000            | -                    |
|                | <b>6,200,000</b>     | <b>4,650,000</b>     |

**Eaglewood Energy Inc.****Notes to the Consolidated Interim Financial Statements**

For the three and six months ended June 30, 2012 and 2011

Canadian dollars unless otherwise stated

**(d) Share-based payments**

The fair value of common share options and performance warrants granted is estimated on the date of grant and is recognized over the vesting period, using the Black Scholes Model.

|   | <b>Six months ended,</b> |               |
|---|--------------------------|---------------|
|   | <b>June 30, 2012</b>     | June 30, 2011 |
| Weighted average fair value of stock options granted (per option) | <b>\$0.24</b>            | \$0.42        |
| Weighted average fair value of performance warrants granted       | <b>n/a</b>               | n/a           |
| Expected life of stock options                                    | <b>4 years</b>           | 4 years       |
| Expected life of performance warrants                             | <b>n/a</b>               | n/a           |
| Expected volatility   | <b>128%</b>              | 141%          |
| Risk-free rate of return  | <b>1.34%</b>             | 2.52%         |
| Dividend yield  | <b>Nil</b>               | Nil           |

A forfeiture rate of 5% (June 30, 2011 – 5%) is used when recording share-based payments. This estimate is adjusted to the actual forfeiture rate. The stock based compensation expense related to the stock options for the three and six months ended June 30, 2012 was \$185,106 and \$292,490 respectively (2011 - \$387,654 and \$725,266), of which \$49,351 and \$94,871 (2011 – \$82,420 and \$195,409) has been capitalized.

**8. Finance income and expenses**

|                              | <b>For the three months ended,</b> |               | <b>For the six months ended,</b> |               |
|------------------------------|------------------------------------|---------------|----------------------------------|---------------|
|                              | <b>June 30, 2012</b>               | June 30, 2011 | <b>June 30, 2012</b>             | June 30, 2011 |
| Finance income:              |                                    |               |                                  |               |
| Interest income              | <b>2,197</b>                       | \$ 5,496      | <b>\$ 5,560</b>                  | \$ 20,724     |
| Foreign exchange gain        | -                                  | (91,092)      | -                                | -             |
|                              | <b>2,197</b>                       | (85,596)      | <b>5,560</b>                     | 20,724        |
| Finance expenses:            |                                    |               |                                  |               |
| Bank fees                    | <b>(1,635)</b>                     | (2,581)       | <b>(5,877)</b>                   | (7,291)       |
| Net foreign exchange loss    | <b>21,367</b>                      | (58,796)      | <b>(2,954)</b>                   | (58,796)      |
| Asset retirement obligation  | <b>684</b>                         | (16,601)      | <b>1,780</b>                     | (53,112)      |
|                              | <b>20,416</b>                      | (77,978)      | <b>(7,051)</b>                   | (119,199)     |
| Net finance (expense) income | <b>22,613</b>                      | (163,574)     | <b>\$ (1,491)</b>                | \$ (98,475)   |

**9. Supplementary cash flow information**

The following table details the components of non-cash working capital:

|  | <b>Six months ended,</b> |               |
|--|--------------------------|---------------|
|  | <b>June 30, 2012</b>     | June 30, 2011 |
| Provided by (used in):                   |                          |               |
| Accounts receivable                      | <b>\$ (156,380)</b>      | \$ 8,077,265  |
| Prepaid expenses                         | -                        | 3,894         |
| Accounts payable and accrued liabilities | <b>(2,031,914)</b>       | (6,772,044)   |
|  | <b>\$ (2,188,294)</b>    | \$ 1,309,115  |

**Eaglewood Energy Inc.****Notes to the Consolidated Interim Financial Statements**

For the three and six months ended June 30, 2012 and 2011

Canadian dollars unless otherwise stated

**10. Financial instruments and risk management****Measurement categories**

Financial assets and liabilities have been classified into categories that determine their basis of measurement and for items measured at fair value, whether changes in fair value are recognized in the statement of income or comprehensive income. The following table shows the carrying values of assets and liabilities for each of the categories at June 30, 2012 and December 31, 2011.

|                           | June 30, 2012 | December 31, 2011 |
|---------------------------|---------------|-------------------|
| <b>ASSETS</b>             |               |                   |
| Loans and receivables     |               |                   |
| Cash and cash equivalents | \$ 10,519,671 | \$ 6,586,499      |
| Accounts receivable       | 326,331       | 169,951           |
|                           | \$ 10,846,002 | \$ 6,756,450      |
| <b>LIABILITIES</b>        |               |                   |
| Amortized costs           |               |                   |
| Accounts payable          | \$ 1,994,642  | \$ 4,026,553      |

**Fair values, including valuation methods and assumptions**

The carrying amounts of financial instruments comprising cash and cash equivalents, restricted cash, accounts receivable and accounts payable and accrued liabilities approximate their fair values due to the immediate or short term nature of these financial instruments.

The Company's assets and liabilities recorded at fair value have been categorized based upon the following fair value hierarchy:

- Level 1 – quoted market prices in active markets for identical assets or liabilities;
- Level 2 – inputs other than quoted market prices included in Level 1 that are observable or the asset or liability, either directly (as prices) or indirectly (derived from prices); and
- Level 3 – unobservable inputs such as inputs for the asset or liability that are not based on observable market data.

The level in the fair value hierarchy within which the fair value measurement is categorized in its entirety is determined on the basis of the lowest level input that is significant to the fair value measurement in its entirety. The fair value of the financial instruments classified as held for trading (cash and cash equivalents) corresponds to a Level 1 classification.

**Financial risk factors**

The Company's activities expose it to a variety of financial risks that arise as a result of its exploration, development, production, and financing activities such as:

- credit risk;
- liquidity risk; and
- market risk.

This note presents information about the Company's exposure to each of the above risks, the Company's objectives, policies and processes for measuring and managing risk, and the Company's management of

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capital. Further quantitative disclosures are included throughout these consolidated interim financial statements.

The Board of Directors oversees managements' establishment and execution of the Company's risk management framework. Management has implemented and monitors compliance with risk management policies. The Company's risk management policies are established to identify and analyze the risks faced by the Company, to set appropriate risk limits and controls, and to monitor risks and adherence to market conditions and the Company's activities.

**(a) Credit Risk**

Credit risk is the risk that a third party fails to meet its contractual obligations that could result in the Company incurring a loss. The Company's accounts receivable are primarily with joint venture partners. Receivables from joint venture partners arise when the Company conducts joint operations on behalf of its partners and invoices them for their share of costs. As at June 30, 2012 and December 31, 2011, there was no allowance for doubtful accounts for the joint venture receivables as all amounts receivable were current.

The maximum exposure to credit risk is as follows:

|                           | Carrying amount     |                    |
|---------------------------|---------------------|--------------------|
|                           | June 30, 2012       | December 31, 2011  |
| Cash and cash equivalents | \$10,519,671        | \$6,586,499        |
| Accounts receivable       | 326,331             | 169,951            |
|                           | <b>\$10,846,002</b> | <b>\$6,756,450</b> |

***Cash and cash equivalents***

The Company limits its exposure to credit risk by only investing in liquid securities and only with major national banks. Given these credit ratings, management does not expect any counterparty to fail to meet its obligations.

***Accounts receivable***

The majority of the Company's operations are conducted in Canada and Papua New Guinea. The Company's exposure to credit risk is influenced mainly by the individual characteristics of each customer.

**(b) Liquidity risk**

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Company's reputation.

Typically the Company ensures that it has sufficient cash on demand to meet expected operational expenses for a period of 60 days, including the servicing of financial obligations; this excludes the potential impact of extreme circumstances that cannot reasonably be predicted, such as natural disasters. To achieve this objective, the Company prepares annual operating and capital expenditure budgets, which are regularly monitored and updated as considered necessary. Further, the Company utilizes authorizations for expenditures on both operated and non-operated projects to further manage capital expenditure.

**(c) Market risk**

Market risk is the risk that changes in market prices, such as commodity prices, foreign exchange rates and interest rates will affect the Company's income or the value of the financial instruments. The

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objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimizing the return.

The Company may use both financial derivatives and physical delivery sales contracts to manage market risks.

(d) Foreign currency exchange risk:

The Company is exposed to risk arising from fluctuations in foreign currency exchange rates and the volatility of those rates. This exposure primarily relates to: (i) certain expenditure commitments, deposits and accounts payable which are denominated in foreign currencies including Canadian dollars, Australian dollars or Papua New Guinea kina; and (ii) its operations in Papua New Guinea.

The Company's foreign currency exchange risk arises from cash and cash equivalents and current liabilities. With a 10% strengthening or weakening of the Canadian dollar against all exchange rates, the net loss for the six months ended June 30, 2012 would be reduced by \$1.4 million (December 31, 2011 - \$0.5 million) or be increased by \$0.5 million (December 31, 2011 - \$0.6 million).

**11. Capital management**

The Company's objective when managing its capital structure is to maintain adequate levels of available working capital, including cash and cash equivalents, to meet its license commitments in PNG.

The Company funds its share of expenditures of all commitments from existing cash and cash equivalent balances received primarily from fees from farming out its Licenses and issuances of shareholders' equity. In order to maintain positive working capital, the Company may issue new shares. The Company does not currently utilize debt and is not subject to any financial covenants.

The Board of Directors regularly reviews the Company's cash and cash equivalents against the expenditure commitments and assesses the timing and need for additional equity financing. The Company's results will impact its access to the capital necessary to meet these expenditure commitments. There can be no assurance that equity financing will be available or sufficient to meet those requirements, or for other corporate purposes, or if equity financing is available, that it will be on terms acceptable to the Company.

**12. Related party transactions**

The Company has entered into transactions with related parties in the normal course of business, which were valued at the exchange amount established and agreed to by the related parties. During the three and six months ended June 30, 2012 and 2011, the related party transactions were as follows:

- (a) the Company paid \$3,000 and \$6,000 respectively (June 30, 2011 - \$3,000 and \$6,000) to a company controlled by a director. These fees were paid for administration services which were provided by the director who previously acted as an officer of the Company. At June 30, 2012, \$nil (December 31, 2011 - \$nil) was included in accounts payable and accrued liabilities.
- (b) the Company paid \$20,556 and 40,355 respectively (June 30, 2011 - \$35,738 and \$53,986) for legal services to a law firm of which a professional corporation controlled by an officer of the Company is a partner. At June 30, 2012, \$1,217 (December 31, 2011 - \$15,059) was included in accounts payable and accrued liabilities.

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*Key management personnel compensation*

In addition to their salaries, the Company also provides non-cash benefits to executive officers and directors. The executive officers include the Chief Executive Officer, the Chief Operating Officer and the Chief Financial Officer. Executive officers and directors also participate in the Company's stock option program. Key management personnel compensation for the three and six months ended June 30, is comprised as follows:

|                              | For the three months ended, |               | For the six months ended, |               |
|------------------------------|-----------------------------|---------------|---------------------------|---------------|
|                              | June 30, 2012               | June 30, 2011 | June 30, 2012             | June 30, 2011 |
| Salaries and wages           | \$ 200,871                  | \$ 200,780    | \$ 377,583                | \$ 531,462    |
| Directors fees               | 16,250                      | 22,179        | 32,500                    | 44,365        |
| Short-term employee benefits | 2,608                       | 2,838         | 10,744                    | 11,966        |
| Share-based payments         | 110,437                     | 151,952       | 161,968                   | 324,133       |
|                              | \$ 330,166                  | \$ 377,749    | \$ 582,795                | \$ 911,926    |

**13. Contingencies and commitments****(a) License commitments**

Pursuant to the terms of the Licenses, the Company has assumed certain financial and work commitments relating its licenses as described below:

| License | Commitment   |
|---------|--|
| PPL 257 | On December 6, 2011, a five year extension to PPL 257 was granted. During the first two years of the extension, the Company must, at a cost of not less than US\$500,000 integrate recently completed studies; conduct further field studies as deemed necessary; integrate seismic interpretation and structural studies; and continue farm-out talks. Prior to the beginning of the third year of the extension, the Company must submit and have approved by the Minister, the work program for the remaining three years of the license which must include drilling one exploration well at a cost of not less than \$US40,000,000, conduct post well studies and comprehensive license review at a cost of not less than \$US500,000; and provide particulars of the financial resources available to the Company to carry out the foregoing work program. Eaglewood has a 100% participating interest in this license.   |
| PPL 258 | In July 2012, the Company was offered and in August accepted a five year extension to this license. Once formally granted, the work commitments will be: during the first two years, the Company must carry out and integrate a number of studies; in the third and fourth year, the Company must drill one exploration well with a second well required in year five. Eaglewood has a 100% participating interest in this license.  |
| PPL 259 | In September 2011, a five-year extension to PPL 259 was granted. Within the first two years from the date of extension of this license, the Company must, at a cost of not less than US\$26,000,000 acquire 100km of 2D seismic, drill one exploration well, and conduct geological and geophysical studies. Prior to the beginning of the third year of the extension, the Company must submit and have approved by the Minister, the work program for the remaining three years of the extension which must include drilling an appraisal well or another exploration well. At June 30, 2012 Eaglewood had a 65% participating interest in this license. On January 24, 2012, the Company announced two farmout agreements related to this license. Each farmout is for 25% of Eaglewood's 90% participating interest in PPL 259. On April 11, 2012, one of these agreements was completed, reducing the Company's participating interest to 65%. In August 2012, the Company announced that the second transaction failed to complete. Eaglewood will therefore maintain a 65% participating interest in PPL 259. |

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|        |  |
|--------|--|
| PRL 28 | In December 2011, a Petroleum Retention License (PRL) was granted for the Ubuntu gas condensate discovery on PPL 259. The license was granted for five years and during this period, the Company must undertake marketing studies with analysis of future hydrocarbon commercialization scenarios for the Ubuntu gas and gas condensate resource; undertake technical studies to (i) re-map and assess the reserves of the Ubuntu feature, focusing on an integration of the Ubuntu seismic; (ii) determine the potential for an integrated development with other nearby fields; (iii) deliver gas and/or condensate to local markets; (iv) identify landowners and required social mapping; and (v) address other commercialization opportunities for gas/condensate. The cost of the above work is to be not less than US\$350,000. Contingent on the conclusions reached on the above items and if the market warrants, the Company must then undertake engineering studies aimed at appraisal and development of gas and/or condensate delivery; perform a conventional or extended well test on Ubuntu-1; consider drilling an appraisal or development well; and undertake commercial negotiation of gas and/or condensate contracts. Eaglewood has a 40% participating interest in this license. |
|--------|--|

The Company has issued bank guarantees totaling approximately \$225,000 (100,000 Papua New Guinea kina for each license) as security against the capital requirements associated with the Licenses. If the Company does not fulfill its commitments under a License and has not applied for and been granted an extension, it could potentially lose its guarantee and the applicable License could be revoked by the PNG government.

**(b) PNG government back in right**

The PNG government retains a 22.5 percent back-in right which can be exercised at the time a development license is granted. If the PNG government exercises its back-in right, it would be required to pay the Company 22.5 percent of all costs incurred in respect of the Licenses up to the election date and to pay 22.5 percent of the ongoing production and development costs of the Licenses.

**(c) Reclamation**

The Company has a commitment to obtain a reclamation certificate relating to an abandoned well site in Alberta which relates to a predecessor company. The cost of any reclamation work relating to the site is not determinable at this time.



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**14. Segmented information**

The Company has one reportable business segment, that being oil and gas exploration and development, in Papua New Guinea.

|  | <b>For the three months ended June 30, 2012</b> |                             |                                      |                     |
|--|---|-----------------------------|--------------------------------------|---------------------|
|  | <b>Corporate</b>                                | <b>Papua New<br/>Guinea</b> | <b>Intercompany<br/>Eliminations</b> | <b>Consolidated</b> |
| Revenue  | \$ -  | \$ 30,133                   | \$ (12,053)                          | \$ 18,080           |
| Expenses   | (461,665)                                       | (252,216)                   | -                                    | (713,881)           |
| Net finance income   | 26,583  | (3,970)                     | -                                    | 22,613              |
| Loss for the period  | \$ (435,082)                                    | \$ (226,053)                | \$ (12,053)                          | \$ (673,188)        |
| Capital additions (excluding foreign currency adjustments) | \$ -  | \$ 954,002                  | \$ (12,053)                          | \$ 941,949          |

|  | <b>For the three months ended June 30, 2011</b> |                             |                     |                |
|--|---|-----------------------------|---------------------|----------------|
|  | <b>Corporate</b>                                | <b>Papua New<br/>Guinea</b> | <b>Consolidated</b> |                |
| Expenses   |   | \$ (553,860)                | \$ (1,859,264)      | \$ (2,413,124) |
| Net finance income   |   | (74,751)                    | (88,823)            | (163,574)      |
| Loss for the period  |   | \$ (628,611)                | \$ (1,948,087)      | \$ (2,576,698) |
| Capital additions (excluding foreign currency adjustments) |   | \$ -                        | \$ 3,055,881        | \$ 3,055,881   |

|  | <b>For the six months ended June 30, 2012</b> |                             |                                      |                     |
|--|---|-----------------------------|--------------------------------------|---------------------|
|  | <b>Corporate</b>                              | <b>Papua New<br/>Guinea</b> | <b>Intercompany<br/>Eliminations</b> | <b>Consolidated</b> |
| Revenue  | \$ -  | \$ 30,133                   | \$ (12,053)                          | \$ 18,080           |
| Expenses   | (819,109)                                     | (486,810)                   | -                                    | (1,305,919)         |
| Net finance income   | 47,402  | (48,893)                    | -                                    | (1,491)             |
| Loss for the period  | \$ (771,707)                                  | \$ (505,570)                | \$ (12,053)                          | \$ (1,289,330)      |
| Segment assets   | \$10,419,585                                  | \$ 51,186,886               | \$ (12,322)                          | \$ 61,594,149       |
| Exploration and evaluation assets                          | -   | \$ 50,517,405               | \$ (12,322)                          | \$ 50,505,083       |
| Capital additions (excluding foreign currency adjustments) | \$ -  | \$ 2,354,048                | \$ (12,053)                          | \$ 2,341,995        |

Assets held in the Corporate segment are primarily cash in nature.

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| <b>For the six months ended June 30, 2011</b>              |                  |                             |                     |
|--|------------------|-----------------------------|---------------------|
|  | <b>Corporate</b> | <b>Papua New<br/>Guinea</b> | <b>Consolidated</b> |
| Expenses   | \$ (1,237,122)   | \$ (1,872,710)              | \$(3,109,832)       |
| Net finance income   | 102,100          | (200,575)                   | (98,475)            |
| Loss for the period  | \$ (1,135,022)   | \$ (2,073,285)              | \$ (3,208,307)      |
| Segment assets   | \$ 6,209,135     | \$ 55,993,026               | \$ 62,202,161       |
| Exploration and evaluation assets                          | -                | \$ 53,338,335               | \$ 53,338,335       |
| Capital additions (excluding foreign currency adjustments) | \$ 2,596         | \$ 9,690,762                | \$ 9,693,358        |

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**15. Subsequent events**

- (a) In July 2012, the Company was offered and in August accepted a five year extension to the PPL 258 license.
- (b) In August 2012, the Company announced that the second of two farmout arrangements on PPL 259 for a 25% participating interest failed to complete. Eaglewood will continue to hold a 65% participating interest in this license.
- (c) In August 2012, the Company completed the sale of its final 10% participating interest in PPL 260 for US \$3.5 million.