Twin Butte Energy Ltd.

# 2008

## ANNUAL REPORT

# Highlights

| | Three months ended December 31 | | | Year ended December 31 | | |
|---|---|---|---|---|---|---|
| | **2008** | 2007 | % Change | **2008** | 2007 | % Change |
| **FINANCIAL** *($ thousands, except per share amounts)* | | | | | | |
| Petroleum and natural gas sales | **13,158** | 9,146 | 44% | **69,100** | 29,941 | 131% |
| Cash flow (1) | **5,243** | 3,255 | 61% | **31,096** | 12,226 | 154% |
| Per share basic & diluted | **0.12** | 0.12 | –% | **0.74** | 0.50 | 48% |
| Net income (loss) | **(4,001)** | 4,272 | | **(2,595)** | (979) | |
| Per share basic & diluted | **(0.09)** | 0.15 | | **(0.06)** | (0.04) | |
| Capital expenditures (net of dispositions) | **9,211** | 3,671 | 151% | **42,372** | 47,659 | (11%) |
| Corporate acquisitions | **–** | – | | **57,252** | – | |
| Net debt (2) | **50,309** | 23,242 | 116% | **50,309** | 23,242 | 116% |
| **OPERATING** | | | | | | |
| Average daily production | | | | | | |
| Crude oil (bbl per day) | **806** | 390 | 107% | **745** | 351 | 112% |
| Natural gas (Mcf per day) | **12,669** | 9,022 | 40% | **12,474** | 7,657 | 63% |
| Natural gas liquids (bbl per day) | **121** | 113 | 7% | **125** | 76 | 65% |
| Barrels of oil equivalent (boe per day, 6:1) | **3,039** | 2,006 | 51% | **2,949** | 1,703 | 73% |
| Average sales price | | | | | | |
| Crude oil ($ per bbl) | **57.00** | 79.04 | (28)% | **94.34** | 73.22 | 29% |
| Natural gas ($ per Mcf) | **7.18** | 6.67 | 8% | **8.69** | 6.68 | 30% |
| Natural gas liquids ($ per bbl) | **50.88** | 74.28 | (32)% | **81.03** | 75.98 | 7% |
| Barrels of oil equivalent ($ per boe, 6:1) | **47.07** | 49.55 | (5)% | **64.03** | 48.16 | 33% |
| Operating netback ($ per boe) | | | | | | |
| Petroleum and natural gas sales | **47.07** | 49.55 | (5)% | **64.03** | 48.16 | 33% |
| Realized gain (loss) on financial instruments | **2.43** | (0.84) | | **(3.39)** | 0.88 | |
| Royalties | **(8.54)** | (9.99) | (15)% | **(10.76)** | (9.74) | 10% |
| Operating Expenses | **(13.31)** | (12.89) | 3% | **(12.54)** | (11.95) | 5% |
| Transportation Expenses | **(2.47)** | (2.54) | (3)% | **(2.65)** | (2.50) | 6% |
| Operating netback | **25.18** | 23.29 | 8% | **34.69** | 24.85 | 40% |
| Common Shares | | | | | | |
| Shares outstanding, end of period | **47,128,425** | 27,752,398 | 70% | **47,128,425** | 27,752,398 | 70% |
| Weighted average shares outstanding – diluted | **43,948,559** | 27,752,398 | 58% | **41,981,359** | 24,284,620 | 73% |

(1) Cash flow means earnings before future taxes, depletion, depreciation and accretion, stock based compensation, and unrealized loss (gain) on financial derivatives. See Management's Discussion & Analysis Non-GAAP Measures.

(2) Net debt at December 31, 2008 excludes financial derivative contracts asset in the amount of $2.1 million. The asset relates to an unrealized gain on financial derivatives recognized at December 31, 2008.

# Report to Shareholders

Two thousand and eight was a year characterized by significant volatility in commodity prices, a widening global economic crises, and overall positive operational results for Twin Butte. Highlights for 2008 include the following:

> Completed and integrated the acquisition of E4 Energy providing an accelerated entry into N.E. British Columbia;

> Increased net asset value of the Company to $3.47 per share, a 4.8% increase from 2007 in a challenging cost environment;

> Increased proved and probable reserves by 75% to 10,603 MBOE including a 15% reserve revision from 6,046 MBOE at year end 2007; proved and probable producing reserves account for 63% of the total;

> Increased reserve life index to 9.6 years from 8.3 years at year end 2007 while replacing production by 522%;

> Significantly increased the Company's net undeveloped land base to 153,700 net undeveloped acres from approximately 58,000 net undeveloped acres at year end 2007;

> Increased Twin Butte's prospect inventory to over 100 locations;

> Increased 2008 average production by 73% to 2,949 boe/d, up from 1,703 boe/d in 2007;

> Increased 2008 cash flow by 154% over 2007 to $31.1 million;

> Increased cash flow per share in 2008 by 48% over 2007 to $0.74 per share;

> Drilled and cased 21 (20.1 net) wells with a 90% success rate for the year;

> Successfully drilled the first multi-stage frac horizontal well in our Jayar light oil pool;

> Earned 3.3 net sections of key Montney lands with the drilling of a horizontal earning well in the Brassey area which came on production in December 2008;

> Drilled a vertical test well at Kelly to earn additional 6.0 net sections of Doig & Montney lands; and

> Closed a $5 million flow through share offering on December 19, 2008 at $1.35 per share.

## OPERATIONAL REVIEW

Twin Butte is pleased to report to shareholders on the Company's activities in 2008.

Since inception, the Company has strived to increase the depth of our prospect inventory and increase our undeveloped land base to build a strong organic growth component for Twin Butte shareholders. As well we have pursued value added acquisitions to accelerate and augment the Company's growth profile. We believe the Company has taken a material step forward in that regard in 2008 and that this effort will yield significant upside to our investors as the Company moves forward. Throughout the year Twin Butte remained focused on building the Company, showing significant growth in production, reserves, and undeveloped land as well as in our prospect inventory, while not sacrificing financial flexibility through proper balance sheet management.

### Production, Drilling and Reserves

The Company grew production and reserves in 2008 through a combination of the acquisition of E4 Energy and the completion of a successful drilling program. Average production grew 73 percent from 1,703 boe/d in 2007 to 2,949 boe/d in 2008. Fourth quarter production averaged 3,039 boe/d comprised of 69 percent natural gas and 31 percent light oil and natural gas liquids.

The Company drilled 21 gross (20.1 net) wells for an overall success rate of 90 percent. Drilling was concentrated largely in the Plains region with 7 wells drilled at Bulwark, 5 wells at Provost and 2 wells at Richdale. In North West Alberta 3 wells were drilled at Thunder while the Company completed its first horizontal well at Jayar. In North Eastern British Columbia the Company completed a 3 well program, including the 2 Montney earning wells at Brassey and Kelly.

Corporate reserves grew significantly from 6.0 million boe's in 2007 to 10.6 million boe's at year end 2008, an increase of 75 percent; replacing production just over 5 times. The quality of the Company's base reserves was evident from the positive reserve revision of 15 percent. Capital efficiency did not meet our expectations in 2008 largely due to mixed results in our Montney program. All in finding development and acquisition costs including change in forward capital were $25.29 per Boe (finding and development alone $25.77; acquisitions alone $24.87). Overall expenditures of $102.1 million were allocated $59.7 million to the acquisition of E4 and $42.4 million to the Company's exploration and development program. Of the exploration and development expenditures $15.3 million was spent on the Montney program which added only 124.5 mboe at year end. Excluding the Montney program the Company's capital efficiency for finding and development alone was $20.93 per boe.

### North West Alberta

Twin Butte drilled three and recompleted a number of wells at Thunder. The areas stable production base and significant reserve life index was apparent as with minimal capital expenditures production has remained flat at approximately 650 boe/d since the property was purchased in mid 2007. The Company continues to develop new exploration leads through an active seismic program. Additional drilling is planned for the area in 2009.

At Jayar, the Company completed its first horizontal multistage frac well with reasonable results. Problems experienced during the drilling and completion phases of this well yielded a disappointing 180 boe/d of initial productivity. However, when the long term stable decline profile is considered, the well will generate positive full cycle economics. The Company has recently completed a technical evaluation of the property's reserve base and long term development strategy which confirms that there are at least 10 horizontal drilling locations that will maximize reserve recovery and overall project economics. Future horizontal wells will target lower recovery, higher pressure portions of the pool which Twin Butte believes will lead to higher initial production rates.

### North East British Columbia

The Company's conventional 2008 capital program in North East British Columbia was somewhat muted with the majority of expenditures being directed to our Montney farm-ins. One development gas well was drilled at Lagarde in 2008 which delineated an existing Baldonal gas pool setting up future development drilling. The Company plans additional development work in 2009 at Oak and Teal. At Oak, two wells were drilled successfully in Q1 2009 in the Baldonal and Gething formations which are currently being tied in to commence production in early Q2. A summer exploratory well at Teal will target a Gething channel play which if successful could lead to a multi well horizontal program.

As part of the earning commitment the Company drilled two deep Montney wells at Brassey and Kelly. The Brassey well was drilled vertically to test reservoir quality and thickness and subsequently whipstocked horizontally. Following a multistage fracture treatment the well commenced production late in 2008. Initial productivity proved disappointing at approximately 1,000 mscf/d of which the Company owns 60 percent. Initial results proved the viability of the Montney on Company lands and enhanced interpretation of the play indicates greater potential for higher productivity unrealized on our land block. Based on these initial results the Company has created a development strategy to exploit this resource. An independent assessment valued the earned lands at $12.4 million. The Company currently has no plans to commit additional funds to Brassey in the current year.

At Kelly the Company drilled a vertical well to test the Montney and Doig formations. The Doig had a number of sidewall cores cut and a repeat formation tester run over the interval giving evidence of permeability and communication with the offset producing Doig pool. Extensive core analysis was performed on the Montney formation to establish reservoir parameters and extend the limits of commercial viability for a resource play to this area. With 10 sections of land under Company control this exposes Twin Butte to significant potential reserves. The Company is currently negotiating with an area processor to gain access to their facility. An independent assessment valued the earned lands at $1.2 million.

### Plains Area

At Bulwark, the Company continued to develop its Viking light oil pool with a multi well drilling program (7 wells) in 2008. The program resulted in a tripling of production from the area from an initial rate of approximately 55 boe/d at the beginning of the year to a 2008 exit rate of approximately 160 boe/d. The company is currently investigating the reactivation of a waterflood pilot project which would add significant reserves and production to the Viking pool. A successful Glauconite gas well was drilled in 2008 which was subsequently offset in early 2009 with a successful gas producer.

At Provost the company drilled four horizontal and one vertical well targeting the Dina formation. Based on this success Twin Butte believes there is potential for a multi well development program of up to 10 wells for this property. Although netbacks on the property remain positive under current pricing further drilling will be deferred until oil prices increase.

## OUTLOOK

With continued uncertainty in the medium term outlook for commodities, particularly natural gas, Twin Butte is committed to protect our balance sheet. With capital markets being all but nonexistent for junior oil and gas companies we know we have to live within our means. Year end reserve valuations are better than expected, our banking partner reconfirmed our line in February, and the new management has scrutinized the assets. Therefore, we believe we will not face any unexpected hurdles over the foreseeable future. Primary to our short term strategy is to preserve the significant underlying value of the Company's asset base for our shareholders.

Difficult times take difficult decisions. We have and will continue to make those tough calls. The predictability and value of our assets have been reconfirmed by new management and independent evaluators. Twin Butte represents compelling value at current market price and we will ensure shareholders benefit from the value they have entrusted management with.

Although our first quarter capital will exceed cash flow by approximately $2 million the remainder of the year's capital program will ensure net debt remains well within our bank lines. Net debt is forecast to remain in the $50 to $52 million range over 2009 (based on forward strip pricing) compared to our current bank line of $65 million.

For the above reasons we now anticipate capital spending to approximate $11 million in 2009 which will maintain production in the range of 2,800 to 3,000 boe/d, in line with our 2008 average.

We continue to believe in the long term outlook for natural gas and feel that our value based approach, and countercyclical thinking has positioned the Company very well for continued long term growth in reserves, production and cash flow per share. Management remains committed to building a solid foundation from which the Company will grow when financial conditions allow.

Two of our Directors, Ken Mullen and Craig Hruska, are not standing for reelection for governance and personal reasons respectively. Both are, and will remain shareholders of Twin Butte, committed to the direction we are taking. Ken and Craig have provided invaluable guidance to the Company since inception. We thank them both for their dedication and commitment.

Twin Butte is pleased to announce that Warren Steckley has joined the Board of Directors, effective immediately. Mr. Steckley is President, Chief Operating Officer and Director of Barnwell of Canada, Limited, an oil and gas company and wholly owned subsidiary of Barnwell Industries Inc., a public company which trades on the American Stock Exchange. Mr. Steckley is currently a director of Wild River Resources, a private oil and gas company. Mr. Steckley is a Professional Engineer with a BSc in Mechanical Engineering from the University of Alberta, and in addition holds a Masters of Business Administration degree, also from the University of Alberta.

Twin Butte is a value oriented junior gas producer with expanding operations in N.E. British Columbia and N.W. Alberta. With a stable low decline production base the Company is well positioned to live within cash flow while continuing to enhance our focus areas. We are committed to growing in 2009 through value added corporate consolidation thereby enhancing the long term potential growth profile for our shareholders.

On behalf of the Board of Directors,

Jim Saunders
President and C.E.O.

March 20, 2009

## Reserves

McDaniel & Associates Consultants Ltd. ("McDaniel"), an independent qualified reserves evaluator, was again retained to complete the December 31, 2008 reserve evaluation on 100% of Twin Butte's oil and gas properties. The report indicated 10,603.1 MBOE of Twin Butte working interest proved plus probable reserves, up 75.4% from 6,045.6 MBOE at the end of 2007. Total reserve additions and revisions, including the acquisition of E4 Energy, represented 5,636.8 MBOE, which replaced 522% of 2008 production. Finding, development and acquisition costs including future development capital and revisions were $25.29 per boe on a proved plus probable basis for 2008.

The following tables outline the Company's reserves as at December 31, 2008 as independently evaluated by McDaniel in accordance with National Instrument 51-101 Standards of Disclosure of Oil and Gas Activities ("NI 51-101"). For the complete NI 51-101 disclosures please refer to the Company's Annual Information Form which will be filed on SEDAR on or before March 31, 2009.

### Summary of Oil & Gas Reserves

| | Proved Producing | Total Proved | Total Probable | Total Proved plus Probable |
|---|---|---|---|---|
| Light/Medium Oil (Mbbl) | | | | |
| Working Interest | 1,201.2 | 1,738.5 | 1,169.3 | 2,907.8 |
| Net After Royalty | 1,075.6 | 1,528.0 | 995.2 | 2,523.2 |
| Natural Gas (MMcf) | | | | |
| Working Interest | 22,464 | 29,449 | 13,730 | 43,179 |
| Net After Royalty | 18,023 | 23,212 | 10,284 | 33,496 |
| Natural Gas Liquids (Mbbl) | | | | |
| Working Interest | 270.9 | 338.9 | 160.0 | 498.9 |
| Net After Royalty | 165.0 | 206.1 | 98.8 | 304.9 |
| Oil Equivalent (Mboe) | | | | |
| Working Interest | 5,216.1 | 6,985.5 | 3,617.6 | 10,603.1 |
| Net After Royalty | 4,244.4 | 5,602.7 | 2,808.0 | 8,410.7 |
| Before Tax Present Value ($M) | | | | |
| Discounted @ | | | | |
| 0% | 171,760 | 198,937 | 122,784 | 321,721 |
| 5% | 135,958 | 153,361 | 78,701 | 232,062 |
| 10% | 113,861 | 124,695 | 54,846 | 179,541 |
| 15% | 98,614 | 104,914 | 40,313 | 145,227 |

The Company increased the net present value of proved plus probable reserves, discounted at 10% before tax, to $179.5 million, up 48% from $98.8 million at December 31, 2007. The commodity prices forecast used by McDaniel in the report include a 2009 AECO hub spot gas price of $7.40/mmbtu and a 2009 WTI oil price of US $60.00/bbl which calculates to an Edmonton light crude oil posting of $69.60/bbl.

**Corporate Working Interest Reserves Reconciliation** (Forecast Prices and Costs)

| Oil Equivalent *(Mboe)* | Total Proved | Total Proved plus Probable |
|---|---|---|
| Opening Balance | 4,263.6 | 6,045.6 |
| Extensions/Discoveries | 896.5 | 1,696.1 |
| Revisions | 779.4 | 925.0 |
| Acquisitions | 2,125.3 | 3,015.7 |
| Dispositions | – | – |
| Production | (1,079.2) | (1,079.2) |
| Closing Balance | 6,985.5 | 10,603.1 |

**Finding, Development, and Acquisition Costs**

| Capital Costs *($MM)* | Proved | Proved plus Probable |
|---|---|---|
| Exploration & Development, with FDC | 59.3 | 67.5 |
| Acquisitions (net of Dispositions), with FDC | 71.0 | 75.0 |
| Total Expenditures, with FDC | 130.3 | 142.5 |
| Total Change in FDC | 28.2 | 40.4 |

| FD&A Costs *($/boe)* | Proved | Proved plus Probable |
|---|---|---|
| Exploration & Development including capitalized | | |
| G&A & Revisions, with FDC | 35.39 | 25.77 |
| All-in FD&A, with FDC | 34.29 | 25.29 |

FD&A costs in 2008 were $34.29 per boe proved and $25.29 per boe proved plus probable including FDC and revisions. Twin Butte's activities in 2008 replaced production by 352% on a total proved basis and 522% on a proved plus probable basis.

**Reserve Life Index**

| | Proved | Proved plus Probable |
|---|---|---|
| Total Company Interest Reserves (Mboe) | 6,985.5 | 10,603.1 |
| Fourth quarter 2008 production (boe/d) | 3,039 | 3,039 |
| RLI based on fourth quarter annualized production (years) | 6.3 | 9.6 |

**December 31, 2008 Net Asset Value per Fully Diluted Share Information**

Using Reserve Value at December 31, 2008 - Forecast Pricing and Costs:

| *($MM except share amounts)* | 10% Before Tax | 15% Before Tax |
|---|---|---|
| Proved Plus Probable Reserve Value | 179.5 | 145.2 |
| Undeveloped Land | 32.5 | 32.5 |
| Tax Pools [(1)] | 1.9 | 7.1 |
| Estimated Net Debt | (50.3) | (50.3) |
| Total Net Assets | 163.7 | 129.4 |
| Fully Diluted Shares Outstanding (MM) [(2)] | 47.1 | 47.1 |
| Estimated Net Asset Value per Fully Diluted Share | $3.47 | $2.75 |

(1) Tax pool valuation only for pools in excess of reserve NPV.

(2) Antidilutive options using a December 31, 2008 closing share price of $0.65/share were excluded.

On a comparative basis, the Company's net asset value per fully diluted share at year-end 2008 increased 4.8% as compared to December 31, 2007.

## READER ADVISORY

Certain information regarding Twin Butte set forth in this report including management's assessment of the Company's future plans and operations, the effect on the Company and on shareholders of Twin Butte, production increases and future production levels contain forward-looking statements that involve substantial known and unknown risks and uncertainties. These forward-looking statements are subject to numerous risks and uncertainties, certain of which are beyond Twin Butte's control including, without limitation, the impact of general economic conditions, industry conditions, volatility of commodity prices, currency fluctuations, imprecision of reserve estimates, environmental risks, competition from other producers, lack of availability of qualified personnel, stock market volatility, ability to access sufficient capital from internal and external sources and uncertainty related to the effect of the Arrangement. Twin Butte's actual results, performance or achievements may differ materially from those expressed in, or implied by, these forward-looking statements and, accordingly, no assurance can be given that any events anticipated by the forward-looking statements will transpire or occur, or if any of them do so, what benefits that Twin Butte will derive there from. Additional information on these and other factors that could affect Twin Butte's results are included in reports on file with Canadian securities regulatory authorities and may be accessed through the SEDAR website (www.sedar.com), or Twin Butte's website (www.twinbutteenergy.com). Furthermore, the forward-looking statements contained in this report are made as at the date of this report and Twin Butte does not undertake any obligation to update publicly or to revise any of the forward-looking statements, whether as a result of new information, future events or otherwise, except as may be required by applicable securities laws.

In this report, reserves and production data are commonly stated in barrels of oil equivalent ("boe") using a six to one conversion ratio when converting thousands of cubic feet of natural gas ("Mcf") to barrels of oil ("bbl") and a one to one conversion ratio for natural gas liquids ("NGLs" or "ngls"). Such conversion may be misleading, particularly if used in isolation. A boe conversion ratio of 6 Mcf: 1 bbl is based on energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.

# Management's Discussion and Analysis

Dated as of March 20, 2009

The following discussion and analysis as provided by the management of Twin Butte Energy Ltd. ("Twin Butte" or the "Company") should be read in conjunction with the audited financial statements for the year ended December 31, 2008 and the unaudited financial statements and management's discussion and analysis for the three quarters ended March 31, 2008, June 30, 2008 and September 30, 2008.

**Basis of Presentation** – The reporting and measurement currency is the Canadian dollar.

**Non-GAAP Measures** – The Management's Discussion and Analysis ("MD&A") contains the term cash flow from operations or cash flow 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. All references to cash flow from operations or cash flow throughout this report are based on cash flow from operating actives before changes in non-cash working capital. The Company also presents cash flow from operations per share whereby per share amounts are calculated using weighted average shares outstanding consistent with the calculation of earnings per share. These measures may not be comparable to other companies.

**boe Presentation** – Barrels of oil equivalent ("boe") may be misleading, particularly if used in isolation. A boe conversion rate of 6 Mcf: 1 bbl is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. All boe conversions in the report are derived by converting gas to oil at the ratio of six thousand cubic feet of gas to one barrel of oil.

**Forward-Looking Information** – Certain statements contained in this MD&A constitute forward-looking information within the meaning of securities laws. Forward-looking information may relate to our future outlook and anticipated events or results and may include statements regarding the future financial position, business strategy, budgets, projected costs, capital expenditures, financial results, taxes and plans and objectives of or involving Twin Butte Energy Ltd. Particularly, statements regarding our future operating results and economic performance are forward-looking statements. In some cases, forward-looking information can be identified by terms such as "may", "will", "should", "expect", "plan", "anticipate", "believe", "intend", "estimate", "predict", "potential", "continue" or other similar expressions concerning matters that are not historical facts.

These statements are based on certain factors and assumptions regarding expected growth, results of operations, performance and business prospects and opportunities. While we consider these assumptions to be reasonable based on information currently available to us, they may prove to be incorrect.

Forward looking-information is also subject to certain factors, including risks and uncertainties that could cause actual results to differ materially from what we currently expect. These factors include risk associated with oil and gas exploration, production, marketing, and transportation such as loss of market, volatility of commodity prices, currency fluctuations, imprecision of reserve estimates, environmental risk, competition from other producers and ability to access sufficient capital from internal and external resources.

Other than as required under securities laws, we do not undertake to update this information at any particular time.

## PETROLEUM AND NATURAL GAS SALES

Twin Butte realized the following production volumes, commodity prices and revenues:

| | Three months ended December 31 | | Year ended December 31 | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| **Average Twin Butte Realized Commodity Prices** (1) | | | | |
| Crude oil ($ per bbl) | **57.00** | 79.04 | **94.34** | 73.22 |
| Natural gas ($ per Mcf) | **7.18** | 6.67 | **8.69** | 6.68 |
| Natural gas liquids ($ per bbl) | **50.88** | 74.28 | **81.03** | 75.98 |
| Barrels of oil equivalent ($ per boe, 6:1) | **47.07** | 49.55 | **64.03** | 48.16 |

(1) The average selling prices reported are before realized financial instrument gains/losses and transportation charges.

| | | | | |
|---|---|---|---|---|
| **Benchmark Pricing** | | | | |
| WTI crude oil (US$ per bbl) | **58.80** | 90.63 | **99.67** | 72.27 |
| WTI crude oil (Cdn$ per bbl) | **71.15** | 88.82 | **105.62** | 77.29 |
| AECO natural gas (Cdn$ per Mcf) (2) | **6.69** | 6.13 | **8.13** | 6.45 |
| Exchange rate – US$/Cdn$ | **1.21** | 0.98 | **1.067** | 0.935 |

(2) The AECO natural gas price reported is the average daily spot price.

| | | | | |
|---|---|---|---|---|
| **Revenue** | | | | |
| $000's | | | | |
| Crude oil | **4,226** | 2,836 | **25,719** | 9,387 |
| Natural gas | **8,365** | 5,540 | **39,678** | 18,667 |
| Natural gas liquids | **567** | 770 | **3,703** | 1,887 |
| Total petroleum and natural gas sales | **13,158** | 9,146 | **69,100** | 29,941 |
| **Average Daily Production** | | | | |
| Crude oil & natural gas liquids (bbl/day) | **927** | 503 | **870** | 427 |
| Natural gas (Mcf/day) | **12,669** | 9,022 | **12,474** | 7,657 |
| Total (boe/d) | **3,039** | 2,006 | **2,949** | 1,703 |

Revenues for the three months ended December 31, 2008 were $13.2 million, as compared to $9.1 million for the three months ended December 31, 2007 representing an increase of $4.1 million or 45%. This increase in revenue is attributed primarily to year over year fourth quarter production average increasing by 51% to 3,039 boe/d in 2008 from 2,006 boe/d in 2007. The increase in revenue is partially offset by a 5% decrease in the average realized commodity price from $49.55 per boe in 2007 to $47.07 in 2008.

Revenues for the year ended December 31, 2008 were $69.1 million as compared to $29.9 million in 2007, representing an increase of 131%. This increase is due mainly to a 73% increase in yearly average production volumes and a 33% increase in comparable average realized prices in 2008 compared to 2007. The increase in year over year volumes is related to production acquired in the acquisition of E4 Energy Inc. in February 2008 and the Company's successful drilling program.

The Company's weighting to natural gas for the fourth quarter of 2008 was 69% and for the year ended December 31, 2008 was 70%, compared to a weighting of 75% for the fourth quarter and the year ended December 31, 2007. The decrease in the Company's natural gas weighting is primarily the result of the production acquired from the acquisition of E4 Energy Inc. that was lower natural gas weighted compared to Twin Butte at the time of the acquisition.

## ROYALTIES

Royalties for the three months ended December 31, 2008 were $2.4 million, as compared to $1.8 million for the three months ended December 31, 2007. As a percentage of revenues, the average royalty rate for the fourth quarter of 2008 were 18% compared to 20% for the comparative period of 2007. Royalties for the year ended December 31, 2008 were $11.6 million, as compared to $6.1 million for the year ended December 31, 2007. As a percentage of revenues, the average royalty rate for the year ended December 31, 2008 was 17% compared to 20% for the comparative period of 2007.

In 2008 the Company was able to take advantage of B.C. royalty credits for summer drilling, and received higher Alberta natural gas processing royalty credits resulting in a decrease in the effective royalty rate. Management anticipates the average royalty rate in 2009 will increase by approximately 1 to 2% based on current price forecasts and the implementation of the New Royalty Framework.

On October 25, 2007, the Alberta Government announced the New Royalty Framework ("NRF") which was subsequently revised on April 10, 2008 to provide further clarification on the NRF as well as to introduce two new royalty programs related to the development of deep oil and natural gas reserves. The NRF was legislated in November 2008 and took effect on January 1, 2009. Subsequent to legislation of the NRF, the Government of Alberta introduced the Transitional Royalty Plan ("TRP") in response to the decrease in development activity in Alberta resulting from declining commodity prices and the global economic downturn. The TRP offers reduced royalty rates for new wells drilled on or after November 19, 2008 that meet certain depth requirements. An election must be filed on an individual well basis in order to qualify for the TRP. The TRP is in place for a maximum of 5 years to December 31, 2013. All wells drilled between 2009 and 2013 that adopt the transitional rates will be required to shift to the NRF on January 1, 2014. The Company does not anticipate a significant benefit in 2009 given that its current wells converted to the NRF effective January 1, 2009. The Company has reviewed the NRF and has determined that its impact will change the Company's corporate forecast royalty rate over the life of the reserves by approximately 1% as compared to the royalty rates that would have been calculated with the royalty regime in place during 2008 based on benchmark pricing as at December 31, 2008.

On March 3, 2009 the Alberta government announced a series of incentives to assist the province's energy section, including a one-year drilling royalty credit for new conventional oil and natural gas wells, and a new well incentive program, which offers a maximum five percent royalty rate for the first year of production from new oil or gas wells. This government initiative will have limited effects on total Company royalty rates.

## OPERATING EXPENSES

Operating expenses were $3.7 million or $13.31 per boe for the quarter ended December 31, 2008 as compared to $2.4 million or $12.89 per boe for the three months ended December 31, 2007. Operating expenses were $13.5 million or $12.54 per boe for the year ended December 31, 2008 as compared to $7.4 million or $11.95 per boe for the year ended December 31, 2007. Higher operating costs in the producing areas from the acquisition of E4 Energy Inc. have contributed to an increase in operating expenses on a per boe basis in 2008. The Company realized an increase in operating costs on a per boe basis in the fourth quarter as a result of increased well servicing costs.

The Company is focusing on reducing operating expenses through improvements in field processes and combined with anticipated cost reductions for services the Company is forecasting a decrease in per unit operating costs of approximately 10%.

## TRANSPORTATION EXPENSES

Transportation expenses for the three months ended December 31, 2008 were $0.7 million or $2.47 per boe compared to $0.5 million or $2.54 per boe in the prior year comparative quarter. Transportation expenses for the year ended December 31, 2008 were $2.9 million or $2.65 per boe compared to $1.6 million or $2.50 per boe in the prior year. Increases in total transportation expenses are the result of increases in production volumes but transportation expenses on a per unit basis remained consistent in 2008.

## GENERAL AND ADMINISTRATIVE ("G&A") EXPENSES

| | Three months ended December 31 | | Year ended December 31 | |
|---|---|---|---|---|
| *($ thousands)* | **2008** | 2007 | **2008** | 2007 |
| G&A expenses | **1,740** | 1,012 | **6,267** | 3,425 |
| Recoveries | **(74)** | (149) | **(401)** | (393) |
| Capitalized G&A expenses | **(374)** | (181) | **(1,726)** | (719) |
| Total net G&A expenses | **1,292** | 682 | **4,140** | 2,313 |
| Total net G&A expenses ($/boe) | **$4.62** | $3.70 | **$3.84** | $3.72 |

General and administrative expenses, net of recoveries and capitalized G&A, were $1.3 million or $4.62 per boe for the current quarter as compared to $0.7 million or $3.70 per boe in the prior year comparative quarter. General and administrative expenses, net of recoveries and capitalized G&A, were $4.1 million, or $3.84 per boe for the year ended December 31, 2008 as compared to $2.3 million or $3.72 per boe for the year ended December 31, 2007. The absolute increase in G&A expenses for the year ended December 31, 2008 relative to the prior year reflects the growth of Twin Butte. In addition, fourth quarter and year end G&A costs include severance costs related to the change in management in the fourth quarter.

### STOCK BASED COMPENSATION EXPENSE

During the three month period ended December 31, 2008, the Company expensed $0.1 million in stock based compensation as compared to $0.2 million in the three month period ended December 31, 2007. Stock based compensation expense amounts to $1.7 million for the year ended December 31, 2008 compared to $0.6 million for the year ended December 31, 2007. Stock based compensation expense in the current quarter is consistent with the prior year comparative quarter. The increase in stock based compensation expense for the year ended December 31, 2008 compared to the prior year comparative period is the result of stock based compensation expense recorded on the remaining unrecognized fair value of outstanding stock options that were cancelled in 2008. This expense recognition is in accordance with accounting standards.

### INTEREST EXPENSE

For the three months ended December 31, 2008, interest expense was $0.5 million, an increase of $0.1 million from $0.4 million for the prior year comparative quarter. For the year ended December 31, 2008, interest expense was $2.2 million compared to $0.9 million for the year ended December 31, 2007. Higher interest costs in the fourth quarter and the year ended December 31, 2008 are due to higher average debt levels. Bank indebtedness levels have increased primarily as a result of net debt in the amount of $19.9 million acquired as part of the acquisition of E4 Energy Inc. in the first quarter and as a result of capital expenditures exceeding cash flow in 2008 by $11.3 million.

The Company's effective interest rate for the three months and year ended December 31, 2008 were 4.6 percent and 5.0 percent, respectively, as compared to the three months and year ended December 31, 2007 of 6.9 percent and 6.7 percent, respectively.

### UNREALIZED AND REALIZED GAINS (LOSSES) ON FINANCIAL DERIVATIVES

During 2007 and 2008, the Company entered into fixed price swap and costless collar contracts for natural gas and crude oil. As part of our financial management strategy, Twin Butte has adopted a commodity price risk management program. The purpose of the program is to reduce volatility in the financial results and to stabilize and hedge future cash flow against the unpredictable commodity price environment, with an emphasis on protecting downside risk.

The Company has recognized a realized gain on financial derivatives in the amount of $0.7 million ($2.43/boe) for the three month period ended December 31, 2008 as compared to a $0.2 million ($0.84/boe) realized loss for the prior year comparative period. For the year ended December 31, 2008, the Company has recognized a realized loss on financial derivatives in the amount of $3.7 million ($3.39/boe) compared to a $0.5 million ($0.88/boe) realized gain for the prior year comparative period. The realized gain on financial derivatives for the three month period ended December 31, 2008 amounted to $36 thousand for natural gas sales price derivatives and $644 thousand for crude oil sales price derivatives. The realized loss on financial derivatives for the year ended December 31, 2008 amounted to $2.5 million thousand for natural gas sales price derivatives and $1.2 million for crude oil sales price derivatives.

As at December 31, 2008, the Company has recognized an unrealized financial derivatives asset in the amount of $2.1 million. The Company has recognized an unrealized gain on financial derivatives in the amount of $2.0 million for the three month period ended December 31, 2008 and $2.6 million for the year ended December 31, 2008. The following is a summary of crude oil sales price derivatives in effect as at December 31, 2008 and their related fair market values (unrealized gain positions):

### Crude Oil Sales Price Derivatives

| Daily quantity per barrel ("bbl") | Remaining term of contract | Fixed price per bbl (WTI) | Costless Collar per bbl (WTI) | Fair market value $ 000's |
|---|---|---|---|---|
| 100 | January 1 to December 31, 2009 | | US $100.00 – US $195.00 | $ 2,075 |
| Crude oil fair value position | | | | $ 2,075 |

As at December 31, 2008 the marked-to-market value of the Company's crude oil sales price derivative was an asset of USD $1.7 million, or a Canadian dollar equivalent of $2.1 million. In February 2009 the Company amended this contract to adjust the floor price from US $100.00 to $60.00 for the period of March 1 through to December 31, 2009. In exchange for amending the terms of the contract, Twin Butte was paid US $1.1 million (CAD $1.4 million) in the month of February 2009.

## DEPLETION, DEPRECIATION AND ACCRETION EXPENSE

For the three month period ended December 31, 2008, depletion and depreciation of capital assets and the accretion of the asset retirement obligations was $8.2 million or $28.80 per boe compared to $4.8 million or $25.69 per boe for the three month period ended December 31, 2007. For the year ended December 31, 2008, depletion and depreciation of capital assets and the accretion of the asset retirement obligations was $30.7 million or $27.91 per boe compared to $18.6 million or $29.48 per boe for the year ended December 31, 2007.

The increase in depletion, depreciation and accretion expense for the three months ended and year ended December 31, 2008 as compared to the same periods in 2007 is due to higher production volumes and reflects an increase in costs on a per unit basis. Per unit costs have decreased for the 2008 year when compared to the 2007 year due to proven reserve additions at a lower cost than historic depletion, depreciation and accretion expense per boe.

## INCOME TAXES

Future income tax expense amounted to $2.9 million for the three month period ended December 31, 2008 compared to a future income tax recovery in the amount of $6.4 million for the three month period ended December 31, 2007. For the year ended December 31, 2008, future income tax expense amounted to $3.9 million compared to a future income tax recovery of $6.6 million for the prior year comparative period.

The Company has existing tax losses and pools of approximately $192 million of which $23.2 million are non-capital losses and the Company has no current tax expense.

## CASH FLOW FROM OPERATIONS, AND NET INCOME (LOSS) AND COMPREHENSIVE INCOME (LOSS)

Cash flow from operations for the three month period ended December 31, 2008 was $5.2 million, an increase of 58% from fourth quarter 2007 cash flow of $3.3 million. Cash flow per share basic and diluted amounted to $0.12 for the fourth quarter of 2008 and 2007. Cash flow from operations for the year ended December 31, 2008 was $31.1 million, an increase of 154% from the year ended December 31, 2007 cash flow of $12.2 million. This represents an increase of 48% in cash flow per share basic and diluted to $0.74 per share for 2008 compared to $0.50 per share for 2007.

The Company posted net loss and comprehensive loss of $4.0 million for the three month period ended December 31, 2008, equating to a basic and diluted net loss per share of $0.09, compared to net income and comprehensive income of $4.3 million for the three month period ended December 31, 2007, equating to a basic and diluted net income per share of $0.15. Net loss and comprehensive loss for the year ended December, 2008 was $2.6 million, or $0.06 per share basic and diluted, compared to a net loss and comprehensive loss for the prior year comparative period of $1.0 million, or $0.04 per share basic and diluted.

The net loss and comprehensive loss of $2.6 million for the year ended December 31, 2008 includes non cash items including depletion, depreciation and accretion expense of $30.7 million, future income tax expense of $3.9 million, unrealized gain on financial derivatives of $2.6 million and stock based compensation expense of $1.7 million.

The following table summarizes netbacks for the past eight quarters on a barrel of oil equivalent basis:

| *($ per boe)* | **Q4 2008** | Q3 2008 | Q2 2008 | Q1 2008 | Q4 2007 | Q3 2007 | Q2 2007 | Q1 2007 |
|---|---|---|---|---|---|---|---|---|
| Petroleum and natural gas sales | **47.07** | 68.69 | 78.91 | 60.67 | 49.55 | 42.91 | 51.38 | 50.76 |
| Royalties | **(8.54)** | (12.59) | (11.15) | (10.64) | (9.99) | (9.08) | (10.52) | (9.55) |
| Realized gain (loss) on financial instruments | **2.43** | (3.88) | (9.30) | (2.71) | (0.84) | 3.07 | 0.93 | – |
| Operating expenses | **(13.31)** | (11.90) | (13.58) | (11.17) | (12.89) | (11.86) | (10.96) | (11.73) |
| Transportation expenses | **(2.47)** | (2.45) | (2.88) | (2.83) | (2.54) | (2.47) | (2.31) | (2.69) |
| Operating netback | **25.18** | 37.87 | 42.00 | 33.32 | 23.29 | 22.57 | 28.52 | 26.79 |
| General and administrative expenses | **(4.61)** | (2.74) | (3.53) | (4.69) | (3.70) | (3.19) | (4.25) | (4.03) |
| Interest expense | **(1.82)** | (1.53) | (1.81) | (3.21) | (1.96) | (2.07) | (0.77) | (0.47) |
| Cash flow from operations | **18.75** | 33.60 | 36.66 | 25.42 | 17.63 | 17.31 | 23.50 | 22.29 |

## QUARTERLY FINANCIAL SUMMARY

The following table highlights Twin Butte's performance for the past eight quarters:

| *($ thousands, except per share amounts)* | **Q4 2008** | Q3 2008 | Q2 2008 | Q1 2008 | Q4 2007 | Q3 2007 | Q2 2007 | Q1 2007 |
|---|---|---|---|---|---|---|---|---|
| Average production (boe/d) | **3,039** | 3,202 | 3,051 | 2,500 | 2,006 | 2,042 | 1,445 | 1,309 |
| Petroleum and natural gas sales | **13,158** | 20,235 | 21,907 | 13,800 | 9,146 | 8,060 | 6,755 | 5,981 |
| Operating netback (per boe) | **25.18** | 37.85 | 42.00 | 33.32 | 23.29 | 22.57 | 28.52 | 26.79 |
| Cash flow from operations | **5,243** | 9,895 | 10,178 | 5,780 | 3,255 | 3,254 | 3,091 | 2,626 |
| Per share basic & diluted | **0.12** | 0.23 | 0.23 | 0.16 | 0.12 | 0.12 | 0.14 | 0.13 |
| Net income (loss) | **(4,001)** | 5,909 | (1,753) | (2,751) | 4,272 | (4,818) | 3,483 | (3,915) |
| Per share basic & diluted | **(0.09)** | 0.14 | (0.04) | (0.07) | 0.15 | (0.18) | 0.16 | (0.19) |
| Corporate acquisitions | **–** | – | – | 57,252 | – | – | – | – |
| Capital expenditures (net of dispositions) | **9,211** | 17,623 | 7,025 | 8,513 | 3,671 | 3,615 | 31,981 | 8,391 |
| Total assets | **190,665** | 189,613 | 187,172 | 186,685 | 120,151 | 112,804 | 116,389 | 81,899 |
| Net debt excluding financial derivatives liability | **50,309** | 51,073 | 43,230 | 46,297 | 23,242 | 22,823 | 38,042 | 9,001 |

## CORPORATE ACQUISITIONS

On February 8, 2008, the Company closed the acquisition of E4 Energy Inc., a publicly traded company with properties in North East British Columbia and in Alberta, for total consideration of approximately $57.3 million including net debt assumed. The purchase was funded through the issuance of 15.7 million common shares of Twin Butte and was accounted for as a business combination using the purchase method of accounting.

## CAPITAL EXPENDITURES

During 2008, the Company invested $42.4 million with the drilling of 21 gross wells (20.1 net) for a success rate of 90 percent. The following tables summarize capital expenditures, drilling results and undeveloped land positions for 2008 and 2007.

| **Capital Expenditures** *($ thousands)* | Three months ended December 31 | | Year ended December 31 | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| Land acquisition | **25** | – | **1,539** | 1,633 |
| Geological and geophysical | **44** | 329 | **1,067** | 895 |
| Drilling and completions | **6,425** | 1,821 | **31,608** | 10,167 |
| Equipping and facilities | **2,350** | 1,551 | **6,348** | 6,504 |
| Property acquisitions | **–** | (267) | **–** | 28,137 |
| Property dispositions | **–** | – | **–** | (466) |
| Other | **367** | 237 | **1,810** | 788 |
| Total net capital expenditures | **9,211** | 3,671 | **42,372** | 47,659 |

### Drilling Results

| Year ended December 31 | **2008** | | 2007 | |
|---|---|---|---|---|
| | **Gross** | **Net** | Gross | Net |
| Crude oil | **13.0** | **12.9** | 9.0 | 7.5 |
| Natural gas | **6.0** | **5.2** | 9.0 | 7.3 |
| Dry and abandoned | **2.0** | **2.0** | - | - |
| Total | **21.0** | **20.1** | 18.0 | 14.8 |
| Success rate (%) | | **90%** | | 100% |

| Three months ended December 31 | **2008** | | 2007 | |
|---|---|---|---|---|
| | **Gross** | **Net** | Gross | Net |
| Crude oil | **–** | **–** | 3.0 | 3.0 |
| Natural gas | **1.0** | **0.6** | 2.0 | 1.5 |
| Dry and abandoned | **–** | **–** | – | – |
| Total | **1.0** | **0.6** | 5.0 | 4.5 |
| Success rate (%) | | **100%** | | 100% |

### Undeveloped Land

| Year ended December 31 | **2008** | 2007 |
|---|---|---|
| Gross Acres | **195,308** | 78,769 |
| Net Acres | **153,721** | 57,896 |

## LIQUIDITY AND CAPITAL RESOURCES

In order to support the Company's growth-oriented business plan, Twin Butte's strategy is to fund its capital expenditure program with cash flows from operations and bank debt. With forecasted decreases in cash flows and tighter credit markets in 2009, Twin Butte plans to limit 2009 capital expenditures to approximately cash flow which should continue to provide the Company an undrawn portion on the Company's credit facility borrowing.

As at December 31, the Company had a credit facility with a Canadian chartered bank in the amount of $65.0 million. The credit facility is composed of a $65.0 million demand revolving operating credit facility. The Company's credit facility is subject to semi-annual review by the bank, and was reconfirmed subsequent to year end on February 19, 2009. The facility is a borrowing base facility that is determined based on, among other things, the Company's current reserve report, results of operations, current and forecasted commodity prices and the current economic environment.

The credit facility provides that advances may be made by way of direct advances, banker's acceptances, or standby letters of credit/guarantees. Direct advances bear interest at the bank's prime lending rate plus an applicable margin. The applicable margin charged by the bank is dependent on the Company's debt to trailing cash flow ratio. The bankers' acceptances bear interest at the applicable bankers' acceptance rate plus a stamping fee, based on the Company's debt to trailing cash flow ratio. The credit facility is secured by a demand debenture and a general security agreement covering all assets of the Company.

At December 31, 2008, the Company had $45.6 million drawn on its credit facility and total net debt of $50.3 million, excluding a net financial derivatives asset in the amount of $2.1 million. As at that date, Twin Butte had met all of its covenants pertaining to this loan agreement and was not required to make any repayments. The covenants pertaining to this loan agreement are based on a measure of the Company's work capital.

## SHARE CAPITAL

On May 31, 2007, the Company consolidated its share capital on a 1:5 basis. All share and per share amounts have been restated to reflect this share consolidation.

On February 8, 2008, the Company closed the acquisition of E4 Energy Inc. ("E4"), a publicly traded company for total consideration of approximately $57.3 million (based on a Company share price of $2.45) excluding transaction costs and including net debt of $19.9 million. The Company issued 15,663,027 common shares to the former shareholders of E4.

On December 19, 2008, the Company closed a bought deal private placement of 3,704,000 flow-through Common Shares at a price of $1.35 per share, for gross proceeds of $5,000,400 ($4,651,725 net of share issue costs).

At December 31, 2008 the Company had 47,128,425 Common Shares issued compared to 27,752,398 Common Shares at December 31, 2007. The increase of 70% in the number of Common Shares outstanding relates to the issuance of 15,663,027 Common Shares to the former shareholders of E4 Energy Inc. on February 8, 2008, the issuance of 9,000 Common Shares on the exercise of employee stock options, and the issuance of 3,704,000 flow-through Common Shares issued in December.

As of March 20, 2009 the Company currently has 47,128,425 Common Shares and 2,836,500 stock options outstanding.

## CONTRACTUAL OBLIGATIONS AND CONTINGENCIES

The issuance of flow through shares in December 2008 for gross proceeds of $5.0 million will require the Company to spend $5.0 million of flow-through share eligible Canadian Exploration Expenditures, as defined in the Canadian Income Tax Act, by December 31, 2009. As at December 31, 2008 the Company had incurred approximately $nil of this commitment.

The Company has other commitments and guarantees in the normal course of business, consisting of an office space lease and equipment rentals which are not considered material.

The Company is involved in legal claims associated with the normal course of operations. The Company has completed an assessment and has not recorded a contingent liability.

## RELATED PARTY TRANSACTIONS

During the year the Company incurred costs totaling $561 thousand for services rendered by companies in which a director of Twin Butte is an officer and a director and an officer of the Company is a director of that company. These costs were incurred in the normal course of business and recorded at the exchange amount.

## NEWLY ADOPTED ACCOUNTING POLICIES

As disclosed in the December 31, 2008 annual audited financial statements, the CICA has issued three new accounting standards, section 1535 "Capital Disclosures", section 3862 "Financial Instruments – Disclosures", and section 3863 "Financial Instruments – Presentation". These standards became effective for the Company in the first quarter of 2008.

Section 1535 requires the disclosure of the Company's objectives, policies and processes for managing capital. This includes qualitative information regarding the Company's objectives, policies and processes for management of capital and quantitative data about what the Company manages as capital. These disclosures are based on information that is provided internally by the Company's key management. The Company has provided these disclosures in the December 31, 2008 and 2007 financial statements.

Effective January 1, 2008, Sections 3862 and 3863 replaced section 3861 "Financial Instruments – Disclosure and Presentation" which revises and enhances financial instruments disclosure requirements and leaves unchanged its presentation requirements. These new sections place increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the Company manages those risks.

## FUTURE ACCOUNTING POLICY CHANGES

In January 2006, the CICA Accounting Standards Board ("AcSB") adopted a strategic plan for the direction of accounting standards in Canada. As part of the plan, accounting standards in Canada for public companies will converge with International Financial Reporting Standards ("IFRS") effective January 1, 2011. The Company continues to monitor, assess and develop its implementation plan for the convergence of Canadian GAAP and IFRS.

## CRITICAL ACCOUNTING ESTIMATES

Management is required to make judgments and use estimates in the application of generally accepted accounting principles that have a significant impact on the financial results of the Company.

### Full Cost Accounting

The Company follows the Canadian Institute of Chartered Accountants' guideline on full cost accounting in the oil and gas industry to account for oil and gas properties. Under this method, all costs associated with the acquisition of, exploration for and development of natural gas and crude oil reserves are capitalized and costs associated with production are expensed. The capitalized costs are depreciated, depleted and amortized using the unit-of-production method based on estimated proved reserves. Reserve estimates can have a significant impact on earnings, as they are a key component in the calculation of depreciation, depletion and accretion ("DD&A"). A downward revision in a reserve estimate could result in a higher DD&A charge to earnings. In addition, if net capitalized costs are determined to be in excess of the calculated ceiling, which is based largely on reserve estimates, the excess must be written off as a expense and charged against earnings. In the event of a property disposition, proceeds are normally deducted from the full cost pool without recognition of a gain or loss unless there is a change in the DD&A rate of 20 percent or greater.

### Asset Retirement Obligations

The Company records a liability for the fair value of legal obligation associated with the retirement of long-lived tangible 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 and the asset retirement obligation. The total amount of asset retirement obligation is an estimate based on the Company's net ownership interest in all wells and facilities and the estimated costs to abandon and reclaim the wells and facilities and the estimated timing of the costs to be incurred in the future periods. The total amount of the estimated cash flows required to settle the asset retirement obligation and the timing of those cash flows are estimates subject to measurement uncertainty. Any changes in these estimates would impact the asset retirement liability.

### Reserves Determination

The proved crude oil, natural gas and natural gas liquid reserves used in determining our depletion rates, the magnitude of the borrowing base available to us from our lender and the ceiling test are based upon management's best estimates, and are subject to uncertainty. Through the use of geological, geophysical and engineering data, the reservoirs and deposits of natural gas, crude oil and natural gas liquids are examined to determine quantities available for future production, given existing operating and economic conditions and technology. The evaluation of recoverable reserves is an ongoing process impacted by current production, continuing development activities and changing economic conditions as reflected in crude oil and natural gas prices and costs. Consequently, the reserves are estimates which are subject to variability. To assist with the reserve evaluation process, we employ the services of independent oil and gas reservoir engineers.

### Income Taxes

The determination of the Company's income and other tax liabilities require interpretation of complex laws and regulations often involving multiple jurisdictions. All tax filings are subject to audit and potential reassessment after lapse of considerable 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 as 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.

### Ceiling Test

Under the full cost accounting method, a ceiling test is performed at least annually to ensure that the net capitalized costs in each country do not exceed the undiscounted future net revenues from proved reserves, plus the cost of unproved properties. Any excess capitalized costs will be written off as an expense and charged to earnings; however, future depletion and depreciation expense would be reduced.

### Financial Derivatives

The Company may use derivative financial instruments from time to time to hedge its exposure to commodity prices, foreign exchange and interest rate fluctuations. The mark to market valuations of these contracts are presented in the Company's financial statements. These valuations are based on forward looking estimates including, but not limited to, volatility, interest rates and commodity prices.

## ASSESSMENT OF BUSINESS RISKS

The following are the primary risks associated with the business of Twin Butte. These risks are similar to those affecting other companies competing in the conventional oil and natural gas section. Twin Butte's financial position and results of operations are directly impacted by these factors and include:

Operational risk associated with the production of oil and natural gas:

- Reserve risk in respect to the quantity and quality of recoverable reserves;
- Exploration and development risk of being able to add new reserves economically;
- Market risk relating to the availability of transportation systems to move the product to market;
- Commodity risk as crude oil and natural gas prices fluctuate due to market forces;
- Financial risk such as volatility of the Canadian/US dollar exchange rate, interest rates and debt service obligations;
- Environmental and safety risk associated with well operations and production facilities;
- Changing government regulations relating to royalty legislation, income tax laws, incentive programs, operating practices and environmental protection relating to the oil and natural gas industry; and
- Continued participation of Twin Butte's lenders.

Twin Butte seeks to mitigate these risks by:

- Acquiring properties with established production trends to reduce technical uncertainty as well as undeveloped land with development potential;
- Maintaining a low cost structure to maximize product netbacks and reduce impact of commodity price cycles;
- Diversifying properties to mitigate individual property and well risk;
- Maintaining product mix to balance exposure to commodity prices;
- Conducting rigorous reviews of all property acquisitions;
- Monitoring pricing trends and developing a mix of contractual arrangements for the marketing of products with creditworthy counterparties;

> Maintaining a hedging program to hedge commodity prices with creditworthy counterparties;

> Adhering to the Company's safety program and adhering to current operating best practices;

> Keeping informed of proposed changes in regulations and laws to properly respond to and plan for the effects that these changes may have on our operations;

> Carrying industry standard insurance;

> Establishing and maintaining adequate resources to fund future abandonment and site restoration costs; and

> Monitoring our joint venture partners' obligations to us and cash calling for capital projects to limit the Company's credit risk.

## STATUS OF TRANSITION TO INTERNATIONAL FINANCIAL REPORTING STANDARDS ("IFRS")

On February 13, 2008, the Canadian Accounting Standards Board confirmed that publicly accountable enterprises will be required to adopt IFRS in place of Canadian Generally Accepted Accounting Principles for interim and annual reporting purposes for fiscal years beginning on or after January 1, 2011.

The Company is in the process of assessing the financial reporting impacts of the adoption of IFRS and, at this time, the impact on future financial position and results of operations is not reasonably determinable or estimable. Further, we anticipate a significant increase in disclosure resulting from the adoption of IFRS and are continuing to assess the level of this disclosure required and any necessary systems changes to gather and process the information.

## INTERNAL CONTROL OVER FINANCIAL REPORTING

Management is responsible for establishing and maintaining adequate internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP. Management assessed the design and effectiveness of internal controls over financial reporting as at December 31, 2008, and based on that assessment determined that the design and operating effectiveness of internal controls over financial reporting was effective.

No changes were made to internal control over financial reporting during the year ended December 31, 2008 that have materially affected, or are reasonably likely to materially affect, internal control over financial reporting.

## DISCLOSURE CONTROLS AND PROCEDURES

Disclosure controls and procedures are designed to provide reasonable assurance that all relevant information is gathered and reported to senior management, including the President & Chief Executive Officer ("CEO") and Vice President, Finance and Chief Financial Officer ("CFO"), on a timely basis so that appropriate decisions can be made regarding public disclosure.

Management has evaluated the effectiveness of the design and operation of its disclosure controls and procedures, under the supervision of its CEO and CFO. Based on this evaluation, Management concluded that the disclosure controls and procedures, as defined in National Instrument 52-109, were effective as of December 31, 2008.

## ADDITIONAL INFORMATION

Additional information relating to Twin Butte, including Twin Butte's AIF and financial statements (to be filed before March 31, 2009) can be found on SEDAR at www.sedar.com.

# Management's Report

To the Shareholders of Twin Butte Energy Ltd.:

### MANAGEMENT'S RESPONSIBILITY FOR CONSOLIDATED FINANCIAL STATEMENTS

The accompanying financial statements of Twin Butte Energy Ltd. and all of the information in this Annual Report are the responsibility of management and have been approved by the Board of Directors.

The financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles. When alternative accounting methods exist, management has chosen those methods it deems most appropriate in the circumstances. Financial statements are not precise since they include certain amounts based on estimates and judgments. Management has determined such amounts on a reasonable basis in order to ensure that the financial statements are presented fairly, in all material respects. The financial information contained elsewhere in this report has been reviewed to ensure consistency with the financial statements.

### MANAGEMENT'S ASSESSMENT OF INTERNAL CONTROLS OVER FINANCIAL REPORTING

Management is also responsible for establishing and maintaining adequate internal control over the Company's financial reporting. Management has established systems of internal controls, which are designed to provide reasonable assurance the Company's assets are safeguarded from loss or unauthorized use and to produce reliable accounting records for the preparation of financial information. Internal control systems, no matter how well designed have inherent limitations. Therefore, even those systems that have been determined to be effective can only provide reasonable assurance with respect to financial statement preparation and presentation.

The Board of Directors is responsible for ensuring that management fulfils its responsibilities for financial reporting and internal controls. It exercises its responsibilities primarily through the Audit Committee, which is comprised of independent, non-management directors. The Audit Committee has reviewed the financial statements with both management and the auditors. This has been reported to the Board of Directors which has approved the financial statements.

The financial statements have been audited by PricewaterhouseCoopers LLP, the external auditors, in accordance with auditing standards generally accepted in Canada on behalf of the shareholders.

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|---|---|
| Jim Saunders | R. Alan Steele |
| President and Chief Executive Officer | Vice-President, Finance & CFO |

March 20, 2009

## Auditors' Report

To the Shareholders of Twin Butte Energy Ltd.:

We have audited the balance sheets of Twin Butte Energy Ltd. as at December 31, 2008 and 2007 and the statements of loss, comprehensive loss and deficit and cash flows for each of the years in the two year period ended December 31, 2008. 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 each of the years in the two year period ended December 31, 2008 in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants
Calgary, Alberta

March 20, 2009

# Balance Sheets

| | December 31 2008 | December 31 2007 |
|---|---|---|
| **ASSETS** | | |
| **Current Assets** | | |
| Accounts receivable | **$ 9,416,746** | $ 5,727,286 |
| Deposits and prepaid expenses | **1,651,966** | 558,263 |
| Financial derivatives (note 9) | **2,075,039** | 266,898 |
| | **13,143,751** | 6,552,447 |
| Future income taxes (note 7) | **1,324,465** | 9,164,477 |
| Property and equipment (note 3) | **176,197,152** | 104,433,701 |
| | **$ 190,665,368** | $ 120,150,625 |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | |
| **Current Liabilities** | | |
| Accounts payable and accrued liabilities | **$ 15,745,084** | $ 8,278,779 |
| Bank indebtedness (note 4) | **45,632,924** | 21,248,583 |
| Financial derivatives (note 9) | **–** | 827,135 |
| | **61,378,008** | 30,354,497 |
| Asset retirement obligation (note 5) | **9,158,775** | 6,945,541 |
| | **70,536,783** | 37,300,038 |
| **Shareholders' Equity** | | |
| Share capital (note 6) | **131,863,112** | 93,722,668 |
| Contributed surplus (note 6) | **2,747,850** | 1,014,991 |
| Deficit | **(14,482,377)** | (11,887,072) |
| | **120,128,585** | 82,850,587 |
| | **$ 190,665,368** | $ 120,150,625 |

Commitments and contingencies (note 10)

*See accompanying notes to financial statements*

On Behalf of the Board of Directors:

Jim Saunders
Director

David Fitzpatrick
Director

## Statements of Loss, Comprehensive Loss and Deficit

| Year Ended December 31 | 2008 | 2007 |
|---|---|---|
| **REVENUE** | | |
| Petroleum and natural gas sales | $ 69,099,751 | $ 29,941,409 |
| Royalties | (11,613,745) | (6,057,074) |
| Realized (loss) gain on financial derivatives | (3,660,486) | 545,552 |
| Unrealized gain (loss) on financial derivatives (note 9) | 2,635,277 | (560,237) |
| | 56,460,797 | 23,869,650 |
| **EXPENSES** | | |
| Operating | 13,538,560 | 7,429,785 |
| Transportation | 2,857,328 | 1,552,291 |
| General and administrative | 4,140,549 | 2,313,498 |
| Stock based compensation | 1,735,843 | 599,278 |
| Interest | 2,193,059 | 908,788 |
| Depletion, depreciation and accretion | 30,739,092 | 18,603,817 |
| | 55,204,431 | 31,407,457 |
| Income (loss) before income taxes | 1,256,366 | (7,537,807) |
| Income taxes | | |
| Future tax expense (recovery) | 3,851,671 | (6,559,010) |
| | 3,851,671 | (6,559,010) |
| Net loss and comprehensive loss | (2,595,305) | (978,797) |
| Deficit, beginning of period | (11,887,072) | (10,908,275) |
| Deficit, end of period | $ (14,482,377) | $ (11,887,072) |
| Basic & diluted loss per share | $ (0.06) | $ (0.04) |
| Weighted average common shares outstanding | | |
| Basic | 41,883,092 | 24,284,620 |
| Diluted | 41,981,359 | 24,284,620 |

*See accompanying notes to financial statements*

## Statements of Cash Flows

| Year Ended December 31 | 2008 | 2007 |
|---|---|---|
| Cash provided by (used in): | | |
| **OPERATIONS:** | | |
| Net loss | $ (2,595,305) | $ (978,797) |
| Items not involving cash: | | |
| Depletion, depreciation and accretion | 30,739,092 | 18,603,817 |
| Future tax expense (recovery) | 3,851,671 | (6,559,010) |
| Unrealized (gain) loss on financial derivatives | (2,635,277) | 560,237 |
| Stock based compensation | 1,735,843 | 599,278 |
| | 31,096,024 | 12,225,525 |
| Expenditures on asset retirement obligations | (88,617) | – |
| Changes in non-cash working capital | (8,563,180) | 1,562,268 |
| | 22,444,227 | 13,787,793 |
| **FINANCING:** | | |
| Change in bank indebtedness | 8,619,341 | 14,929,598 |
| Issuance of share capital | 5,000,400 | 28,650,700 |
| Issuance of share capital on exercise of stock options | 26,190 | – |
| Bank financing and share issue costs | (442,425) | (1,901,821) |
| | 13,203,506 | 41,678,477 |
| **INVESTING:** | | |
| Expenditures on property and equipment | (42,372,070) | (48,124,391) |
| Acquisition expenditures | (362,668) | – |
| Proceeds on disposition of property and equipment | – | 465,721 |
| Changes in non-cash working capital | 7,087,005 | (7,807,600) |
| | (35,647,733) | (55,466,270) |
| Decrease in cash and cash equivalents | – | – |
| Cash and cash equivalents, beginning of period | – | – |
| Cash and cash equivalents, end of period | $ – | $ – |
| Cash interest paid | $ 1,985,434 | $ 898,768 |

*See accompanying notes to financial statements*

# Notes to Financial Statements – December 31, 2008

Twin Butte Energy Ltd. ("Twin Butte" or the "Company") is engaged in the acquisition of, exploration for, and development of petroleum and natural gas properties in Western Canada. On February 3, 2004, a Plan of Arrangement was completed involving Twin Butte (formerly AltaRex Corp.), AltaRex Medical Corp., and Nova Bancorp Investments Ltd. Pursuant to the Arrangement, Twin Butte was transformed into an oil and gas exploration and production company.

## NOTE 1. SIGNIFICANT ACCOUNTING POLICIES

These financial statements have been prepared by management in accordance with accounting principles generally accepted in Canada. As such, the precise determination of many assets, liabilities, revenues and expenses are dependent on future events, the preparation of financial statements for a period necessarily includes the use of estimates and approximations which have been made using careful judgment. Actual results could differ from the estimates. These financial statements have, in management's opinion, been properly prepared within reasonable limits of materiality and within the framework of the accounting policies summarized below.

Summary of significant accounting policies:

**a) Oil and gas operations**

*i) Capitalization of costs*

The Company follows the full-cost method of accounting for oil and natural gas properties whereby all costs of acquisition, exploration and development of petroleum and natural gas reserves are capitalized and accumulated in a single cost centre representing the Company's activity undertaken exclusively in Canada. Such costs include land acquisition costs, geological and geophysical expenses, lease rentals costs on non-producing properties, costs of drilling both productive and non-productive wells, related production equipment costs, and overhead charges directly related to these activities.

Proceeds received on the disposition of oil and gas properties are credited against property and equipment except when the disposition results in a change in the depletion rate of the 20% or more, in which case a gain or loss is recognized.

Office and computer equipment are depreciated using the straight line method ranging between three and five years.

*ii) Depletion and depreciation*

Capitalized costs, excluding costs related to unproven reserves and salvage values, are depleted and depreciated using the unit-of-production method based on the estimated gross proven oil and natural gas reserves before royalties as determined by independent engineers. Oil and natural gas reserves are converted on an energy equivalent basis.

*iii) Ceiling test*

Petroleum and natural gas assets are evaluated on an annual basis to determine that the costs are recoverable and do not exceed the fair value of the properties (the "ceiling test"). 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 fair value of unproved properties exceed the carrying value of the petroleum and natural gas assets. If the carrying value of the petroleum and natural gas is not assessed to be recoverable, an impairment loss is 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 and fair value of unproved properties. The cash flows are estimated using future commodity prices and costs and are discounted using the Company's risk-free rate.

**b) Asset retirement obligations**

The Company records the fair value of an asset retirement obligation ("ARO") as a liability in the period in which it incurs a legal obligation associated with the retirement of long-lived assets that result from the acquisition, construction and development of the assets. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset and depleted and depreciated using a unit of production method over estimated proved reserves. The recorded ARO increases over time through accretion charges to earnings. Revisions to the estimated amount and timing of the obligations are reflected as increases or decreases to the ARO. Actual asset retirement expenditures are charged to the ARO to the extent of the recorded liability with any difference recorded as a gain or loss in the period in which settlement occurs.

**c) Joint operations**

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

**d) Flow-through common shares**

The Company has financed a portion of its exploration and development activities through the issuance of flow-through common shares. Under the terms of the flow-through shares, the income tax attributes of the related expenditures are renounced to the subscribers. To recognize the foregone tax benefits to the Company, the flow-through shares issued are recorded net of the tax benefits when renouncement documents are filed with the tax authorities.

**e) Foreign currency translation**

Monetary assets and liabilities denominated in foreign currencies are translated at exchange rates in effect at the balance sheet date. Non-monetary assets and liabilities denominated in foreign currencies are translated at rates in effect on the dates the assets were acquired or liabilities were assumed. Revenues and or losses on these items are included in the statements of operations.

**f) Income taxes**

The Company follows the liability method of income tax allocation. Under this method, future income taxes are recognized for the future income tax consequences attributable to differences between the carrying values of assets and liabilities and their respective income tax basis. Future income tax assets and liabilities are measured using substantively enacted income tax rates expected to apply to taxable income in the years in which temporary differences are expected to be recovered or settled. The effect on future income tax assets and liabilities of a change in rates is included in earnings in the period that includes the date of substantial enactment. Future income tax assets are recorded in the financial statements if realization is considered more likely than not.

**g) Stock-based compensation and other stock-based payments**

The Company grants stock options to executive officers, directors, employees and consultants pursuant to a stock option plan. Awards of stock options granted to employees, officers and directors are accounted for in accordance with the fair value method and result in compensation expense. The expense is recognized in income over the shorter of the service period of the employees to whom the option was granted or the vesting period of the specific option. The corresponding credit is recorded as a contributed surplus. Any consideration paid on the exercise of stock options and the corresponding value previously recorded to contributed surplus is credited to share capital.

**h) Per share information**

Basic per share amounts are calculated using the weighted average number of common shares outstanding during the period. Diluted per share amounts are calculated adjusting the weighted average number of shares for the dilutive effect of options, using the treasury stock method. Under this method, the dilutive effect of options uses proceeds received on the exercise of options plus the unamortized portion of stock-based compensation to purchase common shares at the average price during the period. The weighted average number of shares outstanding is then adjusted by the net change.

### i) Financial instruments

All financial instruments are required to be measured at fair value on initial recognition of the instrument, except for certain related party transactions. Measurement in subsequent periods depends on whether the financial instrument has been classified as held-for-trading, available-for-sale, held-to-maturity, loans and receivables, or other financial liabilities as defined by the standard.

Financial assets and financial liabilities held-for-trading are measured at fair value with changes in those fair values recognized in net earnings (loss). Financial assets available-for-sale are measured at fair value, with changes in those fair values recognized in other comprehensive income (loss). Financial assets held-to-maturity, loans and receivables and other financial liabilities are measured at amortized cost using the effective interest method of amortization.

The Company has no financial instruments or activities that give rise to other comprehensive income (loss). The Company's cash and cash equivalents are designated as held-for-trading and are measured at carrying value, which approximates fair value due to the short-term nature of these instruments. Accounts receivable are designated as loans and receivables. Accounts payable and accrued liabilities and bank indebtedness are designated as other liabilities. Financial derivatives are designated as held for trading.

### j) Cash and cash equivalents

Cash and cash equivalents consist of cash and term deposits with a maturity date of three months or less.

### k) Revenue recognition

Revenue associated with the sale of crude oil and natural gas are recognized when title passes to the purchaser.

### l) Measurement uncertainty

Management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities as at the date of the financial statements and the reported amounts of revenue and expenses. The amounts recorded for depletion and amortization of petroleum and natural gas properties and equipment and the provision for future asset retirement obligation costs are based on estimates. The ceiling test is based on estimates of proved reserves, production rates, future oil and gas prices, future costs and other relevant assumptions. The amounts recorded for future taxes are based on estimates of future taxable income and anticipated income tax rates. The fair value of stock options is based on estimates using the Black-Scholes option pricing model and is recorded as stock-based compensation expense in the financial statements. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future periods could be significant.

### m) Changes in accounting policies

The CICA issued three new accounting standards, section 1535 "Capital Disclosures", section 3862 "Financial Instruments – Disclosures", and section 3863 "Financial Instruments – Presentation". These standards become effective for the Company in the first quarter of 2008.

Section 1535 requires the disclosure of the Company's objectives, policies and processes for managing capital. This includes qualitative information regarding the Company's objectives, policies and processes for management of capital and quantitative data about what the Company manages as capital. These disclosures are based on information that is provided internally by the Company's key management. The Company had provided these disclosures in the 2007 financial statements (note 6).

Sections 3862 and 3863 replace section 3861 "Financial Instruments – Disclosure and Presentation" which revises and enhances financial instruments disclosure requirements and leaves unchanged its presentation requirements. These new sections place increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the Company manages those risks.

### n) Accounting pronouncements issued and not yet adopted

The following accounting standards will apply to future fiscal periods:

In January 2006, the CICA Accounting Standards Board ("AcSB") adopted a strategic plan for the direction of accounting standards in Canada. As part of the plan, accounting standards in Canada for public companies will converge with International Financial Reporting Standards ("IFRS") effective January 1, 2011. The Company continues to monitor, assess and develop its implementation plan for the convergence of Canadian GAAP and IFRS.

In February 2008, the AcSB issued Handbook Section 3064, Goodwill and Intangible Assets and amended Section 1000, Financial Statement Concepts clarifying the criteria for the recognition of assets, intangible assets and internally developed intangible assets. Items that no longer meet the definition of an asset are no longer recognized with assets. The standard is effective for fiscal years beginning on or after October 1, 2008 and early adoption is permitted. Twin Butte is currently evaluating the impact this section will have on our results of operations and financial position.

## NOTE 2. ACQUISITION EXPENDITURES

On February 8, 2008, the Company purchased all the issued and outstanding shares of E4 Energy Inc., a publicly traded company with properties in North East British Columbia and Alberta for total consideration of $37.3 million, plus assumed bank debt and working capital. The purchase was paid for through the issuance of 15.7 million common shares of Twin Butte and was accounted for as a business combination using the purchase method of accounting as follows:

### Net Assets Acquired

| | Total |
|---|---|
| Petroleum and natural gas properties | $ 59,741,731 |
| Future income tax liability | (576,906) |
| Net working capital deficiency | (19,924,318) |
| Asset retirement obligation | (1,913,109) |
| Total net assets acquired | $ 37,327,398 |

The net working capital deficiency consists of the following:

| | Total |
|---|---|
| Accounts receivable | $ 3,642,964 |
| Deposits and prepaid expenses | 191,847 |
| Accounts payable and accrued liabilities | (7,994,129) |
| Bank indebtedness | (15,765,000) |
| Net working capital deficiency | $ (19,924,318) |

### Consideration

| | Total |
|---|---|
| Shares | $ 36,964,730 |
| Transaction costs | 362,668 |
| Total purchase price | $ 37,327,398 |

## NOTE 3. PROPERTY AND EQUIPMENT

| | | | **December 31, 2008** | December 31, 2007 |
|---|---|---|---|---|
| | Cost | Accumulated Depletion & Depreciation | **Net Book Value** | Net Book Value |
| Petroleum and natural gas properties | $ 232,341,769 | $ 56,261,729 | **$ 176,080,040** | $ 104,352,054 |
| Office and computer equipment | 199,015 | 81,903 | **117,112** | 81,647 |
| Total | $ 232,540,784 | $ 56,343,632 | **$ 176,197,152** | $ 104,433,701 |

The Company has capitalized $1,726,246 of general and administrative expenses directly related to exploration and development activities for the year ended December 31, 2008 ($718,965 - December 31, 2007).

The cost of undeveloped property excluded from the depletion base as at December 31, 2008 was $16,597,792 ($8,158,643 – December 31, 2007). Future development costs on proved undeveloped reserves of $41,683,700 as at December 31, 2008 are included in the calculation of depletion and depreciation ($13,457,000 – December 31, 2007).

The Company performed a ceiling test calculation as at December 31, 2008 to assess the recoverable value of the property and equipment. The oil and gas future price is based on the January 1, 2009 commodity price forecast of the Company's independent reserve evaluators. The Company had no impairment under the December 31, 2008 year end ceiling test.

For calculation of the December 31, 2008 ceiling test, the benchmark prices used were as follows:

| | Oil Edmonton Par Price 40 API CAD $/bbl | Natural Gas AECO – C Spot CAD $/MMbtu |
|---|---|---|
| 2009 | 69.60 | 7.40 |
| 2010 | 83.00 | 8.00 |
| 2011 | 91.40 | 8.45 |
| 2012 | 93.90 | 8.80 |
| 2013 | 96.30 | 9.05 |
| 2014 | 98.30 | 9.25 |
| 2015 | 100.30 | 9.45 |
| 2016 | 102.30 | 9.60 |
| 2017 | 104.20 | 9.80 |
| 2018 | 106.40 | 10.00 |
| 2019 | 108.50 | 10.20 |
| % increase thereafter | 2.00% | 2.00% |

## NOTE 4. BANK INDEBTEDNESS

As at December 31, 2008, the Company had a $65.0 million demand revolving credit facility with a Canadian chartered bank. The credit facility provides that advances may be made by way of direct advances, banker's acceptances, or standby letters of credit/guarantees. The credit facility is composed of a $65.0 million demand revolving operating credit facility. Interest rates on the demand revolving operating credit facility fluctuate based on a pricing grid and range from bank prime to bank prime plus 2.0%, depending upon the Company's then current debt to cash flow ratio of between less than one times to greater than three times. A debt to cash flow ratio of less than one times has interest payable at the bank's prime lending rate. A debt to cash flow ratio greater than three times has interest payable at the bank's prime lending rate plus 2.0%. The credit facility is secured by a demand debenture and a general security agreement covering all assets of the Company.

The facility is a borrowing base facility that is determined base on, among other things, the Company's current reserve report, results of operations, current and forecasted commodity prices and the current economic environment. The Company's credit facility is subject to semi-annual review. Subsequent to year end on February 19, 2009, the bank reconfirmed the Company's credit facility with changes to the pricing grid (note 11).

The Company's effective interest rate for the years ended December 31, 2008 and 2007 was 5.0 percent and 6.7 percent, respectively.

## NOTE 5. ASSET RETIREMENT OBLIGATIONS

Asset retirement obligations are based on the Company's net ownership in wells and facilities, and management's estimate of future costs to abandon and reclaim those wells and facilities as well as an estimate of the future timing of the costs to be incurred.

The Company has estimated the present value of its total asset retirement obligation to be $9,158,775 at December 31, 2008, based on a total future liability of $16,156,000. Payments to settle asset retirement obligations occur over the operating lives of the underlying assets, estimated to be from 1 year to 19 years with the majority of the costs to be incurred between 2009 and 2016. A credit-adjusted risk free rate of eight percent and an inflation rate of two percent were used to calculate the present value of the asset retirement obligation.

Changes to the asset retirement obligation are as follows:

| Year Ended December 31, | **2008** | 2007 |
|---|---|---|
| Asset retirement obligation, beginning of year | **$ 6,945,541** | $ 3,073,325 |
| Liabilities incurred | **482,302** | 540,749 |
| Liabilities settled | **(88,617)** | – |
| Acquisitions | **1,913,109** | 3,521,094 |
| Liabilities related to property dispositions | **–** | (35,940) |
| Revisions in estimated cash outflows | **(663,818)** | (403,449) |
| Accretion of asset retirement obligation | **570,258** | 249,762 |
| Asset retirement obligation, end of year | **$ 9,158,775** | $ 6,945,541 |

## NOTE 6. SHARE CAPITAL

### Authorized

An unlimited number of voting Common Shares and an unlimited number of Preferred Shares.

### Issued

| | Number of shares | Amount |
|---|---|---|
| **Common Shares** | | |
| Balance, December 31, 2006 | 19,275,398 | $ 66,397,721 |
| Issued pursuant to private placement of flow-through shares | 2,927,000 | 12,000,700 |
| Issued pursuant to private placement of common shares | 5,550,000 | 16,650,000 |
| Share issue and financing costs net of tax | – | (1,325,753) |
| Balance, December 31, 2007 | 27,752,398 | $ 93,722,668 |
| Shares issued pursuant to acquisition of E4 Energy Inc. (note 2) | 15,663,027 | 36,964,730 |
| Shares issued upon option exercise | 9,000 | 26,190 |
| Issued pursuant to private placement of flow-through shares | 3,704,000 | 5,000,400 |
| Amounts related to exercised options previously recorded as contributed surplus | – | 2,984 |
| Tax effect of 2007 flow through share issue | – | (3,540,207) |
| Financing and share issue costs net of tax | – | (313,653) |
| **Balance, December 31, 2008** | **47,128,425** | **$ 131,863,112** |

### Common Share Consolidation

On May 31, 2007, the Company consolidated its share capital on a 1:5 basis. All Common Share, stock options, and per share amounts have been restated to reflect this share consolidation.

### Issue of Common Shares

On February 27, 2007 the Company closed a bought deal private placement of 2,927,000 flow-through Common Shares at a price of $4.10 per share, for gross proceeds of $12,000,700 ($11,300,734 net of issue costs). Pursuant to the flow-through share offering, Twin Butte is committed to incur $12,000,700 of qualifying resource expenditures prior to December 31, 2008 (note 10). Twin Butte will renounce the qualifying resource expenditures to holders of the flow-through shares effective on or before December 31, 2007. The future income tax effect and reduction to share capital will be accounted for in the first quarter of 2008, the date that the Company has filed the renouncement documents with tax authorities.

On July 17, 2007 the Company closed a bought deal private placement of 5,550,000 Common Shares at a price of $3.00 per share, for gross proceeds of $16,650,000 ($15,588,744 net of issue costs).

On December 19, 2008 the Company closed a bought deal private placement of 3,704,000 flow-through Common Shares at a price of $1.35 per share, for gross proceeds of $5,000,400 ($4,651,725 net of issue costs). Pursuant to the flow-through share offering, Twin Butte is committed to incur $5,000,400 of qualifying resource expenditures prior to December 31, 2009 (note 10). Twin Butte will renounce the qualifying resource expenditures to holders of the flow-through shares effective on or before December 31, 2008. The future income tax effect and reduction to share capital will be accounted for in the first quarter of 2009, the date that the Company has filed the renouncement documents with tax authorities.

On October 22, 2008, the Company announced that the Toronto Stock Exchange ("TSX") has accepted Twin Butte's Notice of Intention to commence a Normal Course Issuer Bid (the "Bid") to purchase for cancellation, as it considers advisable, up to a maximum of 3,079,323 Common Shares (which is equal to 10% of the "public float" of 43,424,425 Common Shares) on the open market through the facilities of the TSX. The number of Common Shares that can be purchased pursuant to the Bid is subject to a daily maximum of 33,208. The price that Twin Butte will pay for any Common Share under the Bid will be the prevailing market price on the TSX at the time of such purchase. Common Shares acquired under the Bid will be subsequently cancelled. The Bid commenced on October 24, 2008 and will terminate on October 23, 2009 or such earlier time as the Bid is completed or terminated at the option of Twin Butte. As at December 31, 2008, no Common Shares were repurchased by the Company.

### Management of Capital Structure

The Company's objective when managing capital is to maintain a flexible capital structure which will allow it to execute on its capital investment program, which includes investing in oil and gas activities which may or may not be successful. Therefore the Company continually strives to balance the proportion of debt and equity in its capital structure to take into account the level of risk being incurred in its capital expenditures. The Company manages its capital structure and makes adjustments relative to changes in economic conditions and the Company's risk profile. In order to maintain the capital structure, the Company may from time to time issue shares and adjust its capital spending to manage current and projected debt levels. The Company monitors its bank debt level and working capital in order to assess capital and operating efficiency.

In the management of capital, the Company includes share capital and total debt (defined as the sum of current assets and current liabilities including bank indebtedness) in the definition of capital. The Company's share capital is not subject to external restrictions; however, its credit facility is based on its petroleum and natural gas reserves.

The Company manages its capital structure and makes adjustments by continually monitoring its business conditions, including: the current economic conditions; the risk characteristics of the underlying assets; the depth of its investment opportunities, forecasted investment levels; the past efficiencies of our investments; the efficiencies of the forecasted investments and the desired pace of investment; current and forecasted total debt levels; current and forecasted petroleum and natural gas prices and other factors that influence petroleum and natural gas prices and cash flow from operating activities (before changes in non-cash working capital), such as foreign exchange and basis differential.

In order to maintain or adjust the capital structure, the Company will consider: its forecasted debt to forecasted cash flow from operating activities (before changes in non-cash working capital) ratio while attempting to finance an acceptable investment program including incremental investment and acquisition opportunities; the current level of bank credit available from the Company's bank; the level of bank credit that may be obtainable from its bank as a result of natural gas reserve growth; the availability of other sources of debt with different characteristics than the existing bank debt; the sale of assets; limiting the size of the investment program and new common equity if available on favorable terms.

### Stock Options

The Company has a stock option plan under which options to purchase Common Shares may be granted to officers, directors, employees and consultants. The Board has approved a policy of reserving up to 10% of the outstanding Common Shares for issuance to eligible participants. As at December 31, 2008 there were 4,712,842 (2,775,239 – December 31, 2007) Common Shares reserved for issuance under the plan. All options awarded have a maximum term of five years and vest in equal one-third increments on each anniversary of the grant.

The following table sets forth a reconciliation of stock option plan activity through to December 31, 2008:

| | Number of Options | Weighted Average Exercise Price |
|---|---|---|
| Outstanding at December 31, 2006 | 1,465,000 | $ 4.00 |
| Granted | 840,000 | 2.93 |
| Forfeited | (500,000) | 4.00 |
| Outstanding at December 31, 2007 | 1,805,000 | $ 3.15 |
| Granted | 4,296,000 | 2.33 |
| Exercised | (9,000) | 2.91 |
| Cancelled | (1,396,000) | 3.68 |
| Forfeited | (1,238,000) | 2.84 |
| **Outstanding at December 31, 2008** | **3,458,000** | **$ 2.21** |

There were 94,000 options exercisable as at December 31, 2008 at an average exercise price of $2.50 per share.

| | Options Outstanding | | | | | |
|---|---|---|---|---|---|---|
| | **December 31, 2008** | | | December 31, 2007 | | |
| Exercise Price | **Number of Options Outstanding** | **Weighted Average Exercise Price $** | **Weighted Average Years to Expiry** | Number of Options Outstanding | Weighted Average Exercise Price $ | Weighted Average Years to Expiry |
| $0.97 – 1.24 | **1,112,0000** | **1.02** | **4.90** | – | – | – |
| $2.45 – 3.65 | **2,346,0000** | **2.78** | **4.24** | 895,000 | 2.97 | 3.47 |
| $4.00 – 4.10 | – | – | – | 910,000 | 4.01 | 4.49 |
| | **3,458,0000** | **2.21** | **4.45** | 1,805,0000 | 3.15 | 3.98 |

### Stock Based Compensation

The Company accounts for its stock based compensation plan using the fair value method. Under this method, a compensation cost is charged over the vesting period for options granted to employees, consultants, officers, and directors with a corresponding increase to contributed surplus.

The following table reconciles the Company's contributed surplus balance.

| Year Ended December 31, | 2008 | 2007 |
|---|---|---|
| Contributed surplus balance at beginning of period | **$ 1,014,991** | $ 415,713 |
| Stock based compensation for stock options granted | **918,202** | 599,278 |
| Stock based compensation for stock options cancelled | **1,002,738** | – |
| Stock based compensation for stock options forfeited | **(185,097)** | – |
| Stock based compensation for stock options exercised | **(2,984)** | – |
| Contributed surplus balance at end of period | **$ 2,747,850** | $ 1,014,991 |

The fair value of each option granted is estimated on the date of grant using the Black-Scholes option pricing model with assumptions and resulting values for grants for the year ended December 31 as follows:

| | 2008 | 2007 |
|---|---|---|
| Expected volatility | **50%** | 50% |
| Risk free rate of return | **4.5%** | 4.5% |
| Expected stock option life | **3 years** | 3 years |
| Dividend yield rate | **0.0%** | 0.0% |
| Weighted average fair value of stock option grants | **$0.89** | $1.50 |

### Earnings Per Share

The following table sets forth the details of the denominator used for the computation of basic and diluted earnings per share:

| | Three months ended December 31 | | Year ended December 31 | |
|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 |
| Weighted average number of basic shares | **43,947,816** | 27,752,398 | **41,883,092** | 24,284,620 |
| Effect of dilutive securities: | | | | |
| Employee stock options | **743** | – | **98,267** | – |
| Weighted average number of diluted shares | **43,948,559** | 27,752,398 | **41,981,359** | 24,284,620 |

All of the issued stock options were excluded from the calculation of diluted weighted average shares outstanding in 2007 as to include them would be anti-dilutive.

## NOTE 7. TAXES

### Tax Expense

The combined provision for taxes in the statement of operations and retained deficit reflects an effective tax rate which differs from the expected statutory tax rate. Differences were accounted for as follows:

| | 2008 | 2007 |
|---|---|---|
| Income (loss) before taxes | **$ 1,256,366** | $ (7,537,807) |
| Statutory income tax rate | **29.5%** | 32.12% |
| Expected income taxes | **370,628** | (2,421,144) |
| Stock based compensation | **512,074** | 192,488 |
| Recognition of previously unrecognized non-capital loss carryforwards | – | (6,266,007) |
| Change in expected tax rate | **524,886** | 1,096,356 |
| Expiry of non-capital losses | **2,171,325** | 1,695,675 |
| Other | **272,758** | (856,378) |
| Future income tax expense (recovery) | **$ 3,851,671** | $ (6,559,010) |

### Future Income Taxes

| | 2008 | 2007 |
|---|---|---|
| Property, plant, and equipment | **$ 7,322,900** | $ 6,605,800 |
| Asset retirement obligations | **(2,289,700)** | (1,736,400) |
| Share issue cost | **(698,500)** | (700,000) |
| Eligible scientific research & experimental development expenditures | **(3,625,300)** | (4,060,800) |
| Non-capital loss carryforwards | **(6,817,500)** | (18,097,600) |
| Valuation allowance | **4,783,635** | 8,824,523 |
| Future income tax asset | **$ (1,324,465)** | $ (9,164,477) |

As at December 31, 2008, the Company has tax deductions of approximately $192 million that are available to shelter future taxable income. Included in the above is $23.2 million in non-capital losses that expire as follows:

| Year of expiry *($millions)* | |
|---|---|
| 2013 | 3.9 |
| 2014 | 1.1 |
| 2025 | 16.2 |
| 2027 | 2.0 |

## NOTE 8. RELATED PARTY TRANSACTIONS

During the year ended December 31, 2008, the Company incurred costs totaling $561 thousand ($815 thousand – December 31, 2007) for oilfield services rendered by companies in which a director of Twin Butte is an officer and a director and an officer of Twin Butte is a director. These costs were incurred in the normal course of business and recorded at the exchange amount. As at December 31, 2008, the Company has $128 thousand included in accounts payable and accrued liabilities related to these transactions.

During the year ended December 31, 2007 and during which time a former director was related to a professional firm, the Company expensed and capitalized legal fees totaling $159 thousand for services rendered by that professional firm. No amount is included in accounts payable and accrued liabilities related to these transactions. These fees were incurred in the normal course of business and recorded at the exchange amount.

## NOTE 9. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Financial assets and liabilities are comprised of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, bank indebtedness and risk management assets and liabilities. Risk management assets and liabilities arise from the use of derivative financial instruments. Fair values of financial assets and liabilities, summarized information related to risk management positions, and discussion of risks associated with financial assets and liabilities are presented as follows:

### Fair Value of Financial Assets and Liabilities

The fair values of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities approximate their carrying amount due to the short-term maturity of those instruments. The fair value of the bank indebtedness approximates its carrying value as it is based on the bank prime rate.

Risk management assets and liabilities are recorded at their estimated fair value based on the mark-to-market method of accounting, using quoted market prices or, in their absence, third-party market indications and forecasts. The fair value of financial assets and liabilities were as follows:

| | As at December 31, 2008 | | As at December 31, 2007 | |
|---|---|---|---|---|
| | **Carrying Amount** | **Estimated Fair Value** | Carrying Amount | Estimated Fair Value |
| Financial assets | | | | |
| Risk management assets | **$ 2,075,039** | **$ 2,075,039** | $ 266,898 | $ 266,898 |
| Accounts receivable | **9,777,904** | **9,777,904** | 5,727,286 | 5,727,286 |
| Financial liabilities | | | | |
| Risk management liabilities | **$ –** | **$ –** | $ 827,135 | $ 827,135 |
| Accounts payable and accrued liabilities | **15,745,084** | **15,745,084** | 8,278,779 | 8,278,779 |
| Bank indebtedness | **45,632,924** | **45,632,924** | 21,248,583 | 21,248,583 |

## Risk Management Assets and Liabilities

*Net Risk Management Position*

| $ 000's | **December 31, 2008** | December 31, 2007 |
|---|---|---|
| Risk management | | |
| Current asset | **$ 2,075** | $ 267 |
| Current liability | **–** | (827) |
| Net risk management asset (liability) | **$ 2,075** | $ (560) |

*Summary of Unrealized Risk Management Positions*

| | As at December 31, 2008 | | | As at December 31, 2007 | | |
|---|---|---|---|---|---|---|
| $ 000's | **Asset** | **Liability** | **Net** | Asset | Liability | Net |
| Commodity prices | | | | | | |
| Natural gas | **$ –** | **$ –** | **$ –** | $ 267 | $ – | $ 267 |
| Crude oil | **2,075** | **–** | **2,075** | – | (827) | (827) |
| Total fair value | **$ 2,075** | **$ –** | **$ 2,075** | $ 267 | $ (827) | $ (560) |

The net fair value methodologies used to calculate the unrealized risk management positions is the value using quoted prices in the market.

## Net Fair Value of Commodity Price Positions at December 31, 2008

*Crude Oil Sales Price Derivatives*

| Daily quantity per barrel ("bbl") | Remaining term of contract | Fixed price per bbl (WTI) | Costless Collar per bbl (WTI) | Fair market value $ 000's |
|---|---|---|---|---|
| 100 | January 1 to December 31, 2009 | | US $100.00 – US $195.00 | 2,075 |
| Crude oil fair value position | | | | $ 2,075 |

As at December 31, 2008 the marked-to-market value of the Company's crude oil sales price derivative was an asset of USD $1.7 million, or a Canadian dollar equivalent of $2.1 million. In February 2009, the Company amended this contract to adjust the floor price from US $100.00 to $60.00 for the period of March 1 through to December 31, 2009 (note 11). In exchange for amending the terms of the contract, Twin Butte was paid US $1.1 million ($1.4 million CDN) in February 2009.

*Reconciliation of Unrealized Risk Management Positions from January 1 to December 31, 2008*

| | 2008 | |
|---|---|---|
| | **Fair Market Value** | **Total Unrealized Gain (Loss)** |
| Fair value of contracts, beginning of year | $ (560) | $ – |
| Change in fair value of contracts in place at beginning of year | 6,295 | 6,295 |
| Fair value of contracts realized during the period | (3,660) | (3,660) |
| Fair value of contracts, end of period | $ 2,075 | $ 2,635 |

### Risk Associated with Financial Assets and Liabilities

The Company is exposed to financial risks arising from its financial assets and liabilities. The financial risks include market risk relating to commodity prices, interest rates and foreign exchange rates, credit risk and liquidity risk.

***Market Risk***

Market risk, the risk that the fair value or future cash flows of financial assets or liabilities will fluctuate due to movements in market prices is comprised of the following:

- *Commodity Price Risk*

  As a means of mitigating exposure to commodity price risk volatility, the Company has entered into various natural gas and crude oil sales price derivative agreements. The use of derivative instruments is governed under formal policies and is subject to limits established by the Board of Directors. The Company's policy is to not use derivative financial instruments for speculative purposes.

- *Interest Rate Risk*

  The Company is exposed to interest rate risk to the extent that changes in market interest rates will impact any bank indebtedness that has a floating interest rate, potentially affecting future cash flows. At December 31, 2008 the Company did not have any interest rate swaps or hedges in place. Subsequent to December 31, 2008, the Company entered into interest rate swap agreements (note 11).

- *Foreign Exchange Risk*

  The Company operates in Canada and substantially all of the Company's activity is denominated in Canadian dollars. The Company is exposed to fluctuations in the exchange rate between the U.S./Canadian dollar with respect to crude oil sales price derivative agreements that are based in United States dollars.

The Company uses a non-GAAP measure, cash flow from operations, as a measure of current operating efficiency. Cash flow from operations represents cash flow from operating activities prior to changes in non-cash working capital. For the year ended December 31, 2008, the sensitivity of cash flow from operations to changes in Twin Butte's realized crude oil and NGL prices, natural gas prices, and bank interest rate would have been as follows: an increase of $1.00 per bbl in the realized price for crude oil and NGL would have resulted in approximately $194 thousand additional cash flow from operations. An increase by $0.10 per thousand cubic feet in the realized price for natural gas would have resulted in approximately $213 thousand additional cash flow from operations. An increase by 1.0% to the bank interest rate would have resulted in approximately $444 thousand less cash flow from operations. However, the above sensitivity results for crude oil, NGL and for natural gas should not be extrapolated further without considering Twin Butte's hedge portfolio, royalty parameters and potential price-related effects on the results of the period.

***Credit Risk***

Credit risk arises from the potential loss resulting from a counterparty failing to meet its obligations in accordance with the agreed terms. Substantially all of the accounts receivable are with customers and joint venture partners in the oil and gas industry and are subject to normal industry credit risks. The Company generally extends unsecured credit to these customers and therefore, the collection of accounts receivable may be affected by changes in economic or other conditions. Management believes the risk is mitigated by entering into transactions with long-standing, reputable, counterparties and partners. Wherever possible, the Company requires cash calls from its partners on capital projects before they commence. Receivables related to the sale of the Company's petroleum and natural gas production are mainly from major marketing companies who have very good credit ratings. These revenues are normally collected on the 25th day of the month following delivery.

As at December 31, 2008, the counter-party with which the Company maintains a risk management contract (hedge) is a major Canadian chartered bank, which has an investment grade rating.

***Liquidity Risk***
Liquidity risk is the risk the Company will encounter difficulties in meeting its financial liability obligations. The Company manages its liquidity risk through cash and debt management. As disclosed in note 6, a key measure that the Company utilizes in evaluating its capital structure and debt are total debt to cash flow from operating activities (before changes in non-cash working capital) and the current credit available from its creditors in relation to the Company's budgeted capital program. Both of these ratios are in an acceptable range for the Company at year end. The ratios will increase in 2009 as a result of expected lower cash flows resulting from the significant decrease in crude oil and natural gas prices. The Company is forecasting capital expenditures in 2009 to approximate cash flow for the year.

In managing liquidity risk, the Company has access to funding at competitive rates through its banking credit facility. As at December 31, 2008, the Company had available undrawn bank credit facilities from the demand revolving operating credit facility in the amount of $19.4 million. The Company believes it has sufficient funding through the use of this credit facility to meet foreseeable borrowing requirements.

The timing of cash outflows relating to financial liabilities with the exception of bank indebtedness are all within one year from December 31, 2008.

## NOTE 10. COMMITMENTS AND CONTINGENCIES

The Company is committed to future minimum payments for natural gas transmission and processing, operating leases on compression equipment, farm-in agreements and future premiums on financial derivatives .

The Company is committed to incur $5.0 million of flow-through share eligible Canadian Exploration Expenditures, as defined in the Canadian Income Tax Act, by December 31, 2009.

As at December 31, 2008, the Company had contractual obligations and commitments for base office rent and equipment as follows:

| | |
|---|---|
| 2009 | $ 689,920 |
| 2010 | 687,924 |
| 2011 | 330,423 |
| 2012 | 1,800 |
| 2013 | – |

The Company is involved in legal claims associated with the normal course of operations. The Company has completed an assessment and has not recorded a contingent liability.

## NOTE 11. SUBSEQUENT EVENTS

### Bank Indebtedness
On February 19, 2009 the Company's credit facility in the amount of $65.0 million was reconfirmed by the Company's bank. Effective February 19, 2009, changes were made to the bank's pricing grid for the calculation of interest rates. Interest rates on the demand revolving operating credit facility fluctuate based on the revised pricing grid and range from bank prime plus 0.25% to bank prime plus 2.5%, depending upon the Company's then current debt to cash flow ratio of between less than one times to greater than three times. A debt to cash flow ratio of less than one times has interest payable at the bank's prime lending rate plus 0.25%. A debt to cash flow ratio greater than three times has interest payable at the bank's prime lending rate plus 2.5%.

### Financial Derivatives

*Fixed/Floating Interest Rate Swap Contract*

In January 2009, the Company entered into two interest rate swap transactions with the Company's bank. The Company has entered into a contract to borrow $20.0 million at a fixed rate of 1.18% plus applicable bankers' acceptance stamping fees ranging from 1.75% to 4.00% for the period of January 30, 2009 to January 30, 2010, and $20.0 million at a fixed rate of 1.45% plus applicable bankers' acceptance stamping fees ranging from 1.75% to 4.00% for the period of January 30, 2009 to January 30, 2011.

*Crude Oil Sales Price Derivatives*

In February 2009, the Company amended the terms of its crude oil costless collar contract. The floor of the contract was amended from US $100.00 to $60.00 for the period of March 1 through to December 31, 2009 (note 9). In exchange for amending the terms of the contract, Twin Butte was paid US $1.1 million ($1.4 million Canadian) in the month of February 2009.

*Natural Gas Sales Price Derivatives*

In March 2009, the Company entered into a fixed price swap hedge arrangement on a total of 5,000 GJ/d for the period April 1, 2009 to October 31, 2009 at a price of $4.10/GJ (AECO Monthly).

# Corporate Information

## OFFICERS

Jim Saunders
*President and Chief Executive Officer*

Neil Cathcart
*Vice President, Exploration*

Greg Hodgson
*Vice President, Production and Operations*

Colin Ogilvy
*Vice President, Land*

R. Alan Steele
*Vice President, Finance & CFO*

## BOARD OF DIRECTORS

David Fitzpatrick
*Chairman of the Board*

Jim Brown (1) (2)

Paul Colborne (1) (3)

Craig Hruska (2) (3)

Ken Mullen (1) (3)

Jim Saunders

Paul Starnino (2)

Warren Steckley

Member of:
(1) Audit Committee
(2) Reserves Committee
(3) Compensation, Nominating and Governance Committee

## HEAD OFFICE

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## AUDITORS

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Chartered Accountants, Calgary, AB

## BANKERS

National Bank of Canada, Calgary, AB

## SOLICITORS

Burnet, Duckworth & Palmer LLP,
Calgary, AB

## ENGINEERS

McDaniel & Associates Consultants Ltd.  Calgary, AB

## REGISTRAR & TRANSFER AGENT

Valiant Trust Company
Calgary, AB

## STOCK EXCHANGE LISTING

TSX
Trading Symbol "TBE"

Twin Butte Energy Ltd.

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