

**Argosy Energy Inc.**  
**Financial Statements**  
**And**  
**Management Discussion and Analysis**  
**December 31, 2008**

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Norman George

Vice-President, Operations

Tom Dalton

Vice-President, Finance & CFO

Rick Campbell

Vice-President, Engineering

**Directors:**

Brian Mellum – Lead Director

Managing Director, Toscana Capital Corporation

John Poetker

Partner, Borden Ladner Gervais LLP

Jacob Roorda

President & CEO, EnerVest Management Ltd.

Peter Salamon

President & CEO, Argosy Energy Inc.

Michael Kanovsky

President, Sky Energy Company

Kenneth Faircloth

Investment Advisor, Retired

**Banker:**

National Bank of Canada

**Legal Counsel:**

Borden Ladner Gervais

Ray Dobek

Executive Vice-President, Argosy Energy Inc.

**Auditor:**

KPMG LLP

**Reserve Engineers:**

GLJ Petroleum Consultants Ltd.

## Highlights

\$ Thousands except production/day and common shares information	Year Ending December 31, 2007 (1)	Year Ending December 31, 2008 (1)	% Change
Cash flow from operating activities			
Total	7,296	8,354	15
Per share basic	1.77	1.85	4
Net income			
Total	1,025	47	(95)
Per share basic	0.23	0.01	(96)
Per share diluted	0.23	0.01	(96)
Common shares outstanding	4,112,590	4,515,671	10
Debt, including working capital deficiency	37,509	25,219	(33)
Operational :			
Sales plus realized gain on financial instruments	14,855	20,512	41
Royalties	2,816	4,448	58
Operating and transportation costs	1,589	2,243	41
Net Back (3)	10,450	13,821	24
Net Back/ bbl (3)	30.72	38.10	24
General and administrative	1,085	3,177	193
General and administrative \$/bbl	3.19	8.76	175
Volumes :			
Natural gas (mcf/d)	5,119	5,257	3
Oil (bbl/d)	-	44	-
NGL's (bbl/d)	79	71	(10)
Total Boe/d	932	991	6
Wells Drilled (Gross) :			
Oil	-	3	-
Gas	9	10	11
D&A	-	1	-
Total	9	14	56
Capital Expenditures	27,982	23,117	(17)

### Notes:

(1) Includes figures for the periods ending prior to September 30, 2008 on a continuity of Interests basis.

(2)(3) Argosy's definition of cash flow from operations and/or netbacks may not be comparable to that reported by other companies.

See the caption *Non GAAP Measures*.

## **Management Discussion and Analysis**

The following discussion and analysis was prepared on March 30, 2009 and is management's assessment of Argosy's historical financial and operating results and should be read in conjunction with the audited financial statements and related notes for the years ended, December 31, 2008 and 2007.

The financial data presented has been prepared in accordance with Canadian Generally Accepted Accounting Principles ("GAAP"). Comparative figures for periods ending prior to September 30, 2008 are presented in accordance with continuity of interest guidelines as if the assets acquired by Argosy had always operated as a stand-alone entity.

The reporting and measurement currency is the Canadian dollar.

Argosy Energy Inc. is a junior energy company focused on the acquisition, exploration, exploitation and development of oil and natural gas in western Canada.

Additional information may be found on the Company's web site at [www.argosyenergy.com](http://www.argosyenergy.com) and on the SEDAR web site at [www.sedar.com](http://www.sedar.com).

Argosy's shares trade on the Toronto Stock Exchange ("TSX") under the symbol GSY.

### ***The Plan of Arrangement***

Argosy was inactive from the time of its incorporation to September 30, 2008 at which time, and pursuant to a Plan of Arrangement between Accrete Energy Inc. ("Accrete"), Pengrowth Energy Trust, Pengrowth Corporation, Pengrowth Energy Partnership and Argosy ("the Arrangement"), Argosy acquired certain assets including producing and exploratory oil and gas properties and certain tax pools from Accrete effective on the closing date of September 30, 2008. Reference should be made to the Accrete Energy Inc. Management Information Circular dated September 2, 2008 (the "Circular") available at [www.sedar.com](http://www.sedar.com) for further details.

For the period up to September 30, 2008, these financial statements present the historical financial position, results of operations and cash flow of Accrete on a carve-out basis following continuity of interest guidelines as if the assets acquired by Argosy had always operated as a stand-alone entity.

The financial data for the periods prior to September 30, 2008 presented herein was extracted from the books and records of Accrete.

Certain financial statement items were maintained by Accrete at a corporate rather than on a property-by-property basis and accordingly, it was necessary to make allocations of amounts reported.

Accrete shareholders, pursuant to the Arrangement, received one quarter of a share of Argosy for each Accrete share held and, provided that the applicable shareholder was not an insider of Accrete as contemplated by applicable securities laws, one eighth of a warrant to acquire an Argosy share at an exercise price of \$4.60 per share.

A total of 4,494,667 common shares of the Corporation were issued to former Accrete shareholders in connection with the exchange of Argosy common shares for Accrete common shares pursuant to the Arrangement. No Argosy warrants were exercised prior to their expiry date.

At Claresholm, pursuant to the Arrangement, Argosy acquired 16 (13.6 net) natural gas wells, 3 (3 net) oil wells, 3 (2.6 net) potential natural gas wells, 12,682 net undeveloped acres, 47 square kilometres of 3D seismic over such lands, gathering and sales pipelines and a 75% working interest in a natural gas processing facility. Argosy also acquired 1 (.6 net) well that was in the process of being drilled. Argosy targets the Bow Island, Glauconite, Sunburst and Barons formations at depths of 2,000 to 2,300 meters in this area.

At Saxon, pursuant to the Arrangement, Argosy acquired 1 (1 net) producing natural gas well, 15,840 net undeveloped acres together with 36 square miles of 3D seismic and 20 kilometres of 2D seismic over the lands acquired.

At Edson, pursuant to the Arrangement, Argosy acquired 4 (4 net) natural gas wells, 2 of which are producing and 2 of which are still to be tied in together with 6,400 net undeveloped acres of land. Argosy also acquired various interests in the Atlee Buffalo, Peco, Caroline and Saddle Hills areas pursuant to the Arrangement which would be classified as minor miscellaneous interests.

On September 30, 2008 and concurrent with the closing of the Arrangement, Argosy issued 1,208,051 flow through shares at an issue price of \$5.20 per share and 156,116 common shares at an issue price of \$4.60 per share by way of private placement to certain Argosy directors, officers, employees and consultants for total gross proceeds of \$6,999,999.

### ***Forward-Looking Statements***

Certain statements included or incorporated herein constitute forward-looking statements. These statements relate to future events or the future performance of Argosy Energy Inc. ("Argosy"). All statements other than statements of historical fact are forward-looking.

Such forward-looking statements or information are provided for the purpose of providing information about management's current expectations and plans relating to the future. Readers are cautioned that reliance on such information may not be appropriate for other purposes, such as making investment decisions. Forward-looking statements are often, but not always, identified by the use of words such as "seek", "continue", "might", "may", "will", "should", "could", "anticipate", "believe", "expect", "intend", "plan", "estimate", "budget", "forecast", "predict", "project", "potential", or the negative of these terms and similar expressions. In addition, this Annual Information Form may contain forward-looking statements attributed to third party industry sources. These statements involve known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in such forward-looking statements.

Forward-looking statements in this Annual Information Form include, but are not limited to, statements with respect to:

The performance characteristics of Argosy's oil and natural gas properties; oil and gas production levels; the quantity of oil and natural gas reserves; the performance characteristics of oil and natural gas properties; projection of market prices; other trends of the capital markets; the size of and future net revenues from Argosy's oil and natural gas reserves; capital expenditure programs; supply and demand for oil and natural gas and commodity prices; financial conditions; industry conditions; capital expenditure programs; drilling plans; expectations regarding the Argosy's ability to raise capital and to continually add to reserves through acquisitions, exploration and development; treatment under governmental regulatory regimes and tax laws; and realization of the anticipated benefits of acquisitions and dispositions.

Some risks and other factors, which would cause results to differ materially from those expressed in the Forward-looking statements contained in these financial statements and accompanying management discussion, but are not limited to:

general economic conditions in Canada, the United States and globally; industry conditions, including fluctuations in the price of oil and natural gas; governmental regulation of the oil and gas industry, including environmental regulation; changes in income tax laws or changes in tax

laws and incentive programs relating to the oil and gas industry; volatility of commodity prices; environmental risks; fluctuation in foreign exchange or interest rates; liabilities inherent in oil and gas operations; geological, technical, drilling and processing problems; unanticipated operating events which can reduce production or cause production to be shut in or delayed; failure to obtain industry partner and other third party consents and approvals, when required; stock market volatility and market valuations; competition for, among other things, capital, acquisitions of reserves, undeveloped land, skilled personnel, and equipment and facilities; the need to obtain required consents, permits or approvals from regulatory authorities; competition for, among other things, capital, acquisition of reserves, undeveloped land, skilled personnel and equipment and facilities; the lack of availability of qualified personnel or management; uncertainties associated with estimating oil and natural gas reserves; aboriginal land claims; Stock market volatility, and the other factors considered under “Risks”.

Readers are cautioned that the foregoing lists should not be considered to be exhaustive. Readers are also cautioned that these factors and risks are difficult to predict and that the preparation of financial statements in accordance with Canadian GAAP requires management to make certain judgments and estimates that affect the reported amounts of assets, liabilities, revenues and expenses. Forward-looking statements and other information contained herein concerning the oil and gas industry and Argosy’s general expectations concerning this industry are based on estimates prepared by management using data from publicly available industry sources as well as from reserve reports, market research and industry analysis and on assumptions based on data and knowledge of this industry which Argosy believes to be reasonable. However, this data is inherently imprecise, although generally indicative of relative market positions, market shares and performance characteristics. While Argosy is not aware of any misstatements regarding any industry data presented herein, the industry involves risks and uncertainties and is subject to change based on various factors.

Although the assumptions used in the preparation of such information and statements are considered reasonably accurate by the Corporation at the time of preparation may prove to be incorrect. Accordingly, readers are cautioned that the actual results achieved will vary from the information provided herein and the variations may be material.

Statements relating to “reserves” or “resources” are deemed to be forward looking statements, as they involve the implied assessment, based on certain estimates and assumptions, that the reserves and resources described can be profitably produced in the future.

Investors should not place undue reliance on forward-looking statements as there can be no assurance that the plans, intentions or expectations upon which they are based will occur. These forward-looking statements are made as of the date of this or as of the date specified in the documents incorporated by reference into the financial statements and accompanying management discussion., as the case may be.

### ***Non GAAP Measures***

The forgoing contains the term “cash flow from operations” and “netbacks” which should not be considered an alternative to, or more meaningful than cash flow from operating activities as determined in accordance with Canadian Generally Accepted Accounting Principles (“GAAP”) as an indicator of the Company’s performance. Argosy’s definition of cash flow from operations and/or netbacks may not be comparable to that reported by other companies.

The Company evaluates its performance based on net earnings, net back and cash flow from operations. Cash flow from operations as used by the Company is the same as cash flow from operating activities as defined by GAAP.

The Company considers cash flow from operations a key measure as it illustrates the Company’s ability to meet obligations necessary to repay debt and fund future growth through capital investment. Cash flow per

share is presented using the weighted average shares outstanding in a manner consistent with that used to calculate earnings per share.

The following reconciles cash flow from operating activities, the most comparable GAAP measure to cash flow used in this MD&A: The following reconciles cash flow from operating activities, the most comparable GAAP measure to these measures:

<b>\$ Thousands</b>	<b>Year Ended</b>	
	<b>December 31, 2008</b>	<b>December 31, 2007</b>
Cash flow provided by operating activities (GAAP)	9,194	7,792
Net changes in non-cash working capital	(840)	(496)
Cash flow (non – GAAP)	8,354	7,296

The following table reconciles field and corporate netback to income before taxes the most comparable GAAP measure:

<b>\$ Thousands</b>	<b>Year Ended</b>	
	<b>December 31, 2008</b>	<b>December 31, 2007</b>
Net income and comprehensive income (GAAP)	47	1,025
Future income taxes (recovery)	169	(288)
Depletion, depreciation and accretion	7,685	6,329
Stock based compensation cost	453	230
Interest expense	2,290	2,069
Corporate netback (non – GAAP)	10,644	9,365
General and administrative expenses	3,177	1,085
Field netback (non – GAAP)	13,821	10,450

The reader is cautioned that the use of the term boe's ("barrels of oil equivalent") may be misleading particularly when used in isolation. A boe conversion of 6 mcf to 1 boe may not represent a value equivalency at the wellhead.

As the determination of many assets, liabilities, revenues and expenses is dependent upon future events, the preparation of these financial statements requires the use of estimates and assumptions which have been made using careful judgment. In the opinion of management, the unaudited interim financial statements have been properly prepared within reasonable limits of materiality and within the framework of the significant accounting policies summarized in the financial statements.

## ***Business Environment***

The level of natural gas in storage had risen in 2007 so that record levels had been achieved by year end. The fear of a resultant oversupply caused the sales price for natural gas to decrease. Exploration and development activities had slowed down somewhat by the end of 2007 because of the low prices and because of uncertainty surrounding the introduction of a new Crown Royalty regime in Alberta. High natural gas prices overseas, on the other hand, caused LNG shipments to be diverted away from North America and that, in turn, further exacerbated the effect on the diminishing North American natural gas supply.

Cold weather in the consuming regions during the first quarter of 2008 resulted in large withdrawals from storage to feed the increased demand for natural gas for heating and power generation. This, together with reduced supply, and rising oil prices resulted in an increase in the price of natural gas in the first half of 2008.

Near the end of the third quarter of 2008, the upward trend in natural gas prices reversed abruptly. Natural gas prices decreased in tandem with oil prices. Furthermore, a strong growth in natural gas production, large storage injections and shrinking industrial demand caused by the global financial turmoil contributed to the demise of natural gas prices.

For the first half of 2008, oil prices remained volatile because of geopolitical tension overseas but strong demand growth in Asia and a weakened US dollar caused them to trend upward to record levels. That trend reversed itself in the last quarter of 2008 as the global credit crisis emerged. Fears of a world wide recession became a reality and demand for oil was diminished resulting in price weakness.

The prices for oil and natural gas in North America are denominated in US dollars. The effect of a strong Canadian dollar negatively affected pricing of all commodities in Canada somewhat during the first half of 2008. The value of the Canadian dollar fell during the last half, somewhat mollifying the negative effect of falling prices.

The global credit crisis caused capital markets to be virtually inaccessible to junior oil and gas producers while the banks rigorously assessed credit risks and tightened lending policies.

### *Financial Information*

	<b>Total Revenue (\$ thousands)</b>	<b>Net Income (\$ thousands)</b>	<b>Net Income (Loss) Basic \$/Share</b>	<b>Net Income Diluted \$/Share</b>
2008 (1)				
First Quarter	4,728	742	0.18	0.17
Second Quarter	6,019	357	0.09	0.08
Third Quarter	5,282	285	0.07	0.07
Fourth Quarter	4,767	(1,337)	(0.23)	(0.23)
Total	20,796	47	0.01	(0.01)
2007 (1)				
First Quarter	2,116	246	0.06	0.06
Second Quarter	3,029	1,041	0.25	0.24
Third Quarter	4,950	319	0.08	0.07
Fourth Quarter	4,694	(581)	(0.14)	(0.14)
Total	14,789	1,025	0.25	0.23

(1) Figures for the quarters ending prior to September 30, 2008 were carved out from the financial information of Accrete Energy Inc.

(\$ thousands except per share, volume and price information)	<b>Three Months ended Dec 31, 2008</b>	<b>Nine Months ended Sept 30, 2008<sup>(1)</sup></b>	<b>Year ended Dec 31, 2008 (1)</b>	<b>Year ended Dec 31, 2007 (1)</b>
Petroleum and natural gas revenue	4,767	16,029	20,796	14,789
Cash provided by operating activities (GAAP)	1,295	7,899	9,194	7,792
Cash flow (Non – GAAP)	1,164	7,190	8,354	7,296
Per share – basic	0.20	1.94	1.85	1.77
– diluted	0.18	1.63	1.70	1.65
Net income	(1,337)	1,384	47	1,025
Per share – basic	(0.23)	0.34	0.01	0.25
– diluted	(0.23)	0.32	(0.01)	0.23
Daily production (boe/day)	1,139	941	991	932
Total assets	72,357	68,413	72,357	56,735
Working capital deficiency	162	2,293	2,455	430
Bank Indebtedness	25,510	48,273	22,763	37,079
Total other long term liabilities	-	-	-	-
Cash dividends declared	-	-	-	-

(1) Figures for the quarters ending prior to September 30, 2009 were carved out from the financial information of Accrete Energy Inc.

Argosy completed 3 (2.2 net) natural gas wells in the three month period ended December 31, 2008. Of these wells, 1 (0.6 net) was drilled prior to September 30 by Accrete and completed after September 30 by Argosy. A 100% success rate was achieved.

## *Operational Activities*

### **Production**

	<b>3 Months Ended December 31, 2008</b>	<b>3 Months Ended December 31, 2007</b>	<b>12 Months Ended December 31, 2008</b>	<b>12 Months Ended December 31, 2007</b>
<b>Oil (bbl/d)</b>	36	2	44	-
<b>NGL (bbl/d)</b>	104	124	71	79
<b>Total Oil/NGL (bbl/d)</b>	140	126	115	79
<b>Gas (mcf/d)</b>	5,992	5,826	5,257	5,119
<b>Total (boe/d)</b>	1,139	1,097	991	932

### **Natural Gas Production (mcf/d)**

	<b>3 Months Ended December 31, 2008</b>	<b>3 Months Ended December 31, 2007</b>	<b>12 Months Ended December 31, 2008</b>	<b>12 Months Ended December 31, 2007</b>
<b>Area</b>				
Atlee-Buffalo	21	45	35	39
Claresholm	5,470	5,050	4,645	4,350
Edson	357	479	405	644
Saxon	144	252	170	86
<b>Total</b>	<b>5,992</b>	<b>5,826</b>	<b>5,255</b>	<b>5,119</b>

### **Crude Oil Sales (bbl/d)**

	<b>3 Months Ended December 31, 2008</b>	<b>3 Months Ended December 31, 2007</b>	<b>12 Months Ended December 31, 2008</b>	<b>12 Months Ended December 31, 2007</b>
<b>Area</b>				
Atlee-Buffalo	-	-	-	-
Claresholm	36	2	44	-
Edson	-	-	-	-
Saxon	-	-	-	-
<b>Total</b>	<b>36</b>	<b>2</b>	<b>44</b>	<b>-</b>

**Natural Gas Liquids Sales (bbl/d)**

	<b>3 Months Ended December 31, 2008</b>	<b>3 Months Ended December 31, 2007</b>	<b>12 Months Ended December 31, 2008</b>	<b>12 Months Ended December 31, 2007</b>
<b>Area</b>				
Atlee-Buffalo	-	-	-	-
Claresholm	88	107	51	61
Edson	15	17	19	18
Saxon	1	2	1	-
<b>Total</b>	<b>104</b>	<b>126</b>	<b>71</b>	<b>79</b>

7 (5.4 net) natural gas wells were drilled at Claresholm. All but 1 (0.6 net) were put on stream by year end. This together with the purchase of 3 (1.2 net) wells from an industry partner more than offset normal production declines, the effect of a plant turnaround in the fourth quarter at Claresholm and bitter cold in December that curtailed production in the fourth quarter.

Oil production increased because 3 (3 net) oil wells were drilled in the new Barons oil project that was initiated in the Claresholm area in 2008. Argosy believes that this project is extensive but the project will entail water flooding to realize its full potential. Drilling was curtailed soon after the project was initiated due to the dramatic decrease in oil prices in the fourth quarter of 2008.

The gas wells that were added in 2008 produced gas that was lower in liquids content than those that were on production. Thus, natural declines were greater than the natural gas production that was added through the drill bit.

**Product Prices****Natural Gas Prices (\$/mcf)**

	<b>3 Months Ended December 31, 2008</b>	<b>3 Months Ended December 31, 2007</b>	<b>12 Months Ended December 31, 2008</b>	<b>12 Months Ended December 31, 2007</b>
<b>Area</b>				
Atlee-Buffalo	6.91	6.20	8.56	6.25
Claresholm	7.45	6.95	8.94	6.73
Edson	7.25	6.98	8.97	6.50
Saxon	7.80	7.03	9.58	6.46
<b>Average Price</b>	<b>7.44</b>	<b>6.95</b>	<b>8.96</b>	<b>6.70</b>

In 2008, AECO daily index prices averaged \$8.62 / mcf (2007 - \$6.84 / mcf) and the AECO monthly index averaged \$8.61 (2007 - \$7.00). Argosy made adjustments to its marketing arrangements in 2007, the full affect of which was realized in 2008. Liquids are recombined to Company production giving it a higher heating content thereby increasing the prices that are received. A liquids storage facility was added to the Claresholm gas processing facility in 2007. This allows the Company to sell some of the natural gas liquids rather than recombine them. As a result, Claresholm natural gas prices tend to be slightly lower from time to time when the liquids are not recombined.

**Crude Oil Sales Prices (\$/bbl)**

<b>Area</b>	<b>3 Months</b>	<b>3 Months</b>	<b>12 Months</b>	<b>12 Months</b>
	<b>Ended</b>	<b>Ended</b>	<b>Ended</b>	<b>Ended</b>
	<b>December 31,</b>	<b>December 31,</b>	<b>December 31,</b>	<b>December 31,</b>
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Atlee-Buffalo	-	-	-	-
Claresholm	54.69	118.18	81.80	-
Edson	-	-	-	-
Saxon	-	-	-	-
Average Price	54.69	118.18	81.80	-

Crude oil prices in general rose during the first half of 2008 on the back of geopolitical tensions and a perceived growth in demand. That trend reversed itself for the rest of the year. The increase in oil prices in the first half of 2008 was partially offset by an increase in the Canadian dollar. The Canada US exchange rate also reversed its direction and partially offset the decrease in oil prices. Edmonton par prices averaged \$102.13 / bbl for the year (\$76.35 in 2007). Unfortunately, the Claresholm wells were put on stream later in the third quarter thus missing the record prices that were enjoyed earlier in the year. In the past, the minor amount of production that was classified as oil production from the Claresholm area was extremely light condensate, extracted from the natural gas stream. As a result of its market value, the condensate attracted higher prices. The oil steam in 2008 is comprised of more conventional oil production from the Company's new Barons oil project.

**Natural Gas Liquids (NGL) Sales Prices (\$/bbl)**

<b>Area</b>	<b>3 Months</b>	<b>3 Months</b>	<b>12 Months</b>	<b>12 Months</b>
	<b>Ended</b>	<b>Ended</b>	<b>Ended</b>	<b>Ended</b>
	<b>December 31,</b>	<b>December 31,</b>	<b>December 31,</b>	<b>December 31,</b>
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Atlee-Buffalo	-	-	-	-
Claresholm	50.94	70.66	81.42	73.45
Edson	48.19	70.71	86.10	63.04
Saxon	77.13	79.98	113.75	81.30
Average Price	50.88	70.78	83.22	69.06

Natural gas liquid prices, except for those for ethane, moved in tune with oil prices. Saxon natural gas liquids contain more condensate than those in Edson and Claresholm, and thereby attract higher prices.

**Revenue  
Total Sales  
(\$ thousands)**

	<b>3 Months Ended December 31, 2008</b>	<b>3 Months Ended December 31, 2007</b>	<b>12 Months Ended December 31, 2008</b>	<b>12 Months Ended December 31, 2007</b>
<b>Oil</b>	179	17	1,315	7
<b>NGL</b>	485	821	2,150	2,061
<b>Gas</b>	4,103	3,726	17,240	12,503
<b>Processing</b>	-	131	91	218
<b>Total</b>	4,767	4,695	20,796	14,789

**Natural Gas Sales Revenue  
(\$ thousands)**

<b>Area</b>	<b>3 Months Ended December 31, 2008</b>	<b>3 Months Ended December 31, 2007</b>	<b>12 Months Ended December 31, 2008</b>	<b>12 Months Ended December 31, 2007</b>
Atlee-Buffalo	14	26	111	89
Claresholm	3,748	3,230	15,201	10,682
Edson	238	307	1,331	1,530
Saxon	103	163	597	202
<b>Total</b>	4,103	3,726	17,240	12,503

The increase in natural gas sales revenue is mainly due to increased prices. Volumes increased because of new wells that were drilled and put on stream plus production from 3 (1.2 net) wells purchased from an industry partner in 2008 more than offset normal production declines, a plant turnaround in the fourth quarter and bitter cold weather in December that hampered operations.

For the year, natural gas prices received increased approximately 34% while natural gas volumes increased approximately 3%. For the last quarter, prices in 2008 were 7% higher while volumes were 3% higher.

**Crude Oil Sales Revenue**  
(\$ thousands)

	<b>3 Months</b>	<b>3 Months</b>	<b>12 Months</b>	<b>12 Months</b>
	<b>Ended</b>	<b>Ended</b>	<b>Ended</b>	<b>Ended</b>
	<b>December 31,</b>	<b>December 31,</b>	<b>December 31,</b>	<b>December 31,</b>
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
<b>Area</b>				
Atlee-Buffalo	-	-	-	-
Claresholm	179	16	1,315	7
Edson	-	-	-	-
Saxon	-	1	-	-
<b>Total</b>	<b>179</b>	<b>17</b>	<b>1,315</b>	<b>7</b>

The 3 new oil wells that were drilled and put on stream plus the 3 (1.2 net) wells purchased from an industry partner in the Claresholm area caused oil revenues to increase. Prior production comprised a minor amount of very light oil that was extracted from the natural gas liquid stream.

**Natural Gas Liquids (NGL) Sales Revenue**  
(\$ thousands)

	<b>3 Months</b>	<b>3 Months</b>	<b>12 Months</b>	<b>12 Months</b>
	<b>Ended</b>	<b>Ended</b>	<b>Ended</b>	<b>Ended</b>
	<b>December 31,</b>	<b>December 31,</b>	<b>December 31,</b>	<b>December 31,</b>
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
<b>Area</b>				
Atlee-Buffalo	-	-	-	-
Claresholm	415	698	1,524	1,633
Edson	61	112	571	413
Saxon	9	11	55	15
<b>Total</b>	<b>485</b>	<b>821</b>	<b>2,150</b>	<b>2,061</b>

**Processing Revenue**  
(\$ thousands)

	<b>3 Months</b>	<b>3 Months</b>	<b>12 Months</b>	<b>12 Months</b>
	<b>Ended</b>	<b>Ended</b>	<b>Ended</b>	<b>Ended</b>
	<b>December 31,</b>	<b>December 31,</b>	<b>December 31,</b>	<b>December 31,</b>
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
<b>Area</b>				
Atlee-Buffalo	-	-	-	-
Claresholm	-	131	91	218
Edson	-	-	-	-
Saxon	-	-	-	-
<b>Total</b>	<b>-</b>	<b>131</b>	<b>91</b>	<b>218</b>

Processing fees are charged to third parties utilizing Argosy facilities. Argosy bought out its partner in the Claresholm wells from which it derived processing revenue.

**Royalties**  
(\$ thousands)

Area	3 Months		3 Months		12 Months		12 Months	
	Ended		Ended		Ended		Ended	
	December 31,		December 31,		December 31,		December 31,	
	2008		2007		2008		2007	
	Total \$	Rate	Total \$	Rate	Total \$	Rate	Total \$	Rate
Atlee-Buffalo	1	7%	3	11%	12	3%	9	10%
Claresholm	1,001	23%	706	19%	4,201	23%	2,644	21%
Edson	71	28%	43	10%	138	8%	116	6%
Saxon	44	14%	33	19%	97	15%	47	22%
Total	1,117	23%	785	17%	4,448	21%	2,816	19%

Crown royalties were \$1,081,000 for the fourth quarter 2008 and \$4,246,000 for the year ended December 31, 2008. Total gross overriding royalties were \$30,000 and \$196,000 respectively, and freehold royalties totaled \$6,000 and \$6,000 respectively.

The Edson wells enjoyed royalty relief until late 2008 at which time threshold amounts were reached and royalties became eligible. Otherwise royalty rates remained roughly comparable to 2007.

**Production and Transportation Expenses**  
(\$ thousands except per boe information)

Area	3 Months		3 Months		12 Months		12 Months	
	Ended		Ended		Ended		Ended	
	December 31,		December 31,		December 31,		December 31,	
	2008		2007		2008		2007	
	\$	\$/boe	\$	\$/boe	\$	\$/boe	\$	\$/boe
Atlee-Buffalo	1	3.81	5	7.35	28	12.71	38	16.07
Claresholm	659	6.92	256	2.91	1,707	5.35	958	3.34
Edson	58	8.42	148	16.66	375	11.94	530	11.56
Saxon	56	24.02	51	12.67	133	12.27	63	11.73
Total	774	7.38	460	4.55	2,243	6.17	1,589	4.66

Production and transportation expenses increased in 2008 because the Company did a major plant turn around in the fourth quarter 2008 that was not required in 2007. Many of the wells in the Claresholm field are requiring more attention as they age. The Claresholm infrastructure also requires more attention as it ages and is extended. The prices of goods and services, that are required to conduct operations also increased during 2008 as high commodity prices led to shortages of labor and materials.

### *Field and Corporate Netbacks*

Field Netback (\$/boe)	3 Months	3 Months	12 Months	12 Months
	Ended	Ended	Ended	Ended
Area	December 31,	December 31,	December 31,	December 31,
	2008	2007	2008	2007
Atlee-Buffalo	34.84	25.81	37.34	17.51
Claresholm	28.04	35.62	38.46	31.15
Edson	23.55	25.51	44.00	11.56
Saxon	17.31	22.69	38.71	19.78
Field Netback	27.48	34.14	38.92	30.44

Field netbacks for the fourth quarter decreased from those enjoyed in the previous three quarters because of decreased commodity prices and increased operating costs. Field netbacks for the year increased because of higher commodity prices that were enjoyed in the second and third quarters offset in part by higher field costs and falling prices in the fourth quarter.

Corporate Netback (\$ thousands)	3 Months	3 Months	12 Months	12 Months
	Ended	Ended	Ended	Ended
	December 31,	December 31,	December 31,	December 31,
	2008	2007	2008	2007
Field Netback	2,877	3,341	13,821	10,450
General and Administrative	1,491	377	3,177	1,085
Corporate Netback	1,386	2,964	10,644	9,365

Corporate netbacks increased for the year because of increased commodity prices. These were offset in part by higher operating costs, falling prices in the fourth quarter and higher interest and general and administrative costs.

## *General and Administrative Expense*

(\$ thousands)	3 Months	3 Months	12 Months	12 Months
	Ended	Ended	Ended	Ended
	December 31,	December 31,	December 31,	December 31,
	2008	2007	2008	2007
Salary & Benefits	637	262	1,950	802
General Office Expenses	948	177	1,494	528
	1,585	439	3,444	1,330
Recoveries	(94)	(61)	(267)	(245)
Total	1,491	378	3,177	1,085

General and administrative expenses for the year ended December 31, 2008 and for the first nine months of 2008 were carved out of the total general and administrative expenses of Accrete. The general and administrative expenses that were formerly incurred by Accrete were allocated between Argosy and Accrete on basis of relative production volumes. As the production volumes allocated to Argosy comprised 32.5% of total production for 2007, 32.5% of Accrete's general and administrative expenses were allocated to Argosy. A similar calculation was made for the period ended September 30, 2008. Effective October 1, 2008, Argosy bore all of the overhead that had formerly been incurred by Accrete because it retained all of the employees and assumed the office space and other normal administrative costs of Accrete. Accordingly, the comparison between periods is not meaningful.

Approximately \$278,000 (\$271,000 in 2007) of direct salary costs related to geological and geophysical personnel have been capitalized. No other salary or overhead charges are capitalized. Normal office expenses increased in line with inflationary pressure. Argosy incurred approximately \$530,000 of start up costs after the closing of the Arrangement.

## *Interest Expense*

Argosy utilized its operating line of credit and cash flow to fund its 2008 capital program.

Interest expense for periods ending prior October 1, 2008 is similar to general and administrative expense in that it was carved out of that which was incurred by Accrete. The carve out, in this case, was based on the relative cash requirements for the carved out properties relative to the total cash requirements of Accrete. The Arrangement imposed a formula for the calculation of the bank debt assumed by Argosy that had no relation to the historical funding requirements for the properties that were carved out.

As such, a comparison between periods is not meaningful.

## *Stock-Based Compensation*

Stock-based compensation is accounted for using the fair value method. Under the fair value method of accounting, this compensation expense is recorded in the earnings statement over the vesting period.

The fair value of the options granted to December 31, 2008 was estimated to be \$ 1,175,000 (\$2.03 per option granted).

This value is charged to stock based compensation cost over the vesting period. A total of \$383,000 was charged in the fourth quarter and \$453,000 for the year ended December 31, 2008.

### ***Depletion Depreciation & Accretion***

Depletion, depreciation and accretion of the asset retirement obligation for the three and twelve month period ended December 31, 2008 totaled \$2,420,000 or \$23.46/Boe, and \$7,685,000 or \$21.16/Boe respectively. This compares to 2007 charges of \$3,142,000 or \$31.13/boe and \$6,329,000 and \$18.60/boe for the equivalent 3 and 12 month periods.

Costs of \$8,728,000 relating to unproved properties have been excluded from costs subject to depletion for the 12 month period ended December 31, 2008. This included the costs of undeveloped land such as that at Ansell and Saxon that has been purchased at land sales for future exploitation.

### ***Income Taxes***

In the fourth quarter of 2008, the company recorded an income tax recovery of \$316,000.

Argosy has approximately \$43 million of income tax pools at December 31, 2008 and does not anticipate being cash taxable in 2009.

### ***Cash Flow***

Cash flow from operations for the three months ended December 31, 2008 was \$1,164,000 (\$0.20 per share) and \$8,354,000 (\$1.43 per share) for the twelve months ended December 31, 2008.

### ***Capital Expenditures***

Capital expenditures for the twelve months ending December 31, 2008:

<b>(\$ thousands)</b>	<b>12 Months Ended December 31, 2008 \$</b>	<b>3 Months Ended December 31, 2008 \$</b>	<b>3 Months Ended September 30, 2008 \$</b>	<b>3 Months Ended June 30, 2008 \$</b>	<b>3 Months Ended March 31, 2008 \$</b>
Drilling and Completions	10,982	4,344	2,621	2,273	1,744
Geology and Geophysical	2,518	95	222	101	2,100
Equipping and Tie-Ins	2,336	776	808	589	163
Land	1,176	10	-	820	346
Property Acquisitions and Dispositions (net)	6,058	808	(198)	5,448	-
Office Equipment	47	18	18	1	10
<b>Total Cash Expenditures</b>	<b>23,117</b>	<b>6,051</b>	<b>3,471</b>	<b>9,232</b>	<b>4,363</b>

During the fourth quarter the Company drilled 3 gas wells (2.2 net). A success rate of 100% was achieved. For the year, the Company has drilled 14 wells (11.6 net) comprising 3 (3 net) oil wells, 10 (7.6 net) gas wells and 1 (1) dry hole.

## ***Liquidity and Capital Resources***

	\$ <u>(thousands)</u>
2008 Exploration and development program funding	
Cash, Beginning of Year	-
Cash flow from operations	8,354
Change in non-cash working capital	2,025
Increase in Bank Debt	(14,316)
Due to Accrete	(13,067)
Share Issuance	40,121
Cash, end of period	-
<hr/> Net capital expenditures	<hr/> 23,117

The current period of economic slowdown and low commodity prices may limit the Company's ability to make investments in drilling and exploration activities. Commodity prices and production volumes have a large impact on the ability of the Company to generate adequate cash flow. A prolonged period of low commodity prices would negatively affect cash flow from operations that would likely result in a reduction in the amount of cash flow available for investment in drilling programs which would in turn negatively impact future production volumes. A prolonged period of low commodity prices may also affect the availability of funds that might be available by way of bank financing because the bank financing is dependent on the value of the Company's reserves. The value of the company's reserves would be negatively impacted by commodity pricing and lower production volumes.

The Company has elected to limit its drilling activities to a level that would potentially maintain current production levels, meet its flow through commitment and preserve capital. It will continue its geological and geophysical activities with a view to capitalizing on them when the economy turns.

The Company will continue to strive for higher operating efficiencies and take advantage of lowered costs that may be available to it due to the economic downturn.

Argosy intends to fund its capital expenditure program from internally generated cash flow, debt, and new equity or other funding if available on favorable terms.

At December 31, 2008 the Company's credit facility comprised a Revolving Operating Demand Loan facility with a credit limit of \$22,000,000 and an Acquisition/Development Demand Loan with a credit limit of \$9,000,000.

The Revolving Operating Demand Loan bore interest at bank prime plus one eighth percent and has no specific terms of repayment aside from the bank's right of demand and periodic review. A covenant to the Revolving Operating Demand Loan facility requires that the Company maintain a working capital ratio, exclusive of bank indebtedness, of at least 1 to 1. For purposes of this calculation, the undrawn availability under the facility is added to current assets. The Company is in compliance with this debt covenant at December 31, 2008.

The Revolving Operating Demand Loan bore interest at bank prime plus one eighth percent and has no specific terms of repayment aside from the bank's right of demand and periodic review.

The Acquisition/Development Demand Loan bore interest at bank prime rate plus one half percent and required monthly principal payments of \$400,000 with repayments commencing the month following drawdown and was also subject to the Bank's right of demand and periodic review.

Subsequent to December 31, 2008, the Company's credit facility was reviewed by the Bank and the \$22 million Revolving Operating Demand Loan and the \$9 million Acquisition / Development Demand Loan were replaced with a Revolving Operating Demand Loan with a credit limit of \$29 million and an Acquisition / Development Demand Loan with a credit limit of \$2 million.

The Revolving Operating Demand Loan is subject to the Bank's right of demand and periodic review and bears interest at Bank prime plus a percentage determined in accordance with the bank's pricing grid. The Bank's pricing grid is dependent on the Company's debt to cash flow ratio. At this time it is expected that the application of the Bank's pricing grid will result in a rate which is 0.75% greater than the Bank's prime rate.

The Acquisition/Development Demand Loan is also subject to the Bank's right of demand and periodic review, requires unspecified monthly principal repayments over the engineering half life of the reserves being financed as determined by the Bank, bears interest at a rate which is 0.25% higher than the Revolving Operating Demand Loan and has a standby fee of one quarter of one percent of the undrawn portion of the credit.

The next Bank review is scheduled for June 1, 2009.

See the caption entitled "*Risks*" for further items that could affect liquidity.

### ***Risk Management***

The Company's business, exploration for and development of crude oil and natural gas is inherently risky. There can be no guarantee that crude oil and natural gas can be found and produced on an economic basis.

In order to mitigate that risk, the Company operates in areas in which it has technical and operating expertise. The Company uses the latest technology to further reduce risk and increase the probability of success.

The Company carries insurance to protect itself from catastrophic events and it reviews its coverage at least annually to ensure that the insurance policies that are in place are adequate. The company follows all environmental and industry regulations and has instituted formal procedures to ensure that this occurs. Such procedures are communicated to all personnel and contractors.

The Company's operations are funded through internally generated cash flow, debt and new equity if available on favorable terms.

Cash flow can be materially affected by fluctuations in commodity prices and foreign currency which are out of the Company's control. The Company may use financial instruments that are derivative contracts classified as "held for trading" to manage volatility of commodity gas prices from time to time. Argosy and Accrete did not enter into any contracts that would have mitigated its exposure to foreign currency but Accrete entered into various contracts that were intended to reduce its exposure to fluctuations in commodity prices during 2008. These were derivative contracts classified as "held for trading". These contracts were scheduled to expire in October 2008 but were unwound prior to September 30, 2008.

The aggregate realized loss for 2008 from these contracts was \$804,000 of which \$284,000 was allocated to the properties that were transferred to Argosy as a result of the Arrangement. This allocation was made on basis of the ratio of the production volumes from those properties to the total production of Accrete.

There were no such contracts open at December 31, 2008.

The Company operates all of its production and this allows it to a great extent to control the timing and costs in the areas in which it operates. Programs can thus be expanded or contracted on a timely basis in response to changing parameters.

In this time of extreme market volatility, Argosy intends to limit its drilling activities to a level that would potentially maintain current production levels, preserve capital and manage its borrowings. See also "*Liquidity and Capital Resources*".

## ***Outlook***

The global financial crisis has caused a deterioration of the condition of credit markets and extreme volatility in commodity markets. In these uncertain times, the Company has chosen to limit its drilling activities to a level that would potentially maintain current production levels and preserve capital.

## ***Sensitivities***

The Company's performance is affected by factors such as changes in production volumes, commodity prices and interest rates.

The following table illustrates the impact on cash flows and net earnings as a result of changes in commodity prices and interest rates based on forecast cash flows and capital expenditures of between \$6 and \$8 Million for 2009:

\$ Thousand	Cash Flow and Pretax Earnings
<hr/>	
Impact on the year ended December 31, 2008	
Change in Canadian crude oil by \$1/ bbl	15
Change in field gate price of Natural Gas by \$1/ mcf	2,131
Change in Natural Gas Liquids price by \$1/ bbl	285
Change of 1% in prime interest rates	285

## ***Critical Accounting Estimates***

### **Oil and Gas Accounting**

The Company follows the full-cost method of accounting whereby all costs related to the acquisition, exploration and development of petroleum and natural gas properties, net of government incentives, are capitalized. Such costs include lease acquisition costs, geological and geophysical expenditures, costs of drilling both productive and non-productive wells and related plant and production equipment costs.

Proceeds on disposition of petroleum and natural gas properties are accounted for as a reduction of capitalized costs with no gains or losses recognized unless such disposition results in a change of 20% or more in the depletion rate.

Capitalized costs, together with estimated future capital costs associated with proved reserves are depleted and depreciated using the unit-of-production method based on estimated gross proved reserves of petroleum and natural gas as determined by independent engineers. For purposes of this calculation, reserves and production are converted to equivalent units of oil based on the relative energy content of six thousand cubic feet of natural gas to one barrel of oil. Unproved properties are excluded from the depletion base until it is determined whether proved reserves are attributable to the properties or impairment occurs.

The net amount at which petroleum and natural gas properties are carried is subject to a cost recovery test (the “ceiling test”).

Oil and gas assets are evaluated at least annually to determine that the costs are recoverable and do not exceed the fair value of the properties. The costs are assessed to be recoverable if the sum of the undiscounted cash flows expected from the production of proved reserves and the lower of cost and market of unproved properties exceed the carrying value of the oil and gas assets. If the carrying value of the oil and gas assets is not assessed to be recoverable, an impairment loss will be recognized to the extent that the carrying value exceeds the sum of the discounted cash flows expected from the production of proved and probable reserves and the lower of cost or market value unproved properties. The cash flows are estimated using future product prices and costs and are discounted using the risk free rate.

The Company records a liability for the fair value of legal obligations associated with the retirement of long-lived assets in the period in which they are incurred, normally when the asset is purchased or developed. On recognition of the liability, there is a corresponding increase in the carrying amount of the related asset known as the asset retirement cost which is depleted using the unit-of- production method. The liability is adjusted in each reporting period to reflect the passage of time, with the accretion charged to earnings, and for revisions to the estimated future cash flows.

### **Income Taxes**

The determination of the Company’s income and other tax liabilities requires interpretation of complex laws and regulations often involving multiple jurisdictions. All tax filings are subject to audit and potential reassessment after a considerable lapse of time. Accordingly, the actual income tax liability may differ significantly from the liability estimated or recorded.

### **Other Estimates**

The accrual method of accounting requires management to incorporate certain estimates, including estimates of revenues, royalties and production costs at a specific reporting date but for which actual revenues and costs have not yet been received; and estimates on capital projects which are in progress or recently completed where actual costs have not been received at a specific reporting date.

The Company ensures that the individuals with the most knowledge of the activity are responsible for the estimate. These estimates are then reviewed for reasonableness and past estimates are compared to actual results in order to make informed decisions on future estimates.

### **Stock Based Compensation**

The Company has not incorporated an estimated forfeiture rate for stock options that will not vest and will account for actual forfeitures as they occur. The fair value of each stock option is determined at each grant date using the Black-Scholes model.

### ***Risks***

#### **Current Economic Conditions**

The period of economic slowdown, scarcity of credit and volatile capital and commodity markets that grips the globe at this time further exacerbates the risks that are hereinafter enunciated. If current conditions persist for a prolonged period of time, future results of operations, liquidity and financial condition could be materially adversely affected.

#### **Exploration, Development and Production Risks**

Oil and natural gas exploration involves a high degree of risk, which even a combination of experience, knowledge and careful evaluation may not be able to overcome. There is no assurance that expenditures made on future exploration by Argosy will result in new discoveries of oil or natural gas in commercial quantities. Without the continual addition of new reserves, any existing reserves that Argosy may have at any particular time and the production there from will decline over time as such existing reserves are depleted. It is difficult to project the costs of implementing an exploratory drilling program due to the inherent uncertainties of drilling in unknown formations, the costs associated with encountering various drilling conditions such as over pressured zones and tools lost in the hole, and changes in drilling plans and locations as a result of prior exploratory wells or additional seismic data and interpretations thereof.

The long-term commercial success of Argosy depends on its ability to find, acquire, develop and commercially produce oil and natural gas reserves. No assurance can be given that Argosy will be able to continue to locate satisfactory properties for acquisition or participation. Moreover, if such acquisitions or participations are identified, Argosy may determine that current markets, terms of acquisition and participation or pricing conditions make such acquisitions or participations uneconomic.

Future oil and gas exploration may involve unprofitable efforts, not only from dry wells, but from wells that are productive but do not produce sufficient net revenues to return a profit after drilling, operating and other costs. Completion of a well does not assure a profit on the investment or recovery of drilling, completion and operating costs. In addition, drilling hazards or environmental damage could greatly increase the cost of operations, and various field operating conditions may adversely affect the production from successful wells. These conditions include delays in obtaining governmental approvals or consents, shut-ins of connected wells resulting from extreme weather conditions, insufficient storage or transportation capacity or other geological and mechanical conditions. While diligent well supervision and effective maintenance operations can contribute to maximizing production rates over time, production delays and declines from normal field operating conditions cannot be eliminated and can be expected to adversely affect revenue and cash flow levels to varying degrees.

In addition, oil and gas operations are subject to the risks of exploration, development and production of oil and natural gas properties, including encountering unexpected formations or pressures, premature declines of reservoirs, blow-outs, cratering, sour gas releases, fires and spills. Losses resulting from the occurrence of any of these risks could have a materially adverse effect on Argosy and its future results of operations, liquidity and financial condition.

### **Prices, Markets and Marketing of Crude Oil and Natural Gas**

Oil and natural gas are commodities whose prices are determined based on world demand, supply and other factors, all of which are beyond the control of Argosy. World prices for oil and natural gas have fluctuated widely in recent years. Any material decline in prices could result in a reduction of net production revenue. Certain wells or other projects may become uneconomic as a result of a decline in world oil prices and natural gas prices, leading to a reduction in the volume of Argosy's oil and gas reserves. Argosy may also elect not to produce from certain wells at lower prices. All of these factors could result in a material decrease in Argosy's future net production revenue, causing a reduction in its oil and gas acquisition and development activities. In addition, bank borrowings available to Argosy are in part determined by the value of the underlying reserves of Argosy. A sustained material decline in prices from historical average prices could result in a significant decrease in the value of Argosy's reserves, thus reducing the bank credit available to Argosy, and could require that a portion of any existing bank debt of Argosy be repaid, may require the curtailment of capital programs and may result failure of the Company to meet its contractual obligations. In addition to establishing markets for its oil and natural gas, Argosy must also successfully market its oil and natural gas to prospective buyers. The marketability and price of oil and natural gas which may be acquired or discovered by Argosy will be affected by numerous factors beyond its control. Argosy will be affected by the differential between the price paid by refiners for light quality oil and the grades of oil produced by Argosy. The ability of Argosy to market its natural gas may depend upon its ability to acquire space on pipelines which deliver natural gas to commercial markets. Argosy will also likely be affected by deliverability uncertainties related to the proximity of its reserves to pipelines and processing facilities and related to operational problems with such pipelines and facilities and extensive

government regulation relating to price, taxes, royalties, land tenure, allowable production, the export of oil and natural gas and many other aspects of the oil and natural gas business. Argosy has limited direct experience in the marketing of oil and natural gas. Argosy employs the services of an outside marketing firm. The Company reviews the credit worthiness of that firm from time to time.

### **Substantial Capital Requirements – Liquidity**

Argosy anticipates that it could make substantial capital expenditures for the acquisition, exploration, development and production of oil and natural gas reserves in the future. If Argosy's revenues or reserves decline, the Corporation may have limited ability to expend the capital necessary to undertake or complete future drilling programs. There can be no assurance that debt or equity financing, or cash generated by operations will be available or sufficient to meet these requirements or for other corporate purposes or, if debt or equity financing is available, that it will be on terms acceptable to Argosy. Moreover, future activities may require Argosy to alter its capitalization significantly. The inability of Argosy to access sufficient capital for its operations could have a material adverse effect on Argosy's financial condition, results of operations or prospects as well as its ability to meet its flow through obligations. The current global economic slowdown, scarcity of credit and volatile capital markets may exacerbate Argosy's liquidity risk. Argosy intends to limit its drilling activities to a level that would potentially maintain current production levels, preserve capital and manage its liquidity.

### **Additional Funding Requirements**

Argosy's cash flow from its reserves may not be sufficient to fund its ongoing activities at all times. From time to time, Argosy may require additional financing in order to carry out its oil and gas acquisition, exploration and development activities. Failure to obtain such financing on a timely basis could cause Argosy to forfeit its interest in certain properties, to miss certain acquisition opportunities, to fail to meet its flow through obligations and/or to reduce or terminate its operations. If Argosy's revenues from its reserves decrease as a result of lower oil and natural gas prices or otherwise, it will affect Argosy's ability to expend the necessary capital to replace its reserves or to maintain its production. If Argosy's cash flow from operations is not sufficient to satisfy its capital expenditure requirements, there can be no assurance that additional debt or equity financing will be available to meet these requirements or available on terms acceptable to Argosy. This risk is also particularly important given the current economic slowdown, scarcity of credit and volatile capital markets.

### **Insurance**

Argosy's involvement in the exploration for and development of oil and gas properties may result in Argosy becoming subject to liability for pollution, blow-outs, property damage, personal injury or other hazards. Although Argosy has obtained insurance in accordance with industry standards to address such risks, such insurance has limitations on liability that may not be sufficient to cover the full extent of such liabilities. In addition, such risks may not, in all circumstances be insurable or, in certain circumstances, Argosy may elect not to obtain insurance to deal with specific risks due to the high premiums associated with such insurance or other reasons. The payment of such uninsured liabilities would reduce the funds available to Argosy. The occurrence of a significant event that Argosy is not fully insured against, or the insolvency of the insurer of such event, could have a material adverse effect on Argosy's financial position, results of operations or prospects.

## **Competition**

Argosy actively competes for reserve acquisitions, exploration leases, licenses and concessions and skilled industry personnel with a substantial number of other oil and gas companies, many of which have significantly greater financial resources than Argosy. Argosy's competitors include major integrated oil and natural gas companies and numerous other independent oil and natural gas companies and individual producers and operators

The oil and gas industry is highly competitive. Argosy's competitors for the acquisition, exploration, production and development of oil and natural gas properties, and for capital to finance such activities, include companies that have greater financial and personnel resources available to them than Argosy. Certain of Argosy's customers and potential customers are themselves exploring for oil and natural gas, and the results of such exploration efforts could affect Argosy's ability to sell or supply oil or gas to these customers in the future. Argosy's ability to successfully bid on and acquire additional property rights, to discover reserves, to participate in drilling opportunities and to identify and enter into commercial arrangements with customers will be dependent upon developing and maintaining close working relationships with its future industry partners and joint operators and its ability to select and evaluate suitable properties and to consummate transactions in a highly competitive environment.

## **Environmental Risks**

All phases of the oil and natural gas business present environmental risks and hazards and are subject to environmental regulation pursuant to a variety of international conventions and state and municipal laws and regulations. Environmental legislation provides for, among other things, restrictions and prohibitions on spills, releases or emissions of various substances produced in association with oil and gas operations. The legislation also requires that wells and facility sites be operated, maintained, abandoned and reclaimed to the satisfaction of applicable regulatory authorities. Compliance with such legislation can require significant expenditures and a breach may result in the imposition of fines and penalties, some of which may be material. Environmental legislation is evolving in a manner expected to result in stricter standards and enforcement, larger fines and liability and potentially increased capital expenditures and operating costs. The discharge of oil, natural gas or other pollutants into the air, soil or water may give rise to liabilities to foreign governments and third parties and may require Argosy to incur costs to remedy such discharge. No assurance can be given that environmental laws will not result in a curtailment of production or a material increase in the costs of production, development or exploration activities or otherwise adversely affect Argosy's financial condition, results of operations or prospects. In addition, Argosy has agreed to certain indemnities in respect to potential environmental liabilities related to assets retained by Argosy for a period of one year from the closing date of the Arrangement.

## **Kyoto Protocol**

Canada is a signatory to the United Nations Framework Convention on Climate Change. Canada has ratified the Kyoto Protocol established there under. The Kyoto Protocol came into force February 16, 2005. Annex B parties to the Kyoto Protocol, which includes Canada, are required to establish legally binding targets to reduce nation-wide emissions of carbon dioxide, methane, nitrous oxide and other so-called "greenhouse gases". Argosy's exploration and production facilities and other operations and activities emit a small amount of greenhouse gases which may subject Argosy to legislation in Canada regulating emissions of greenhouse gases. Future Canadian federal legislation, together with provincial emission reduction requirements may require the reduction of emissions or emissions intensity from Argosy's operations and facilities. The direct and indirect costs of complying with these emissions regulations may adversely affect the business of Argosy.

## **Reserve Replacement**

Argosy's future oil and natural gas reserves, production, and cash flows to be derived there from are highly dependent on Argosy successfully acquiring or discovering new reserves. Without the continual addition of new reserves, any existing reserves Argosy may have at any particular time and the production there from will decline over time as such existing reserves are exploited. A future increase in Argosy's reserves will depend not only on Argosy's ability to develop any properties it may have from time to time, but also on its ability to select and acquire suitable producing properties or prospects.

The current economic climate may curtail Argosy's ability to access the capital required to do so – see "Liquidity and Capital Resources". Further, there can be no assurance that Argosy's future exploration and development efforts will result in the discovery and development of additional commercial accumulations of oil and natural gas.

## **Reliance on Operators and Key Employees**

Argosy business strategy has been to operate its oil and gas properties. However, to the extent Argosy is not the operator of its oil and gas properties, Argosy will be dependent on such operators for the timing of activities related to such properties and will largely be unable to direct or control the activities of the operators.

The success of Argosy will be largely dependent upon the performance of its management and key employees. Argosy does not have any key man insurance policies, and therefore there is a risk that the death or departure of any member of management or any key employee could have a material adverse effect on Argosy.

## **Corporate Matters**

To date, Argosy has not paid any dividends on its common shares and may not pay dividends on them in the future. Certain of the directors and officers of Argosy are also directors and officers of other oil and gas companies involved in natural resource exploration and development, and conflicts of interest may arise between their duties as officers and directors of Argosy and as officers and directors of such other companies. Such conflicts must be disclosed in accordance with, and are subject to such other procedures and remedies as applicable under, the Business Corporations Act (Alberta).

## **Permits and Licenses**

The operations of Argosy may require licenses and permits from various governmental authorities. There can be no assurance that Argosy will be able to obtain all necessary licenses and permits that may be required to carry out exploration and development at its projects.

## **Issuance of Debt**

From time to time Argosy may enter into transactions to acquire assets or the shares of other corporations. These transactions may be financed partially or wholly with debt, which may increase Argosy's debt levels above industry standards. Neither Argosy's articles nor its by-laws limit the amount of indebtedness that Argosy may incur. The level of Argosy's indebtedness from time to time could impair Argosy's ability to obtain additional financing in the future on a timely basis to take advantage of business opportunities that may arise. The results could have material adverse effects given the current economic slowdown, scarcity of capital and volatile capital markets.

In this time of extreme market volatility, Argosy intends to limit its drilling activities to a level that would potentially maintain current production levels, preserve capital and manage its borrowings.

## **Dilution**

Argosy may make future acquisitions or enter into financing or other transactions involving the issuance of securities of Argosy which may be dilutive.

## **Title to Properties**

Although title reviews will be done according to industry standards prior to the purchase of most oil and natural gas producing properties or the commencement of drilling wells, such reviews do not guarantee or certify that an unforeseen defect in the chain of title will not arise to defeat the claim of the Corporation which could result in a reduction of the revenue received by the Corporation.

## **Aboriginal Claims**

Aboriginal peoples have claimed aboriginal title and rights to portions of western Canada. Argosy is not aware that any claims have been made in respect of its property and assets, however, if a claim arose and was successful this could have an adverse effect on Argosy and its operations.

## **Delays in Business Operations**

In addition to the usual delays in payments by purchasers of oil and natural gas to Argosy or to the operators, and the delays by operators in remitting payment to Argosy, payments between these parties may be delayed due to restrictions imposed by lenders, accounting delays, delays in the sale or delivery of products, delays in the connection of wells to a gathering system, adjustment for prior periods, or recovery by the operator of expenses incurred in the operation of the properties. Any of these delays could reduce the amount of cash flow available for the business of Argosy in a given period and expose Argosy to additional third party credit risks.

## **Changes in Legislation**

The return on an investment in securities of Argosy is subject to changes in Canadian federal and provincial tax laws and government incentive programs and there can be no assurance that such laws or programs will not be changed in a manner that adversely affects Argosy or the holding and disposing of the securities of Argosy.

## **Seasonality**

The level of activity in the Canadian oil and gas industry is influenced by seasonal weather patterns. Wet weather and spring thaw may make the ground unstable. Consequently, municipalities and provincial transportation departments enforce road bans that restrict the movement of rigs and other heavy equipment, thereby reducing activity levels. Also, certain oil and gas producing areas such as Saxon are located in areas that are inaccessible other than during the winter months because the ground surrounding the sites in these areas consists of swampy terrain. Seasonal factors and unexpected weather patterns may lead to declines in exploration and production activity and corresponding declines in the demand for the goods and services of Argosy.

## **Income Taxes**

To its knowledge, the Corporation believes that it is in compliance with the provisions of the Income Tax Act (Canada) and all applicable provincial tax legislation. However, income tax returns filed by Argosy may be subject to reassessment by the applicable taxation authority. In the event of a successful reassessment of the Corporation, whether by re-characterization of exploration and development expenditures or otherwise, such reassessment may have an impact on current and future taxes payable.

## **Assessments of Value of Acquisitions**

Acquisitions of oil and gas issuers and oil and gas assets are typically based on engineering and economic assessments made by independent engineers and Argosy's own assessments. Both of these assessments will include a series of assumptions regarding such factors as recoverability and marketability of oil and gas, future prices of oil and gas and operating costs, future capital expenditures and royalties and other government levies which will be imposed over the producing life of the reserves. Many of these factors are subject to change and are beyond Argosy's control. In particular, the prices of and markets for oil and natural gas products may change from those anticipated at the time of making such assessment. In addition, all such assessments involve a measure of geologic and engineering uncertainty which could result in lower production and reserves than anticipated. Initial assessments of acquisitions may be based on reports by a firm of independent engineers that are not the same as the firm that Argosy uses for its year end reserve evaluations. Because each of these firms may have different evaluation methods and approaches, these initial assessments may differ significantly from the assessments of the firm used by Argosy. Any such instance may offset the return on and value of the Argosy shares.

## **Accounting Write-Downs as a Result of GAAP**

Canadian Generally Accepted Accounting Principles ("GAAP") requires that management apply certain accounting policies and make certain estimates and assumptions which affect reported amounts in Argosy's financial statements. The accounting policies may result in non-cash charges to net income and write-downs of net assets in the financial statements. Such non-cash charges and write-downs may be viewed unfavorably by the market and result in an inability to borrow funds and may result in a decline in the trading price of the Argosy shares.

Under GAAP, the net amounts at which petroleum and natural gas costs on a property or project basis are carried are subject to a cost-recovery test which is based in part upon estimated future net cash flow from reserves. If net capitalized costs exceed the estimated recoverable amounts, Argosy will have to charge the amounts of the excess to earnings. A decline in the net value of oil and natural gas properties could cause capitalized costs to exceed the cost ceiling, resulting in a charge against earnings.

Hedge accounting and accounting for derivative financial instruments may result in non-cash charges against net income as a result of changes in the fair market value of hedging instruments. A decrease in the fair market value of the hedging instruments as a result of fluctuations in commodity prices and foreign exchange rates may result in a write-down of net assets and a non-cash charge against net income. Such write-downs and non-cash charges may be temporary in nature if the fair market value subsequently increases.

## **Borrowing**

Argosy's Bank has been provided with security over substantially all of the assets of Argosy. The Bank reviews the engineering values underlying such security from time to time using its own forecast of commodity prices and production. A sustained decline in prices could reduce the value of the Bank's security thereby reducing the amount of credit available to the Company and could possibly result in a portion of the bank indebtedness to be repaid. Furthermore, there is a risk that the lines of credit may not be renewed on terms that would be favorable to the Company, if at all. This risk is also particularly important given the current economic slowdown, scarcity of credit and volatile capital markets. Argosy intends to limit its drilling activities to a level that would potentially maintain current production levels, preserve capital and manage its borrowings.

If Argosy becomes unable to pay its debt service charges or otherwise commits an event of default, such as bankruptcy, or if the value of the underlying security, as determined by the Bank, is less than that which would be acceptable to it, the Bank may demand payment and it may foreclose on or sell Argosy's properties. The proceeds of any such sale would be applied to satisfy amounts owed to Argosy's Bank and other creditors and only the remainder, if any, would be available to Argosy.

### **Third Party Credit Risk**

Argosy is or may be exposed to third party credit risk through its contractual arrangements with its current or future joint venture partners, marketers of its petroleum and natural gas production and other parties. In the event such entities fail to meet their contractual obligations to Argosy, such failures could have a material adverse effect on Argosy and its cash flow from operations. Argosy mitigates third party risk by controlling the operation of all of its properties. It reviews the credit worthiness of its marketer periodically.

### ***Changes in Legislation***

#### **Alberta Royalties**

On October 25, 2007, the Government of Alberta released its New Royalty Framework (“NRF”) which is to be the basis of royalty regulations that became effective on January 1, 2009. The NRF imposes a regime whereby Alberta Crown Royalty rates are based on production rates, well depths and commodity prices.

The NRF includes a shallow rights reversion policy whereby mineral rights to shallow gas formations that are not being developed would revert back to the Government of Alberta and would be available for lease.

On April 10, 2008 the Government of Alberta introduced new 5 year programs that offered incentives to continue to explore for deeper targets. Under these programs, exploration oil wells over 2,000 meters and similar program for gas wells drilled to depths of 2,500 meters or greater may qualify for 12 months royalty credits to a maximum of \$1 million.

On November 19, 2008, the Government of Alberta announced a five year program of transitional royalty rates. Under this program, new natural gas or conventional oil wells that are drilled between November 19, 2008 and December 13, 2013 and that are drilled to depths between 1,000 and 3,500 meters will be given a one time option, on a well by well basis, to elect to pay royalties under the NRF or the transitional rates.

.On March 3, 2009, the Government of Alberta announced an incentive program that would provide a \$200 per meter drilled royalty credit to companies on a sliding scale based on their production levels for the previous year. In addition, a new well incentive program was announced that would offer a maximum five-percent royalty rate for the first year of production from new oil or gas wells.

The NRF will have the effect of increasing the royalties on the Company’s existing production. The incentive programs announced on April 10, 2008 and March 3, 2009 the transitional program announced on November 19, 2008 may reduce royalty costs for 2009 to the extent that qualifying wells are drilled in 2009. Such reductions will be based on drilling activity. The current economic slowdown and low commodity price regime may limit the Company’s ability to take full advantage of the incentive programs. See “Liquidity and Capital Resources”.

#### **Greenhouse Gas and Air Emissions Legislation**

The Federal Government released on April 26, 2007, its Action Plan to Reduce Greenhouse Gases and Air Pollution (the “Action Plan”), also known as ecoACTION and which includes the Regulatory Framework for Air Emissions. This Action Plan covers not only large industry, but regulates the fuel efficiency of vehicles and the strengthening of energy standards for a number of energy-using products. Regarding large industry and industry related projects, the Government’s Action Plan intends to achieve the following: (i) an absolute reduction of 150 megatonnes in greenhouse gas emissions by 2020 by imposing mandatory targets; and (ii) air pollution from industry is to be cut in half by 2015 by setting certain targets. New facilities using cleaner fuels and technologies will have a grace period of three years. In order to facilitate companies’ compliance with the Action Plan’s requirements, while at the same time allowing them to be cost-effective, innovative and adopt cleaner technologies, certain options are provided. These are: (i) in-

house reductions; (ii) contributions to technology funds; (iii) trading of emissions with below-target emission companies; (iv) offsets; and (v) access to Kyoto's Clean Development Mechanism.

On March 8, 2007, the Alberta Government introduced Bill 3, the Climate Change and Emissions Management Amendment Act, which intends to reduce greenhouse gas emission intensity from large industries. Bill 3 states that facilities emitting more than 100,000 tonnes of greenhouse gases a year must reduce their emissions intensity by 12% starting July 1, 2007; if such reduction is not initially possible the companies owning the large emitting facilities will be required to pay \$15 per tonne for every tonne above the 12% target. These payments will be deposited into an Alberta-based technology fund that will be used to develop infrastructure to reduce emissions or to support research into innovative climate change solutions. As an alternate option, large emitters can invest in projects outside of their operations that reduce or offset emissions on their behalf, provided that these projects are based in Alberta. Prior to investing, the offset reductions offered by a prospective operation must be verified by a third party to ensure that the emission reductions are real. Given the evolving nature of the debate related to climate change and the control of greenhouse gases and resulting requirements, it is not possible to predict the impact of those requirements on the Company and its operations and financial condition. Bill 3 does not currently have an impact on the Company as it does not own any facilities emitting in excess of 100,000 tonnes per year.

### ***Disclosure Controls and Internal Controls Over Financial Reporting***

Disclosure controls and procedures have been designed to ensure that information required to be disclosed by the Company is accumulated and communicated to Argosy's management as appropriate to allow timely decisions regarding required disclosure. Argosy's Chief Executive Officer and Chief Financial Officer have concluded, based on their evaluation as of the end of the period covered by the annual filings, that the Company's disclosure controls and procedures as of the end of such period are effective to provide reasonable assurance that material information related to the Company is made known to them by others within the Company.

Argosy's Chief Executive Officer and Chief Financial Officer have assessed the effectiveness of the Company's internal control over financial reporting as defined by Multilateral Instrument 52-109, *Certification of Disclosure in Issuer's Annual and Interim Filings*. This assessment was based on the framework in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations. Argosy's Chief Executive Officer and Chief Financial Officer have concluded that the Company's control over financial reporting was effective as of December 31, 2008.

Argosy's Chief Executive Officer and Chief Financial Officer are required to cause the Company to disclose herein any change in the Company's internal controls over financial reporting that occurred during the Company's most recent interim period that has materially affected, or is reasonably likely to affect, the Company's internal controls over financial reporting. No material changes in the Company's internal controls were identified during the period ended December 31, 2008 that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting. During 2008, Argosy engaged external consultants to assist in documenting and assessing the Company's internal controls over financial reporting.

It should be noted that a control system, including the Company's disclosure and internal controls and procedures, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system will be met and it should be not be expected that the disclosure and internal controls and procedures will prevent all errors or fraud.

Management acknowledges that there is a lack of segregation of duties within several of the Company's processes due to its small size. Management has identified the specific functions with the potential to compromise the Company's overall control objectives. Appropriate compensating controls have been implemented to management's satisfaction in response to the identified risks.

## ***Contractual Obligations***

The Company issued 1,208,051 common flow through shares at an issuance price of \$5.20 per share. The tax deductions related to the flow through shares issued in 2008 were renounced to flow through shareholders and booked to the accounts in February 2008. The Company will be required to spend approximately \$5,816,000 in 2009 on CEE expenditures to fulfill its flow through obligation.

As consequence of the Plan of Arrangement, Argosy has agreed to indemnify Accrete or its successors from any claims arising from liabilities not retained by Accrete, for breaches of representations and warranties of Accrete and Argosy for breaches of covenants by Accrete, which survives the effective date of the arrangement for one year.

Accrete entered into an agreement with a major drilling contractor. Accrete was obligated to utilize the contractor's rig for a period of 200 days during the one year term of the agreement that commenced August 15, 2007. Argosy has assumed this obligation pursuant to the Arrangement. The Company has estimated that a liability of up to \$500,000 could be incurred. The Company is currently negotiating the settlement of this obligation. In 2009, \$252,000 was paid to the drilling contractor as a good faith gesture, however, a further \$248,000 could be incurred should negotiations fail.

The Company has entered into various commitments related to the leasing of office premises and office equipment. The payments due under such leases are as follows:

<b>Contractual obligations (\$ thousands)</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>Thereafter</b>
Office Premises	708	708	741	808	879	
Office equipment	2	1	-	-	-	
	710	709	741	808	879	

At December 31, 2008 the Company's credit facility comprised a Revolving Operating Demand Loan facility with a credit limit of \$22,000,000 and an Acquisition/Development Demand Loan with a credit limit of \$9,000,000.

The Revolving Operating Demand Loan bore interest at bank prime plus one eighth percent and has no specific terms of repayment aside from the bank's right of demand and periodic review  
The Revolving Operating Demand Loan bore interest at bank prime plus one eighth percent and had no specific terms of repayment aside from the bank's right of demand and periodic review.

The Acquisition/Development Demand Loan bore interest at bank prime rate plus one half percent and required monthly principal payments of \$400,000 with repayments commencing the month following drawdown and was also subject to the Bank's right of demand and periodic review.

Security for these facilities include a general assignment of book debts, a \$75,000,000 debenture with a first floating charge over all assets with a negative pledge and an undertaking to provide fixed charges on the Company's major producing reserves at the request of the bank.

A covenant to the Revolving Operating Demand Loan facility requires that the Company maintain a working capital ratio, exclusive of bank indebtedness, of at least 1 to 1. For purposes of this calculation, the

undrawn availability under the facility is added to current assets. The Company is in compliance with this debt covenant at December 31, 2008.

### ***Change in Accounting Policies and Recent Accounting Pronouncements***

As of January 1, 2009, the Company will be required to adopt CICA Handbook Section 3064 “Goodwill and Intangible Assets”, which defines the criteria for the recognition of intangible assets.

On February 13, 2008, Canada’s Accounting Standards Board confirmed January 1, 2011 as the effective date for the convergence of Canadian GAAP to International Financial Reporting Standards (“IFRS”) Argosy has begun to assess the effect of adopting IFRS and has engaged independent outside consultants to assist in implementing the transition with a view to presenting an opening 2010 balance sheet.

### ***Transactions With Related Parties***

The Corporation has not entered into any transactions with related parties, nor did it have any balances outstanding with related parties at year end.

### ***Off Balance Sheet Arrangements***

The Corporation has not entered into any off-balance sheet transactions.

## MANAGEMENT'S STATEMENT OF RESPONSIBILITY

The accompanying financial statements of Argosy Energy Inc. (the "Company") are the responsibility of Management and have been approved by the Board of Directors. The financial statements have been prepared by Management in Canadian dollars and in accordance with Canadian Generally Accepted Accounting Principles and include certain estimates that reflect Management's best judgments. When alternative accounting methods exist, Management has chosen those it considers most appropriate in the circumstances. These financial statements have been prepared on a carve-out basis from Accrete Energy Inc. as described in Note 2 to the financial statements.

Management is also responsible for establishing and maintaining adequate internal control over the Company's internal control over the Company's financial reporting. The Company's internal control system was designed to provide reasonable assurance that all transactions are accurately recorded to permit preparation of financial statements in accordance with Generally Accepted Accounting Principles, and that the Company's assets are safeguarded.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal control. The Board exercises this responsibility through the Audit Committee of the Board, with assistance from the Reserve Committee of the Board regarding the annual evaluation of our petroleum and natural gas reserves. The Audit Committee meets regularly with management and the independent auditors to ensure that Management's responsibilities are properly discharged and to review the financial statements. The Audit Committee also considers, for review by the Board of Directors and approval by the shareholders, the engagement or re-appointment of the external auditors. The audit committee of the Board of Directors is comprised entirely of independent directors.

KPMG LLP was appointed by the Company's shareholders, conducts an examination of the financial statements in accordance with Canadian generally accepted auditing standards so as to express an opinion on the financial statements. KPMG LLP has full and free access to the Audit committee and Management.

*"Peter M. Salamon"*

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Peter M. Salamon  
President and Chief Executive Officer

*"Thomas R. Dalton"*

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Thomas R. Dalton  
Vice President, Finance  
& Chief Financial Officer

## **AUDITORS' REPORT TO THE SHAREHOLDERS**

We have audited the balance sheets of Argosy Energy Inc. as at December 31, 2008 and 2007 and the statements of income, comprehensive income, retained earnings and accumulated other comprehensive income, 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 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”*

Chartered Accountants  
Calgary, Canada  
March 30, 2009

**Argosy Energy Inc.**  
**Balance Sheets**

(\$ Thousands)	December 31, 2008	December 31, 2007 (note 2)
<b>ASSETS</b>		
Current assets		
Accounts receivable	3,296	3,351
Prepaid expenses	606	540
	3,902	3,891
Property and equipment (note 4)	68,192	52,844
	72,094	56,735
<b>LIABILITIES</b>		
Current liabilities		
Accounts payable and accrued liabilities	6,357	4,321
Bank indebtedness (note 5)	22,763	37,079
	29,120	41,400
Asset retirement obligation (note 7)	771	614
Future income tax (note 8)	6,171	2,735
	36,062	44,749
<b>SHAREHOLDERS' EQUITY</b>		
Share capital (note 6)	36,986	-
Net investment by Accrete in Argosy	-	11,986
Contributed surplus (note 6)	383	-
Accumulated other comprehensive income	-	-
Deficit	(1,337)	-
	36,032	11,986
	72,094	56,735

Commitments (note 11)

See accompanying notes to financial statements

Approved by the Board of Directors:

*"Peter Salamon"*

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P.Salamon

*"Brian Mellum"*

\_\_\_\_\_  
B.Mellum

**Argosy Energy Inc.**  
**Statements of Income and Comprehensive Income**

(\$ Thousands)	Year Ended December 31,	
	2008	2007
Revenue		(note 2)
Petroleum and natural gas revenue	20,796	14,789
Royalties	(4,448)	(2,816)
Realized gain/(loss) on derivative instruments	(284)	66
	16,064	12,039
Expenses		
Production expenses	1,791	1,522
Transportation expenses	452	67
General and administrative, net of recoveries	3,177	1,085
Interest Expense	2,290	2,069
Stock based compensation cost (note 6)	453	230
Depletion, depreciation and accretion	7,685	6,329
	15,848	11,302
Income before income taxes	216	737
Future income taxes (note 8)	(169)	288
Net income and comprehensive income	47	1,025
Income per share:		
Basic	0.01	0.25
Diluted	0.01	0.23

See accompanying notes to financial statements.

**Argosy Energy Inc.**  
**Statements of Retained Earnings, Comprehensive Income and Accumulated Other**  
**Comprehensive Income**

(\$ Thousands)	Year Ended December 31,	
	2008	2007
Retained Earnings:		(note 2)
Retained Earnings, beginning of year	-	(1,234)
Net income for the year	47	1,025
Retained earnings allocated to Accrete	(1,384)	209
Retained Earnings (Deficit) , end of year	<u>(1,337)</u>	<u>-</u>
Comprehensive Income:		
Net income for the period	47	1,025
Other comprehensive income	-	-
Comprehensive income	<u>47</u>	<u>1,025</u>
Accumulated other comprehensive income:		-
Accumulated other comprehensive income, beginning of year	-	-
Changes during the period	<u>-</u>	<u>-</u>
Accumulated other comprehensive income, end of year	<u>-</u>	<u>-</u>

See accompanying notes to financial statements.

**Argosy Energy Inc.**  
**Statements of Cash Flows**

(\$ Thousands)	Year Ended December 31,	
	2008	2007
Cash provided by (used in):		(note 2)
Operating Activities		
Net income	47	1,025
Items not affecting cash:		
Stock based compensation cost	453	230
Future income taxes	169	(288)
Depletion, depreciation and accretion	7,685	6,329
	8,354	7,296
Change in non-cash working capital (note 10)	840	496
	9,194	7,792
Investing Activities		
Property and equipment additions	(20,993)	(27,982)
Change in non-cash working capital (note 10)	19,115	1,249
	(1,878)	(26,733)
Financing Activities		
Bank debt	(14,316)	18,941
Issue of flow through shares	7,000	-
	(7,316)	18,941
Increase (decrease) in cash	-	-
Cash – beginning of year	-	-
Cash – end of year	-	-
Supplemental Information :		
Interest Paid	2,290	2,069

See accompanying notes to financial statements.

**Argosy Energy Inc.**  
**Notes to the Financial Statements**  
**For the years ended December 31, 2008 and 2007**

**1. Description of Business**

Argosy Energy Inc. (“Argosy”) is an independent public corporation engaged in the acquisition, exploration, exploitation, development and production of crude oil and natural gas in Alberta, Canada.

Argosy was inactive from the time of its incorporation under the Business Corporations Act (Alberta) on June 6, 2008 to September 30, 2008 at which time, and pursuant to a Plan of Arrangement between Accrete Energy Inc. (“Accrete”), Pengrowth Energy Trust, Pengrowth Corporation, Pengrowth Energy Partnership and Argosy (“the Arrangement”), Argosy acquired certain assets including producing and exploratory oil and gas properties and certain tax pools from Accrete effective on the closing date of September 30, 2008.

Argosy is listed on the TSX under the symbol “GSY”.

**2. Basis of Presentation**

The financial data presented has been prepared in accordance with Canadian Generally Accepted Accounting Principles (“GAAP”). The reporting and measurement currency is the Canadian dollar. As the determination of certain assets, liabilities, revenues and expenses is dependent upon future events, the preparation of these financial statements requires the use of estimates and assumptions which have been made using careful judgment. In the opinion of management, these financial statements have been properly prepared within reasonable limits of materiality and within the framework of the significant accounting policies summarized below.

**Continuity of Interests**

For the period up to September 30, 2008, these financial statements present the historical financial position, results of operations and cash flow of Accrete on a carve-out basis following continuity of interest guidelines as if the assets acquired by Argosy had always operated as a stand-alone entity.

The financial data for the periods prior to September 30, 2008 presented herein was extracted from the books and records of Accrete.

Certain financial statement items were maintained by Accrete at a corporate rather than on a property-by-property basis and accordingly, it was necessary to make allocations of amounts reported in the financial statements of Accrete in order to prepare these financial statements for the carved-out assets.

The allocations that were made include:

Accumulated depreciation, general and administrative expenses, prepaids (excluding Crown royalty deposit), stock based compensation, fair value of and realized and unrealized gain (loss) on derivative instruments were allocated based on the ratio of the production volumes from the carved-out properties to the total production volumes of Accrete.

Interest expense and bank indebtedness was allocated based on cash requirements for the carved-out properties to the total cash requirements of Accrete.

Future income taxes were estimated on basis that the carve-out was a separate entity.

As a result of the basis of presentation described above, these historical financial statements may not necessarily be indicative of the results that would have been attained if Argosy had operated as a stand-alone entity for the periods prior to September 30, 2008.

The carrying values of financial statement items that were acquired by Argosy pursuant to the Arrangement were as follows:

	\$ 000's
Property, plant and equipment	64,583
Asset retirement obligations	(739)
Future income taxes	(6,511)
	<u>57,333</u>

The amounts recorded in Argosy's financial statements in respect to consideration for the above was:

	\$000's
Common shares	29,986
Bank debt	27,347
	<u>57,333</u>

#### Oil and Gas Operations

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

The Company follows the full-cost method of accounting whereby all costs related to the acquisition, exploration and development of petroleum and natural gas properties, net of government incentives, are capitalized in a cost centre. Such costs include lease acquisition costs, geological and geophysical expenditures, costs of drilling both productive and non-productive wells and related plant and production equipment costs. Costs centres are established for each country. There is only one cost centre for the Company, that being Canada.

Proceeds on disposition of petroleum and natural gas properties are accounted for as a reduction of capitalized costs with no gains or losses recognized unless such disposition results in a change of 20% or more in the depletion rate.

Capitalized costs, together with estimated future capital costs associated with proved reserves are depleted and depreciated using the unit-of-production method based on estimated gross proved reserves of petroleum and natural gas as determined by independent engineers. For purposes of this calculation, reserves and production are converted to equivalent units of oil based on the relative energy content of six thousand cubic feet of natural gas to one barrel of oil. Unproved properties are excluded from the depletion base until it is determined whether proved reserves are attributable to the properties or impairment occurs. A separate impairment assessment is conducted at least annually on these unproved properties. Impairment tests are conducted more frequently if events indicate a material change in circumstances from the most recent impairment test.

Office furniture and fixtures are recorded at cost and are depreciated over their useful lives on a declining balance basis at 20% per annum.

The net amount at which petroleum and natural gas properties are carried is subject to a cost recovery test (the “ceiling test”). Oil and gas assets are evaluated at least annually to determine that the costs are recoverable and do not exceed the fair value of the properties. The costs are initially assessed to be recoverable if the sum of the undiscounted cash flows expected from the production of proved reserves and the costs (less any impairment) of unproved properties exceed the carrying value of the oil and gas assets in the cost centre. The cost centre includes the cost of oil and gas properties being depleted together with unproved properties. If the carrying value of the oil and gas assets is assessed not to be recoverable, an impairment loss will be recognized to the extent that the carrying value of oil and gas properties in the cost centre exceeds the sum of the discounted cash flows expected from the production of proved and probable reserves and the cost of the unproved properties. Fair value is estimated using the present value approach whereby future cash flows, calculated based on future product prices and expenditures, are discounted using a risk free rate of interest.

The Company records a liability for the fair value of legal obligations associated with the retirement of long-lived assets in the period in which they are incurred, normally when the asset is purchased or developed. On recognition of the liability, there is a corresponding increase in the carrying amount of the related asset, known as the asset retirement cost, which is depleted using the unit-of- production method. The liability is adjusted in each reporting period to reflect the passage of time, with the accretion charged to earnings, and for revisions to the estimated future cash flows.

#### Joint Operations

A significant portion of the Company’s exploration and production activities are conducted jointly with others and the financial statements reflect only the Company’s proportionate interest in such activities.

#### Stock Based Compensation

The Company has an employee stock option plan. The compensation cost in respect of this plan is recognized in the financial statements using the fair market value method and the cost is recognized over the vesting period of the underlying security. The Company has not incorporated an estimated forfeiture rate for stock options that will not vest and account for actual forfeitures as they occur.

#### Measurement Uncertainty

Amounts recorded for depreciation and depletion, and amounts used for ceiling test calculations are based on estimates of oil and natural gas reserves. The Company’s reserve estimates are reviewed annually by an independent engineering firm. By their nature, these estimates of reserves and future cash flows are subject to measurement uncertainty, and the impact on the financial statements of future periods could be material.

#### Per Share Amounts

The Company uses the treasury stock method to determine the dilutive effect of stock options and other dilutive instruments. This method assumes that proceeds received from the exercise of in-the-money stock options and other dilutive instruments are used to purchase common shares at the average market price during the year.

#### Flow through Shares

The resource expenditure deductions for income tax purposes related to exploratory and development activities funded by flow through share arrangements are renounced to investors in accordance with income tax legislation. Future income tax liabilities and share capital are adjusted by the estimated cost of the renounced income tax deductions when the related flow through expenditures are renounced to investors.

#### Income Taxes

The Company follows the asset and liability method of accounting for income taxes. Temporary differences arising from the differences between the carrying amounts of assets and liabilities and their tax bases are used to calculate future income tax assets or liabilities. Future income tax assets or liabilities are calculated using the rates that are anticipated to be in effect in the periods that the temporary differences are expected to reverse. The effect on future tax assets and liabilities of a change in income tax rates is recognized in net earnings in the period in which the change occurs. Future income tax assets are limited to the amount that is more likely than not to be realized in future periods.

#### Financial Instruments

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument to another entity. Upon initial recognition all financial instruments, including derivatives, are recognized on the balance sheet at fair value. Subsequent measurement is then based on the financial instruments being classified into one of five categories: held for trading, held to maturity, loans and receivables, available for sale and other liabilities. The Company has designated its cash and cash equivalents as held for trading which are measured at fair value. Accounts receivable are classified as loans and receivables which are measured at amortized cost. Accounts payable, accrued liabilities and bank debt are classified as other liabilities which are measured at amortized cost, which is determined using the effective interest method.

The Company is exposed to market risks resulting from fluctuations in commodity prices and interest rates in the normal course of operations. A variety of derivative instruments may be used by the Company to reduce its exposure to fluctuations in commodity prices and interest rates. The Company does not use these derivative instruments for trading or speculative purposes. The Company considers all of these transactions to be economic hedges, however, the majority of the contracts that the Company would normally enter in to would not qualify or would not be designated as hedges for accounting purposes. As a result, all derivative contracts would normally be classified as held for trading and would be recorded on the balance sheet at fair value, with changes in the fair value recognized in net income, unless specific hedge criteria are met.

The fair values of these derivative instruments are based on an estimate of the amounts that would have been received or paid to settle these instruments prior to maturity based on quoted market prices, or if quotes are not available, third party market market indications and forecasts and other relevant factors. Proceeds and costs realized from holding the derivative contracts are recognized in net income at the time each transaction under a contract is settled.

The Company has elected to account for its physical delivery sales contracts as non-financial derivatives.

The Company measures and recognizes embedded derivatives separately from host contracts when the economic characteristics and risks of the embedded derivative are not closely related to those of the host contract, when it meets the definition of a derivative and when the entire contract is not measured at fair value. Embedded derivatives are recorded at fair value. The Company immediately expenses all transaction costs incurred in relation to the acquisition of a financial asset or liability.

The Company applies trade-date accounting for the recognition of a purchase or sale of cash equivalents and derivative contracts.

### 3. Change In Accounting Policies

#### Capital Disclosures

As of January 1, 2008, the Company was required to adopt CICA Handbook Section 1535 “Capital Disclosures”, which will require the Company to disclose its objectives, policies and processes for managing capital.

#### Goodwill

As of January 1, 2009, the Company will be required to adopt CICA Handbook Section 3064 “Goodwill and Intangible Assets”, which defines the criteria for the recognition of intangible assets.

#### International Financial Reporting Standards (“IFRS”)

On February 13, 2008, Canada’s Accounting Standards Board (“AcSB”) confirmed January 1, 2011 as the effective date for the mandatory convergence of Canadian GAAP to IFRS.

Argosy intends to adopt the requirements set out by AcSB and other regulatory bodies. The impact of adopting IFRS is not reasonable to estimate at this time. Argosy has engaged independent consultants to assist in implementation of IFRS. The independent consultants are currently in the initial scoping stages of the project.

The first financial statements that the Company will have to prepare under IFRS will be the unaudited statements for the quarter ended March 31, 2011 that will include unaudited comparative financial information for the quarter ended March 31, 2010. The first audited financial statements that the Company will have to prepare will be those for the year ended December 31, 2011 with comparative financial information for the year ended December 31, 2010. As a result, all of the opening balance sheet figures as at January 1, 2010 must be computed prior to the issuance of the unaudited financial statements for the quarter ended March 31, 2011 so as comparative figures may be shown.

### 4. Property and Equipment

(\$ thousands)	As at December 31, 2008 \$	As at December 31, 2007 \$
Petroleum and natural gas properties and equipment	90,562	67,626
Furniture, fixtures and other	176	129
	90,738	67,755
Less: Accumulated depletion and depreciation	22,546	14,911
	68,192	52,844

At December 31, 2008 costs of \$8,728,000 (\$7,911,000 at December 31, 2007) with respect to unproved properties have been excluded from costs subject to depletion. At December 31, 2007 a total of \$1,713,000 of future development costs were included in the depletion calculation (2007 - \$1,480,000). Direct salary costs related to geological and geophysical personnel in the amount of \$208,000 (\$271,000 in 2007) have been capitalized during the year. The net amount at which petroleum and natural gas properties are carried is subject to a cost recovery test (the “ceiling test”). The ceiling test at December 31, 2008 indicated that

the net undiscounted recoverable amount from proved oil and natural gas reserves and the lower of cost or market of unproved properties exceeded the net carrying value of the petroleum and natural gas properties and equipment. The prices used in the ceiling test evaluation of the Company's petroleum and natural gas properties and equipment were as follows:

	Crude Oil		Natural Gas
	West Texas Intermediate (Cdn\$/bbl) (1)	Edmonton Par Price (Cdn\$/bbl)	AECO Gas Price (Cdn\$/ mmbtu)
2009	69.70	68.61	7.58
2010	77.71	78.94	7.94
2011	84.57	83.54	8.34
2012	91.89	90.92	8.70
2013	96.85	95.91	8.95
2014-2018 (2)	97.68	101.87	9.54
Thereafter (3)	+ 2%	+2%	+2%

(1) US / Canadian Exchange rates 2009 - 0.825, 2010 - 0.875, 2011 - 0.875, 2012 - 0.925, 2013 and thereafter - 0.95

(2) Average prices for the period

(3) Represents the change in future prices from 2018 to the end of the reserve life

## 5. Bank Indebtedness

At December 31, 2008 the Company's credit facility comprised a Revolving Operating Demand Loan facility with a credit limit of \$22,000,000 and an Acquisition/Development Demand Loan with a credit limit of \$9,000,000.

The Revolving Operating Demand Loan bore interest at bank prime plus one eighth percent and has no specific terms of repayment aside from the bank's right of demand and periodic review. The Revolving Operating Demand Loan bore interest at bank prime plus one eighth percent and had no specific terms of repayment aside from the bank's right of demand and periodic review.

The Acquisition/Development Demand Loan bore interest at bank prime rate plus one half percent and required monthly principal payments of \$400,000 with repayments commencing the month following drawdown and was also subject to the Bank's right of demand and periodic review.

Subsequent to December 31, 2008, the Company's credit facility was reviewed by the Bank and the \$22 million Revolving Operating Demand Loan and the \$9 million Acquisition / Development Demand Loan were replaced with a Revolving Operating Demand Loan with a credit limit of \$29 million and an Acquisition / Development Demand Loan with a credit limit of \$2 million.

The Revolving Operating Demand Loan bears interest at Bank prime plus a percentage determined in accordance with the bank's pricing grid. The Bank's pricing grid is dependent on the Company's debt to cash flow ratio. At this time it is expected that the application of the Bank's pricing grid will result in a rate which is 0.75% greater than the Bank's prime rate. The Acquisition/Development Demand Loan bears interest at a rate which is 0.25% higher than the Revolving Operating Demand Loan.

The Revolving Operating Demand Loan has no specific terms of repayment aside from the Bank's right of demand and periodic review. The Acquisition/Development Demand Loan requires unspecified monthly principal repayments over the engineering half life of the reserves being financed as determined by the Bank.

Security for the facilities includes a general assignment of book debts, a \$75,000,000 debenture with a first floating charge over all assets with a negative pledge and an undertaking to provide fixed charges on the Company's major producing reserves at the request of the bank.

A covenant to the Revolving Operating Demand Loan facility requires that the Company maintain a working capital ratio, exclusive of bank indebtedness, of at least 1 to 1. For purposes of this calculation, the undrawn availability under the facility is added to current assets. The Company is in compliance with this debt covenant at December 31, 2008. The next review of the facilities is scheduled for June 1, 2009.

## 6. Share Capital

Authorized:

An unlimited number of common voting shares and an unlimited number of preferred shares issuable in series for which the directors may fix, among other things, the rights, privileges, restrictions, conditions, voting rights, rates, method of calculation and dates of payment of dividends and terms of redemption, purchase and conversion if any, and any other provisions.

Issued and outstanding:

Common Voting Shares	Number of Shares	\$ Thousands
Issued on incorporation, June 6, 2008	1	.1
Cancelled on closing of the Arrangement	(1)	(.1)
Issued pursuant to the Arrangement	4,494,667	29,986
Issued on private placement to officers, directors and employees – flow through shares	1,208,051	6,282
Issued on private placement to officers, directors and employees – common shares	156,116	718
Balance, December 31, 2008	5,858,834	36,986

The tax deductions related to the flow through shares issued in 2008 were renounced to flow through shareholders and booked in February 2009.

The following reconciles the common shares used in calculating net earnings per common share:

	December 31,	
	2008	2007
Weighted average common voting shares outstanding - basic	4,515,671	4,112,590
Effect of dilutive stock options	384,309	306,125
Weighted average common shares outstanding - diluted	4,899,980	4,418,715

### Share Purchase Warrants

A total of 2,247,341 warrants to purchase Argosy common shares were issued to Accrete shareholders pursuant to the Arrangement. The holder of the warrant was entitled, provided such holder did not participate in the private placements, to acquire a common share of Argosy for \$4.60 per share prior to November 13, 2008. None of the warrants were exercised and they expired prior to December 31, 2008.

## Stock Options

Under the terms of the Argosy Energy Inc. 2008 Incentive Stock Option Plan, as amended, (the “plan”), directors, officers, employees and consultants (the “Participant(s)”) are eligible to be granted options to purchase common shares. The plan provides that the Company can reserve up to 10% of the common shares that are issued and outstanding for the granting of options.

The maximum number of option shares that may be reserved for issuance to any one Participant under the plan cannot exceed 5% of the issued and outstanding common shares.

The grant price under the plan is defined by the plan to be the closing price on the principal stock exchange on which the common shares are traded on the last business date preceding the date of grant or if the common shares did not trade on that date, the weighted average price for the five trading days preceding the date of grant if the common shares are listed and posted for trading on a stock exchange or the value conclusively determined by the Board of Directors if it is not. .

The vesting of stock options is determined by the board of directors and the term, as also determined by the board of directors cannot exceed five years from the date of grant of such options.

A Participant’s entitlement under the plan ceases upon ceasing to be a Participant. If such cessation is involuntary, then the vested and unvested options can be exercised for a period of ninety days after such date. Where a Participant is terminated for cause, the Participant may only exercise those options that have become vested. Where a Participant is terminated by the company without cause, the Participant is entitled to exercise stock options that have vested during the notice period or in the event of compensation being paid in lieu of notice, for 21 days after ceasing to be a Participant.

Options granted under the plan are not assignable and no financial assistance is extended to optionees.

The board of directors is empowered to amend the plan. Any amendment to the plan is subject to the receipt of necessary regulatory approvals and any amendment required by applicable law or regulatory policy to be approved by shareholders does not become effective until so approved.

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

Options outstanding:

Balance September 30, 2008	-
Granted	580,000
<u>Balance, December 31, 2008</u>	<u>580,000</u>

The Company has accounted for its employee stock options granted using the fair value method at the date of grant in 2008 using the Black-Scholes model.

The fair value of the options granted to December 31, 2008 was estimated to be \$ 1,175,000 (\$2.03 per option granted).

This value is expensed as stock based compensation cost over the vesting period. A total of \$383,000 was charged in the fourth quarter and \$453,000 for the year ended December 31, 2008.

The assumptions used in calculating the fair value include a volatility factor ranging of 46%, a weighted average risk free interest rate of 3% and a weighted average expected life of the options of 5 years.

<b>Grant Price</b>	<b>Options Outstanding</b>	<b>Remaining Contractual Life</b>	<b>Number Exercisable (Vested)</b>	<b>Weighted Average Exercise Price (\$/Share)</b>
(1)	376,000		376,000	4.60
(2)	204,000		-	4.60
	580,000		376,000	

- (1) Five year term, vest equally over a three year period commencing on the date of grant.  
(2) Five year term, vest equally over a three year period commencing on the first anniversary of the date of grant.

#### Contributed Surplus

(\$ thousands)	Year Ended December 31,	
	2008	2007
Balance, beginning of year	-	-
Stock Based Compensation	383	-
Balance, end of year	383	-

#### 7. Asset Retirement Obligation

Asset retirement obligation comprises:

(\$ thousands)	Year Ended December 31,	
	2008	2007
Balance, beginning of year	614	258
Liabilities incurred	144	324
Liabilities settled	-	-
Dispositions	-	-
Accretion expense	13	32
Balance, end of year	771	614

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 to settle the asset retirement obligation is approximately \$2,169,000 (2007 \$1,147,000) which will be incurred over the next twenty five years. A credit adjusted risk-free rate of 8% (2007 7%) and an inflation rate of 2% (2007 2%) was used to calculate the fair value of the obligations.

#### 8. Income Taxes

At December 31, 2008, the Company's exploration and development expenditures and undepreciated capital costs total \$43,000,000. These costs may be carried forward indefinitely to reduce future taxable income.

The following reconciles the difference between income tax recorded and the expected income tax expense obtained by applying the expected income tax rate to earnings before taxes:

(\$ thousands)	Year Ended December 31,	
	2008	2007
Income/(Loss) before income taxes	216,275	737,000
Statutory Rate	29.50%	32.12%
Expected income tax expense at the combined federal and provincial statutory rate	63,801	236,724
Change in valuation allowance	-	(132,767)
Stock based compensation cost	113,079	73,876
Tax-rate adjustments	(9,222)	(467,975)
Other	1,355	2,305
Future income tax expense	169,013	(287,837)

The following table summarizes the tax effect of temporary differences:

(\$ thousands)	December 31,	
	2008	2007
Future income tax assets (liabilities):		
Carrying value of capital assets in excess of tax basis	(6,363)	(2,735)
Asset retirement obligation	192	-
	(6,171)	(2,735)

## 9. Financial Instruments

Financial instruments consist primarily of accounts receivable, accounts payable and accrued liabilities and bank debt. There are no significant differences between the carrying value of these instruments and their estimated fair value.

A portion of the Company's accounts receivable are from joint venture partners in the oil and gas business and are subject to normal industry credit risk. Purchasers of the Company's petroleum and natural gas products are subject to an internal credit review designed to mitigate the risk of non-payment and the carrying value reflects management's assessment of the associated credit risks.

Argosy did not enter into any contracts that would have mitigated its exposure to foreign currency but Accrete entered into various contracts that were intended to reduce its exposure to fluctuations in commodity prices during 2008. These were derivative contracts classified as "held for trading". These contracts were scheduled to expire in October 2008 but were settled prior to September 30, 2008. The aggregate realized loss for 2008 from these contracts was \$805,000 of which \$284,000 was allocated to the properties that were transferred to Argosy as a result of the Arrangement. This allocation was made on basis of the ratio of the production volumes from those properties to the total production of Accrete.

There were no such contracts open at December 31, 2008.

## 10. Supplemental Cash Flow Information

Change in non-cash working capital comprises:

December 31,

(\$ thousands)	2008	2007
Accounts receivable	55	(2,264)
Prepaid expenses	(66)	(509)
Accounts payable and accrued liabilities	2,036	2,028
Net investment by Accrete	17,930	2,490
<b>Change in non-cash working capital</b>	<b>19,955</b>	<b>1,745</b>
Relating to:		
Investing activities	840	1,249
Operating activities	19,115	496
	19,955	1,745

## 11. Commitments

As a consequence of the Plan of Arrangement, Argosy has agreed to indemnify Accrete or its successors from any claims arising from liabilities not retained by Accrete, for breaches of representations and warranties of Accrete and Argosy for breaches of covenants by Accrete until September 30, 2009. The Company issued 1,208,051 common flow through shares at an issuance price of \$5.20 per share. The tax deductions related to the flow through shares issued in 2008 were renounced to flow through shareholders and booked to the accounts in February 2009. The Company will be required to spend approximately \$5,816,000 in 2009 on CEE expenditures to fulfill its flow through obligation.

Accrete entered into an agreement with a major drilling contractor. Accrete was obligated to utilize the contractor's rig for a period of 200 days during the one year term of the agreement that commenced August 15, 2007. Argosy has assumed this obligation pursuant to the Arrangement. The Company has estimated that a liability of up to \$500,000 could be incurred. The Company is currently negotiating the settlement of this obligation. In 2009, \$252,000 was paid to the drilling contractor as a good faith gesture however, a further \$248,000 could be incurred should negotiations fail.

The Company has entered into various commitments related to the leasing of office premises and office equipment. The payments due under such leases are as follows:

Contractual obligations (\$ thousands)	2009	2010	2011	2012	2013	Thereafter
Office Premises	708	708	741	808	879	-
Office equipment	2	1	-	-	-	-
	710	709	741	808	879	-

## 12. Capital Structure

The Company's objective is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain the future development of the business.

The Company manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of the underlying petroleum and natural gas assets.

The Company's capital structure is comprised of shareholder's equity, bank indebtedness and working capital. In order to maintain or adjust the capital structure, the Company may from time to time issue shares and adjust its capital spending to manage its current and projected debt levels.

The Company monitors capital based on the ratio of net debt to cash flow from operations. This ratio is calculated as net debt, defined as outstanding bank indebtedness plus or minus working capital, divided by cash flow from operating activities for the most recent calendar quarter, annualized (i.e. multiplied by four). The Company's strategy is to maintain a ratio that is in keeping with that of its industry peer group. The ratio may increase at certain times as a result of acquisitions or extremely low commodity prices. The Company prepares annual capital expenditure budgets, which are updated as necessary depending on varying factors including current and forecast prices, successful capital deployment and general industry conditions in order to manage the ratio. The annual and updated budgets are approved by the Company's Board of Directors.

The Company's share capital is not subject to external restrictions, however the bank debt facility is based on petroleum and natural gas reserves. The Company has not paid or declared any dividends since the date of incorporation, nor are any contemplated in the foreseeable future. There were no changes in the Company's approach to capital management during the period.

### **13. Fair value of Financial Instruments**

The Company's financial instruments as at December 31, 2008 include cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities and bank indebtedness. The fair value of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities approximate their carrying amounts due to their short-terms to maturity.

The fair value of derivative contracts is determined by reference to market information provided by the Company's bank.

Bank debt bears interest at a floating market rate and accordingly the fair market value approximates the carrying value.

## 14. Financial Risk Management

The Company has exposure to the following risks from its use of financial instruments including:

- Credit risk
- Liquidity risk
- 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 capital. Further quantitative disclosures are included throughout these financial statements.

The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework. The Board 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.

The period of economic slowdown, scarcity of credit and low cost equity, and volatile capital and commodity markets that has existed since the beginning of the fourth quarter 2008 exacerbates these risks. If current conditions persist for a prolonged period of time, the liquidity and financial condition of the Company could be materially adversely affected.

### Credit risk

Credit risk is the risk of financial loss to the Company if a joint venture partner, natural gas marketer, customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Company's receivables from joint venture partners and petroleum and natural gas marketers. As at December 31, 2008 the Company's receivables consisted of \$1,246,000 (2007 - \$526,000) from joint venture partners, \$1,542,000 (2007 - \$1,721,000) of receivables from petroleum and natural gas marketers and \$44,000 (2007 - \$1,110,000) of other trade receivables.

Receivables from petroleum and natural gas marketers are normally collected on the 25th day of the month following production. The Company's policy to mitigate credit risk associated with these balances is to establish marketing relationships with large purchasers. The Company historically has not experienced any collection issues with its petroleum and natural gas marketers. Joint venture receivables are typically collected within one to three months of the joint venture bill being issued to the partner. The Company attempts to mitigate the risk from joint venture receivables by obtaining partner approval of significant capital expenditures prior to expenditure. However, the receivables are from participants in the petroleum and natural gas sector, and collection of the outstanding balances is dependent on industry factors such as commodity price fluctuations, escalating costs and the risk of unsuccessful drilling, in addition further risk exists with joint venture partners as disagreements occasionally arise that increase the potential for non-collection. The Company does not typically obtain collateral from petroleum and natural gas marketers or joint venture partners. The Company collects cash advances from joint venture partners to the extent possible and it does have the ability to withhold production from them in certain cases in the event of non-payment.

The carrying amount of accounts receivable represents the maximum credit exposure. The Company does not have an allowance for doubtful accounts as at December 31, 2008 and 2007 and did not provide for any doubtful accounts nor was it required to write-off any receivables during the year ended December 31, 2008 and 2007.

## Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet 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, under both normal and stressed conditions without incurring unacceptable losses or risking harm to the Company's reputation.

The Company prepares annual 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 expenditures. To facilitate the capital expenditure program, the Company has a Revolving operating Demand Loan facility, as outlined in note 4 that is reviewed periodically by the lender. The Company also attempts to match its payment cycle with collection of petroleum natural gas revenues on the 25th of each month.

The following are the contractual maturities of financial liabilities and associated interest payments as at December 31, 2008.

<b>Financial Liability (\$000's)</b>	<b>Less Than 1 Year</b>	<b>1-2 Years</b>	<b>2-5 Years</b>	<b>Thereafter</b>
Accounts payable and accrued liabilities	6,357	-	-	-
Bank indebtedness	22,763	-	-	-
	29,120	-	-	-
Flow Through Obligation	5,816	-	-	-

## 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 Company may utilize both financial derivatives and physical delivery sales contracts from time to time to manage market risks. All such transactions are conducted in accordance with the risk management policy that has been approved by the Board of Directors. Argosy has not entered into any contracts of this nature and no contracts are outstanding at December 31, 2008.

## Commodity price risk

Commodity price risk is the risk that the fair value or future funds flow will fluctuate as a result of changes in commodity prices. Commodity prices for petroleum and natural gas are impacted by not only the relationship between the Canadian and United States dollar, as outlined above, but also world economic events that dictate the levels of supply and demand. The Company may attempt to mitigate commodity price risk through the use of various financial derivative and physical delivery sales contracts. The Company's banking agreement limits the volumes that the Company can contract by way of commodity contracts to 50% of the Company's production.

Accrete entered into various financial contracts that were intended to reduce its exposure to fluctuations in commodity prices during 2007. The contracts were financial in nature and did not require the dedication of production. These were derivative contracts classified as "held for trading". These contracts expired on October 31, 2007. The realized gain for 2007 from these collars was \$209,000.

There were no such contracts open at December 31, 2007 but subsequent, Accrete entered into a financial costless collar based 3,000 Gj/d of natural gas for the period from April 1, 2008 to October 31, 2008 with a

put price of \$6.635/Gj and a call price of \$7.365/Gj. This financial instrument derivative contract was classified as "held for trading". These contracts were terminated and realized losses of \$809,000 were incurred prior to the closing of the Arrangement.

Argosy has not entered into any contracts of this nature and no contracts are outstanding at December 31, 2008.

#### Interest rate risk

Interest rate risk is the risk that future funds flow will fluctuate as a result of changes in market interest rates. The Company is exposed to interest rate fluctuations on its bank debt which bears a floating rate of interest. As at December 31, 2008, if interest rates had been 1% lower with all other variables held constant, pre tax net earnings for the twelve month period would have been \$285,000 higher, due to lower interest expense. An equal an opposite impact would have occurred to pre tax earnings had interest rates been 1% higher.