

MANAGEMENT'S DISCUSSION AND ANALYSIS

Management's Discussion and Analysis

The following Management's Discussion and Analysis ("MD&A") for Second Wave Petroleum Inc. ("Second Wave" or the "Company") should be read in conjunction with the audited consolidated financial statements and notes of the Company for the year ended December 31, 2008. This MD&A incorporates information up to and including April 29, 2009. The consolidated financial statements have been prepared in accordance with Canadian Generally Accepted Accounting Principles ("GAAP"). All of the amounts reported in this MD&A are in Canadian dollars, unless otherwise indicated. Certain other information with respect to the Company is available on SEDAR, at www.sedar.com and at the Company's website at www.secondwavepetroleum.com. Information can also be obtained by contacting the Company at Second Wave Petroleum Inc, Suite 1700, 520, 5th Ave. S.W., Calgary, Alberta, T2P 3R7.

NON-GAAP FINANCIAL MEASUREMENTS

The Company has used certain measures of financial reporting that are commonly used benchmarks within the oil and gas industry in this MD&A that are considered non-GAAP measures. The measures used in this document include "funds from operations", "funds from operations per share", and "netback". The term funds from operations contained within the MD&A should not be considered as an alternative to, or more meaningful than, cash flow from operating activities as determined in accordance with GAAP. The Company believes that funds from operations is a useful supplementary measure as investors may use this information to analyze operating performance, leverage and liquidity. Funds from operations, as disclosed within this MD&A, represents cash flow from operating activities before changes in non-cash working capital. The Company presents funds from operations per share whereby per share amounts are calculated consistent with the calculation of net loss and comprehensive loss per share. The Company believes that the term netback contained within the MD&A is also a useful supplementary measure as investors may use this information to analyze field level operating performance of the Company's oil and gas properties. Further supplemental indicators of performance common to the oil and gas industry are the measurement of costs and expenses on a per barrel of oil equivalent (boe). These non-GAAP measures may not necessarily be comparable to similarly titled measures used by other entities and readers of this MD&A are cautioned in attempting to make such comparisons.

OTHER MEASUREMENTS

For the purposes of calculating unit costs, natural gas has been converted to a barrel of oil equivalent ("BOE") using 6,000 cubic feet (6 Mcf) of natural gas equal to one barrel of oil (6:1), unless otherwise stated. The BOE conversion ratio of 6 Mcf to 1 barrel is based on an energy equivalency conversion method and does not represent a value equivalency. Therefore BOEs may be misleading if used in isolation. References to natural gas liquids ("NGLs") in this MD&A include condensate, propane, butane and ethane and one barrel of NGLs is considered to be equivalent to one barrel of crude oil equivalent (BOE).

ADVISORY REGARDING FORWARD LOOKING STATEMENTS

Certain statements included or incorporated by reference in the MD&A constitute forward-looking statements or forward-looking information under applicable securities legislation. Forward-looking statements or information typically contain statements with words such as "anticipate", "expect", "plan", "intend", "estimate", "propose", or similar words suggesting future outcomes or statements regarding an outlook. Forward-looking statements in this MD&A include, but are not limited to, statements with respect to reserves, crude oil and natural gas prices, well productivity, operating costs, general and administrative costs, taxation rates, interest rates, and capital expenditure plans for 2008 and beyond. Existing or potential investors should not place undue reliance on forward-looking statements as there can be no assurance that the plans, intentions or expectations they are based on will occur. By their nature, forward-looking statements involve numerous assumptions, known and unknown, risks and uncertainties, both general and specific that contributes to the possibility that although the predictions, forecasts, projections and other forward-looking statements are reasonable, there can be no assurance that such expectations will prove to be correct. Some of the risks and other factors which could cause results to differ materially from those expressed in the forward-looking statements contained in the presentation include general economics, business and market conditions; volatility of energy prices; fluctuations in interest rates; energy supply and demand; competition, access to future funding, timing and amount of capital expenditures, imprecision in estimation future productive

capacity, well productivity, operating cost adjustments; cost overruns; and such other risks and uncertainties described from time to time. Existing or potential investors are cautioned that the foregoing list of important factors is not exhaustive. Furthermore, the forward-looking statements contained in this document are made as of the date this report. The forward-looking statements contained herein are expressly qualified by this cautionary statement.

This management discussion and analysis is dated as at April 29, 2009.

Overview

	Three months ended December 31,			Year ended December 31,		
	2008	2007	% Change	2008	2007	% Change
<i>(\$000s, except share amounts)</i>						
Petroleum and natural gas sales	4,688	2,494	88	21,618	5,862	269
Royalties	(560)	(338)	66	(2,801)	(980)	186
Lease operating costs	(2,468)	(1,047)	136	(7,443)	(1,719)	333
Transportation	(163)	(50)	226	(384)	(127)	202
Operating netback⁽³⁾	1,497	1,059	41	10,990	3,036	262
Realized gain (loss) on financial derivatives	12	-	-	(361)	-	-
Other income	-	14	-	-	35	-
General and administrative	(478)	(558)	(14)	(2,529)	(2,104)	20
Financing expenses	123	(858)	114	(356)	(1,956)	(82)
Asset retirement expenditures	(85)	-	-	(213)	(56)	280
Funds from operations⁽¹⁾	1,069	(345)	410	7,531	(1,045)	821
Unrealized gain on financial derivatives	22	-	-	-	-	-
Depletion, depreciation and accretion	(2,499)	(898)	178	(6,809)	(2,318)	194
Write-off of goodwill	-	(145)	-	-	(514)	-
Future income taxes	-	(11)	-	-	1,342	-
Non-cash portion of financing expense	-	(5)	-	-	(401)	-
Accretion of convertible debenture	-	(60)	-	(13)	(101)	(87)
Stock-based compensation	(264)	(178)	48	(1,214)	(565)	115
Asset retirement expenditures	85	-	-	213	56	280
Net income (loss) before non-controlling interest	(1,587)	(1,640)	3	(292)	(3,546)	92
Non-controlling interest in loss of Milagro	-	-	-	47	-	-
Net income (loss) and comprehensive income (loss)	(1,587)	(1,640)	3	(246)	(3,546)	93
Funds from operations per share ⁽¹⁾ :						
Basic (\$)	0.03	(0.02)	250	0.26	(0.10)	360
Diluted (\$)	0.03	(0.02)	250	0.25	(0.10)	350
Net income (loss) and comprehensive income (loss) per share:						
Basic (\$)	(0.05)	(0.13)	62	(0.01)	(0.39)	97
Diluted (\$)	(0.05)	(0.11)	55	(0.01)	(0.31)	103
Average number of shares outstanding (000s):						
Basic ²	31,089	12,968	140	28,557	9,079	215
Diluted ²	31,229	15,209	105	29,966	11,338	164

(1) Funds from operations and funds from operations per share are non-GAAP measures that do not have a standardized meaning as prescribed by GAAP and is therefore unlikely to be comparable to similar measures presented by other oil and gas companies. We consider it an important measure as it demonstrates our ability to generate the cash flow necessary to fund future growth through capital investment.

(2) On May 26, 2008, the Company exercised its right to convert all of its Class B shares into Class A shares, whereby for each Class B share outstanding 10 Class A shares were issued. On June 25, 2008, shareholders approved the consolidation of the Class A shares of the company on a one for ten (1:10) basis, the cancellation of Class B shares, and the re-designation of the Class A shares into Common shares. Share amounts have been retroactively adjusted to reflect the share consolidation.

(3) Operating netback is a non GAAP measure that does not have a standardized meaning as prescribed by GAAP. Management considers it an important measure as it demonstrates the Company's ability to generate the cash flow necessary to fund future growth through capital investment.

As of the reporting date of April 29, 2009, Second Wave had 36,932,340 common shares outstanding.

Reconciliation Funds from Operations to GAAP measure (\$000s)	Three months ended December 31,			Year ended December 31,		
	2008	2007	% Change	2008	2007	% Change
Cash flow from (used in) operating activities (GAAP) ⁽²⁾	2,445	(937)	361	5,779	(1,538)	476
Change in non-cash working capital (GAAP)	(1,376)	593	(332)	1,752	493	255
Funds from operations (non-GAAP)	1,069	(344)	411	7,531	(1,045)	821

Petroleum and natural gas sales

Sales volumes		Three months ended December 31,			Year ended December 31,		
		2008	2007	Change %	2008	2007	Change %
Oil	<i>bbl/d</i>	546	285	92	450	145	210
Natural gas liquids	<i>bbl/d</i>	44	22	100	35	22	59
Natural gas	<i>mcf/d</i>	2,711	868	212	2,000	739	171
Combined (6:1)	<i>boe/d</i>	1,042	451	131	819	290	182
Oil versus natural gas weighting (%)							
Oil & liquids		56	68	(18)	59	58	2
Natural Gas		44	32	38	41	42	(2)
Total		100	100	-	100	100	-

Sales volumes, on a boe basis, averaged 1,042 boe per day during the fourth quarter of 2008, up 131% from the 451 boe per day average in the fourth quarter of 2007. Oil sales volumes increased 92% to 546 bbl/d in the three months ended December 31, 2008 from 285 bbl/d for the same period in 2007. Natural gas liquids (“NGL”) sales volumes increased 100% in the three months ended December 31, 2008 from the same period in 2007. Natural gas sales volumes increased 212% during the fourth quarter 2008 to 2,711 mcf/d as compared to the 868 mcf/d in same period in 2007.

The increase in sales volumes for both liquids and natural gas is primarily due to the Milagro acquisition in May 2008 and increased volumes in the Provost area as a result of development successes. Second Wave has included Milagro sales volumes in its results subsequent to the May 8, 2008 date of acquisition.

For the year, sales volumes averaged 819 boe/d, an increase of 182% from the 290 boe/d achieved in the comparable period of 2007. As a result of the acquisition in May 2008, the 2008 versus 2007 year to date comparison is not representative of the full year impact.

As a result of low commodity pricing, the Company shut-in approximately 110 boe/d of uneconomical production during the first quarter of 2009. The decrease is offset by increases in production from capital expenditures in late 2008.

Subsequent to these operational changes the Company expects first quarter production to average approximately 950 boe/d.

Revenues (\$000s)	Three months ended December 31,			Year ended December 31,		
	2008	2007	Change %	2008	2007	Change %
Oil	2,729	1,840	48	14,628	3,582	308
Natural gas liquids	194	138	41	946	453	109
Natural gas	1,765	516	242	6,044	1,827	231
Total oil and gas	4,688	2,494	88	21,618	5,862	269

Gross revenue from the sale of petroleum and natural gas in the fourth quarter of 2008 totaled \$4,688,000 up by 88% from the same quarter last year. Increase in total revenues was a result of increased production volumes from acquisitions, an extensive capital and workover program, and higher average product prices year-over-year.

Oil revenue rose 48% to \$2,729,000 in the three months ended December 31, 2008 from \$1,840,000 in the same period of 2007.

In January 2008, Second Wave entered into a costless collar to hedge 100 bbl of oil per day from April 1, 2008 to October 31, 2008 at prices between US\$80 - US\$101/bbl. As a result of the hedging activity, during the fourth quarter and year ended December 31, 2008 Second Wave realized a gain of \$12,000 (\$0.13/boe) and loss of \$361,000 (\$1.20/boe).

Natural gas liquids revenue rose 41% to \$194,000 in the three months ended December 31, 2008 from \$138,000 in the same period of 2007.

Overall natural gas sales were \$1,765,000 for the three months ended December 31, 2008, 242% higher than the \$516,000 received in the fourth quarter of 2007.

Revenues for the year ended December 31, 2008, were \$21,618,000, a 269% increase over the \$5,862,000 in the comparable period of 2007.

Average Sales Prices ⁽¹⁾		Three months ended December 31, %			Year ended December 31, %		
		2008	2007	Change	2008	2007	Change
Oil	<i>\$/bbl</i>	54.28	70.18	(23)	88.81	67.54	31
Natural gas liquids	<i>\$/bbl</i>	48.35	69.04	(30)	72.99	57.66	27
Natural gas	<i>\$/mcf</i>	7.08	6.46	10	8.25	6.77	22
Combined (6:1)	<i>\$/boe</i>	48.90	60.05	(19)	72.13	55.39	30

(1) Average sales prices do not include the impact of hedging activities

Benchmark Pricing		Three months ended December 31, %			Year ended December 31, %		
		2008	2007	Change	2008	2007	Change
WTI crude oil (US\$ /bbl)		58.80	90.63	(35)	99.67	72.27	38
WTI crude oil (Cdn\$ /bbl)		71.15	88.82	(20)	105.62	77.29	37
AECO natural gas (Cdn\$/mcf) ¹		6.69	6.13	(9)	8.13	6.45	26
Exchange rate (US\$/Cdn\$)		1.21	0.98	23	1.067	0.935	14

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

During the third quarter of 2008 commodity prices commenced a steep decline and currently remain at significantly lower levels than the average pricing of 2008. As a result, based upon the current market conditions the Company's revenue will be negatively impacted during 2009.

The overall average price received from sale of oil and gas products in the fourth quarter of 2008 was down 19%, to \$48.90/boe, from the \$60.05/boe received during the fourth quarter of 2007.

Oil prices decreased 23% during the fourth quarter of 2008 to \$54.28/bbl, as compared with \$70.18/bbl in the fourth quarter of 2007.

Natural gas prices have strengthened in the fourth quarter of 2008 up 10% to \$7.08/mcf versus the \$6.46/mcf in the comparative period of 2007.

At the end of the third quarter commodity prices commenced a steep decline and currently remain lower than those experienced in 2008. Based upon these current market conditions the Company's average sales prices will be negatively impacted during 2009.

Royalties

(\$000s)	Three months ended			Year ended		
	2008	2007	Change	2008	2007	Change
			%			%
Crown royalties	233	192	21	1,448	736	97
Freehold	269	116	132	1,083	136	696
Gross overriding	58	30	93	270	108	150
Total	560	338	66	2,801	980	186
As % of oil and gas revenues	12%	14%	(14)	13%	17%	(24)
Per boe (\$)¹	5.84	8.13	(28)	9.35	9.26	1

⁽¹⁾ Royalties per boe is a non GAAP measure that does not have a standardized meaning as prescribed by GAAP. Management considers it an important measure as it provides supplemental disclosure of the Company's performance on one of its important costs.

Total royalties increased in the fourth quarter of 2008, totaling \$560,000 versus \$338,000 in the same period of 2007. The absolute dollar increase in royalties is attributed to the increase in production in the period as a result of acquisitions and additional production volumes achieved through the Company's capital program mainly on freehold lands. Royalties as a percentage of working interest revenues amounted to 12% during the fourth quarter of 2008, compared to 14% during the same quarter last year. Royalties per boe dropped in the fourth quarter of 2008 due mainly to the reduction of \$157,000 of crown royalties from the impact of a joint venture partner royalty review and correction from a prior year.

Aggregate royalties increased by 186% to \$2,801,000 in 2008, as compared with \$980,000 in 2007. Acquisitions and new production volumes, and higher commodity pricing resulted in the absolute increase.

The royalty rate as a percentage of revenue declined due mainly to the impact from the Milagro acquisition having a lower overall corporate royalty rate.

On October 25, 2007, the Alberta government released a report entitled "The New Royalty Framework" (the "NRF") containing the government's proposals for Alberta's new royalty regime, which became the foundation for the *Mines and Minerals (New Royalty Framework) Amendment Act, 2008*. The Royalty Framework and applicable new legislation became effective on January 1, 2009, and establishes new increased royalty rates for petroleum and natural gas in Alberta.

In response to a drop in commodity prices, and lower industry activity, on November 19, 2008, the Alberta government introduced a new 5 year transitional royalty regime with the objective of promoting the drilling of new wells. Under this program companies drilling new oil and natural gas wells (between 1,000 and 3,500 meters deep) will be given a one-time option, on a well by well basis, to adopt either the new transitional royalty rates until January 1, 2014 (at which time the royalties revert to the "NRF") or those outlined in the Royalty Framework. Wells qualifying for this program must be drilled during the period commencing on November 19, 2008 until December 31, 2013.

On March 3, 2009, the Alberta government announced a three-point incentive program to encourage additional activity in the oil and gas sector, of which only the first two aspects are relevant to oil and gas producers; i) drilling royalty credit, ii) new well incentive program, iii) reclamation and abandonment program for old well sites. A drilling royalty credit will offer \$200 in royalty credits per meter drilled on new conventional oil and natural gas wells spud and rig released between April 1, 2009 and April 1, 2010. The new well incentive program will reduce the royalty to a maximum 5% rate on any wellbore that has not produced between January 1 and April 1, 2009 for the period of the earlier of: i) the production of 50,000 barrels of oil production, ii) 500 million cubic feet (MMcfe) of gas production, or iii) 12 calendar months. Once this incentive expires, royalties will be based on either the transitional royalty rates or the NRF rates, as applicable.

The Company drilled 3 gross (3 net) wells in Alberta during the first quarter of 2009, all of which were successful and all of which did not commence production until subsequent to April 1, 2009. As a result, the Company expects to benefit from the 5% royalty rate on these wells. The Company also expects to elect these wells to qualify for the transitional royalty regime.

In evaluating the remainder of our 2009 drilling program, we will evaluate whether the combination of all of the Alberta incentives, justify further drilling in Province of Alberta.

Lease Operating Costs

<i>(\$000s, except per boe)</i>	Three months ended			Year ended		
	2008	2007	Change %	2008	2007	Change %
Lease operating costs	2,286	1,047	118	6,419	1,719	273
Workovers, repairs and maintenance	182	-	-	1,024	-	-
Total operating costs	2,468	1,047	136	7,443	1,719	333
Lease operating costs per boe (\$) ¹	23.85	25.21	(5)	21.41	16.24	32
Workovers, repairs and maintenance per boe (\$)	1.90	-	-	3.43	-	-
Total operating costs per boe (\$)	25.75	25.21	1	24.84	16.24	53

⁽¹⁾ Lease operating costs per boe is a non GAAP measure that does not have a standardized meaning as prescribed by GAAP. Management considers it an important measure as it provides supplemental disclosure of the Company's performance on one of its important costs.

Total lease operating costs increased from \$1,047,000 or \$25.21/boe in the fourth quarter last year to \$2,468,000 or \$25.75/boe in the fourth quarter of 2008. Absolute operating costs have increased due to the increase in production volumes, however a material amount of the increase was a result of non-recurring workovers, repairs and maintenance which is outlined below.

For the year ended December 31, 2008, lease operating costs increased by 333% from the comparable period of 2007. On a boe basis, lease operating costs increased 53% from 2007, due to the amount of workover, repairs and maintenance required on the acquired properties.

Corporate average lease operating costs have been an area of focus for management since the recapitalization of the Company in January 2008. The acquisition of certain assets out of receivership in October 2007, and the acquisition of undercapitalized assets in Milagro Energy Inc. ("Milagro") in 2008, provided the Company with significant development upside, however these assets were significantly under-maintained. During the year, Second Wave expended \$1,024,000 or \$3.43/boe on operational projects to meet regulatory operational standards and to improve operating efficiencies at these properties. Management's focus during 2008 was on lowering the operating costs at the Provost and Coronation areas acquired from the receiver, and in 2009 it expects to shift its focus toward the assets acquired in the Milagro acquisition.

The Provost capital expenditures have been focused on the Provost battery upgrade, tie-in of single well batteries and installation of a low pressure gas gathering system. As a result of these operations, Provost production has materially increased and is expected to result in future lower operating costs on a per unit basis.

During the fourth quarter the Company spent \$120,000 or \$1.25/boe on re-activations in its Coronation field and workovers on its two new horizontal oil wells in Provost. In Provost, the Company spent \$60,000 completing sand clean outs on its two horizontal oil wells due to excessive frac sand production during the start up of these wells. Ultimately the pumping systems were re-designed to facilitate the high sand production and the original pumping equipment was replaced in Q1 of 2009. The new pumping systems have substantially reduced the down time and costs associated with the sand production from these wells.

Notwithstanding Company facility improvements, during the fourth quarter of 2008, a significant amount of one time costs were experienced in the Provost and Coronation fields associated with third party shut downs. Due to unscheduled third party gas infrastructure shut downs, Second Wave was required to curtail or shut in all of its gas production from the Provost field for a period of approximately 4 weeks. Due to the uncertainty surrounding the total length of these shut downs, the Company set-up temporary production facilities to maximize the amount of oil produced and to minimize the volume of gas flared. Total additional cost associated with the set-up, rental and operation of these temporary facilities was \$130,000 or \$1.36/boe for the quarter. These costs were associated with the rental of temporary facilities, trucking of both emulsion and equipment and additional third party processing fees.

The Company took control over the assets of Milagro on May 8, 2008. On a high level the Milagro asset base has historically had high operating costs as the production facilities tended to be over built for the existing throughput with little to no maintenance capital being directed to these assets over a period of several years. Through the third and fourth quarter of 2008, Second Wave has re-directed capital to these assets to improve operating efficiencies and to meet regulatory standards. In the third and fourth quarter of 2008 the Milagro asset base had average production rates of 310 boe/d and 321 boe/d with operating costs of \$46.07/boe and \$32.81/boe, respectively. In the fourth quarter the Company shut in 110 boe/d of production due to negative operating netbacks and the Milagro asset base exited the year at approximately 180 boe/d. For the last two quarters these assets have represented only 32% of Second Wave production while accounting for 45% of its lease operating expenses.

Management believes that 2009 will show an improvement for the Milagro assets as the majority of the clean up and maintenance issues have been resolved and the Company is now directing 75% of its budgeted capital in 2009 to these fields. Currently the Milagro asset base is producing approximately 350 boe/d even with 110 boe/d of production remaining shut in. With increased capital drilling activity and thus increased volumes through the Milagro facilities the Company believes that the operating costs on a per unit basis for these assets will drop significantly in 2009.

Transportation

(\$000s, except per boe)	Three months ended December 31, %			Year ended December 31, %		
	2008	2007	Change	2008	2007	Change
Transportation	163	50	226	384	127	202
Per boe (\$)'	1.70	1.20	42	1.28	1.20	7

⁽¹⁾ Transportation costs per boe is a non GAAP measure that does not have a standardized meaning as prescribed by GAAP. Management considers it an important measure as it provides supplemental disclosure of the Company's performance on one of its costs.

Transportation costs for the three months ended December 31, 2008 amounted to \$163,000 with the transportation costs for the comparative period in 2007, amounting to \$50,000.

On a boe basis, transportation costs increased 42% in the three months ended December 31, 2008 to \$1.70 per boe from \$1.20 per boe in the same period of 2007. The increase in absolute amount and per boe amount is a result of the acquisition of properties that occurred in October 2007, the Milagro acquisition, and new production brought on-stream as a result of the 2008 capital program.

For the year ended December 31, 2008 and 2007, transportation costs were \$384,000 and \$127,000 respectively.

Operating Netback

(\$/boe)	Three months ended December 31, %			Year ended December 31, %		
	2008	2007	Change	2008	2007	Change
Petroleum and natural gas sales	48.90	60.05	(19)	73.12	55.39	32
Royalties	(5.84)	(8.13)	(28)	(9.35)	(9.26)	1
Lease operating costs	(25.75)	(25.21)	2	(24.84)	(16.24)	53
Transportation	(1.70)	(1.20)	42	(1.28)	(1.20)	7
Operating netback ⁽¹⁾	15.61	25.51	39	37.65	28.69	31

⁽¹⁾ Operating netback is a non GAAP measure that does not have a standardized meaning as prescribed by GAAP. Management considers it an important measure as it demonstrates the Company's ability to generate the cash flow necessary to fund future growth through capital investment.

Operating netbacks were significantly lower for the three months ended December 31, 2008, when compared to the prior year period, due mainly to the decrease in commodity prices.

Irrespective that Second Wave expects to achieve reductions in royalties and lease operating expenses, netbacks are expected to drop in 2009, due to the current lower level commodity price environment for crude oil.

Operating netbacks were higher for the year ended December 31, 2008, when compared to the prior year period, due mainly to the significant increase in commodity prices during the summer of 2008. Higher sales revenues were offset mainly by higher royalties and lease operating costs.

Operating netbacks are expected to remain weaker than those experienced in 2008, until such time as commodity prices improve.

General and Administrative (“G&A”)

<i>(\$000s, except per boe)</i>	Three months ended			Year ended		
	2008	2007	Change	2008	2007	Change
			%			%
G&A expenses	778	558	39	3,193	2,104	52
Capitalized G&A expenses	(301)	-	-	(664)	-	-
Net G&A expenses	477	558	(15)	2,529	2,104	20
Per boe (\$) ¹	4.97	13.40	(63)	8.44	20.67	(59)
Per boe (\$) Excluding non-recurring charges	4.02	13.40	(70)	7.76	20.67	(62)

⁽¹⁾ G&A per boe is a non GAAP measure that does not have a standardized meaning as prescribed by GAAP. Management considers it an important measure as it provides supplemental disclosure of the Company’s performance on one of its important costs.

General and administrative expenses, net of capitalized G&A, decreased 15% in the fourth quarter of this year, to \$477,000 from \$558,000 in the same period last year. The overall decrease in G&A expenses in the quarter is related to the capitalization of G&A expenses. Aggregate G&A costs increased 39% mainly due to an increase in personnel from 7 to 13 employees and non-recurring corporate restructuring costs of \$91,000 (\$0.95/boe). On a boe basis, general and administrative expenses, net of capitalized G&A, were 63% lower in the comparative quarter due to the increase in production volumes.

G&A costs per unit typically trended downward throughout 2008’s from \$11.64/boe in the first quarter, \$12.94 in the second quarter, \$9.62 in the third quarter, and \$4.97/boe in the fourth quarter. Management expects that G&A costs on a per unit basis will continue to trend lower than the 2008 average as a result of increased production volumes from both the acquisition of Milagro, and the benefits of Second Wave’s capital program.

For the year ended December 31, 2008, general and administrative expenses, net of capitalized G&A, increased 20% from those of the comparative period last year. The overall increase in G&A expenses in the period is related to an increase in personnel from 7 to 13 employees and non-recurring corporate restructuring costs of \$204,000 (\$0.68/boe).

Although the Company’s G&A per boe has decreased significantly when compared with 2007, due to the recent drop in commodity prices, the Company has taken initiatives to further reduce its G&A levels in 2009. Subsequent to year end the Company has reduced its employee count from 13 to 11 as its capital program has been reduced due to commodity prices. Additional G&A expenses such as software rentals and consultants have also been reduced in 2009.

Stock-Based Compensation

Stock-based compensation expense, net of capitalized stock-based compensation, for the three months ended December 31, 2008 was \$264,000, as compared to \$178,000 in the comparative period of 2007. The increase in stock-based compensation expense is due to the overall increase in personnel. Stock-based compensation expenses of \$257,000 were capitalized during the fourth quarter of 2008 (2007 – Nil).

For the year ended December 31, 2008 and 2007, stock-based compensation expense, net of capitalized stock-based compensation, was \$1,214,000 and \$565,000 respectively. Stock-based compensation expenses of \$661,000 were capitalized during the year ended December 31, 2008 (2007 – Nil).

Financing Expenses

(\$000s, except per boe)	Three months ended			Year ended		
	2008	2007	Change	2008	2007	Change
			%			%
Interest on current portion of debt	113	106	6	327	635	(48)
Interest on convertible debenture	-	228	-	31	591	(95)
Interest on long term portion of debt	147	-	-	381	-	-
Finance charges on flow through share obligations	(383)	524	(173)	(383)	730	(152)
Total cash component	(123)	858	(114)	356	1,956	(82)
Non cash component						
Loan extension fees - warrants	-	5	-	-	401	-
Total financing expenses	(123)	863	(114)	356	2,357	(85)
Per boe (\$)'	(1.28)	20.77	(1,062)	1.19	22.27	(95)

⁽¹⁾ Financing costs per boe is a non GAAP measure that does not have a standardized meaning as prescribed by GAAP. Management considers it an important measure as it provides supplemental disclosure of the Company's performance on one of its important costs.

Financing expenses decreased by 1,062% from \$863,000 in 2007 to (\$123,000) in the fourth quarter of 2008. The majority of the decrease related to the reversal of \$383,000 of financing charges related to flow through share obligations in 2007, overall lower debt levels for most of 2008, and loan extension and other lender fees on the Company's debt facilities expenses in 2007.

For the year ended December 31, 2008, financing expenses decreased by 85% to \$356,000 as compared with \$2,357,000 in 2007.

Given the global credit crisis and the higher borrowing costs charged by lenders, our borrowing costs are expected to increase in 2009. Although the bank's prime lending rate is currently 2.5%, down from approximately 5.25% at this time last year, the expected increase in rate premiums offsets the drop in prime interest rates. As Company debt levels are higher than they were at this time in 2008, we expect an aggregate increase in financing costs. Recent amendments to the Company's financing arrangements with its principal lender result in expected annualized borrowing rate of approximately 6.3% for the majority of the Company's debt.

Depletion, Depreciation and Accretion

(\$000s, except per boe)	Three months ended			Year ended		
	2008	2007	Change	2008	2007	Change
			%			%
Depletion	2,339	859	172	6,392	2,241	185
Depreciation	6	10	(40)	19	22	(14)
Accretion of asset retirement obligations	154	29	431	398	55	624
Total	2,499	898	178	6,809	2,318	194
Per boe (\$)'	26.07	21.63	21	22.72	21.90	4

⁽¹⁾ Depletion, depreciation and accretion per boe is a non GAAP measure that does not have a standardized meaning as prescribed by GAAP. Management considers it an important measure as it provides supplemental disclosure of the Company's performance on one of its important non cash costs.

Depletion, depreciation and accretion expense increased 178% in the fourth quarter of 2008 to \$2,499,000 from \$898,000 in the same period of 2007. This increase in absolute dollar amount is a result of the increased production impacts from the property acquisition in October 2007, the Milagro acquisition, and the 2008 capital program. On a boe basis depletion, depreciation and accretion expense increased by 21% to \$26.07/boe compared to \$21.63/boe in the same period of 2007.

Depletion, depreciation and accretion expense increased 194% in the year ended December 31, 2008 to \$6,809,000 from \$2,318,000 in the same period of 2007. On a boe basis, depletion, depreciation and accretion expense increased by 4% to \$22.72/boe compared to \$21.90/boe in the same period of 2007.

Accretion of Convertible Debenture

Accretion of convertible debenture was \$13,000 during the year ended December 31, 2008 and \$101,000 during the comparative period in 2007. The convertible debenture commenced in the third quarter of 2007 and was converted into equity in January 2008.

Income Taxes

The income tax provision for the three months ended December 31, 2008 was \$Nil, compared to expense of \$11,000 in the comparative period of 2007.

The income tax provision for the year ended December 31, 2008 was Nil, compared to a recovery of \$1,342,000 in the comparative period of 2007. The 2007 recovery was a result of reversal of a valuation allowance as at December 31, 2006.

Income taxes are comprised of two components: current and future income taxes. The statutory 2008 income tax rate as a percentage of pre-tax income is 29.7%. Due to the reversal of the valuation allowance on existing tax losses, the Company had no income tax provision in the 2008 periods.

Capital Expenditures

During the three months ended December 31, 2008, \$7,256,000 (2007 - \$12,627,000), and for the year ended December 31, 2008 \$21,656,000 (2007 - \$14,109,000) was cash expenditures on capital activities as summarized below:

Capital Expenditures (\$000s)	Three months ended December 31,			Year ended December 31,		
	2008	2007	% Change	2008	2007	Change %
Land and acquisitions	1,567	9,670	84	5,447	9,840	45
Geological and geophysical	915	-	-	1,130	-	-
Drilling and completion	458	2,933	85	7,326	4,032	82
Facilities and equipment	4,015	24	16,629	7,089	237	2,891
Capitalized G&A	301	-	-	664	-	-
Total cash additions	7,256	12,627	(43)	21,656	14,109	53
Non-cash additions						
Acquisition of Milagro Energy Inc.	-	-	-	26,265	-	-
Acquisition of Stone Castle Exploration Inc.	-	-	-	-	2,056	-
Asset retirement obligations	77	80	(4)	139	116	20
Capitalized stock-based compensation	257	-	-	661	-	-
Total capital expenditures	7,590	12,707	(40)	48,721	16,281	199

A comparison of the activities of the Company from 2008 to 2007 is not a meaningful analysis as a new management team was put in place in January 2008, in connection with the recapitalization of the Company. The overall decrease in capital expenditures in the three months ended December 31, 2008 was mainly as a result of the closing of a significant asset acquisition in the fourth quarter of 2007. In 2008, a significant amount of capital was expended on existing assets with the objective of increasing production, and streamlining operations.

In the fourth quarter of 2008, the Company drilled of 1 gross well (1 net) of which included, 1 (1 net) oil wells for a 100% success rate. Additional capital expenditures related to the equipping and tie-in portion of the successful wells and costs associated with the equipping and tie-in's of wells previously drilled were also incurred in the quarter.

For the year ended December 31, 2008, Second Wave has drilled 10 gross wells (8.7 net), which included 7 (6 net) oil wells and 3 (2.7 net) D&A wells for an overall 70% success rate.

Drilling Results (wells drilled)	Three months ended December 31, 2008			Year ended December 31, 2008		
	gross	net	working interest %	gross	net	working interest %
Productive	1	1.0	100	7	6.045	86
Dry and abandoned	-	-	-	3	2.65	88
Total	1	1.0	100	10	8.695	87

Drilling Results (wells drilled)	Three months ended December 31, 2007			Year ended December 31, 2007		
	gross	net	working interest %	gross	net	working interest %
Productive	1	0.2	20	2	1.2	60
Standing awaiting further evaluation	10	3.4	34	10	3.4	34
Dry and abandoned	1	0.6	60	1	0.6	60
Total	12	4.2	35	13	5.2	40

Liquidity and Capital Resources

The junior oil and gas business is inherently risky and capital intensive and can require significant capital resources to grow reserves and cashflow. Given the nature of the oil and gas business, and the size of Second Wave, it may need to access capital markets to expand its production and reserve base.

On January 17, 2008, the Company was recapitalized, and Brookfield Bridge Lending Fund Inc. (“Brookfield”) obtained majority control of the outstanding shares. As at April 29, 2009, Brookfield owns approximately 67% of the issued and outstanding common shares of Second Wave

In June 2007, Section 1400 of the CICA Handbook was amended to require management to assess and disclose an entity’s ability to continue as a going concern. This section applies for interim and annual periods beginning on or after January 1, 2008. The Company has adopted this section on January 1, 2008. Recent market events, including disruptions in credit markets and other financial systems and the deterioration of global economic conditions have resulted in significant declines in commodity prices. As at December 31, 2008, the Company had a working capital deficiency of \$2,311,041 and had drawn \$15,675,606 on its \$18,000,000 demand revolving operating line. Subsequent to year end, the senior lender re-determined the borrowing base and maintained the facility at \$18,000,000 but assigned \$5,500,000 of this total as a term loan due September 30, 2009 at which time the senior lender will again re-determine the borrowing base. As the available lending limits under the facility are based on the senior lender’s interpretation of the Company’s reserves and future commodity prices, there can be no assurance as to the amount of the facility that will be available as at September 30, 2009. To help manage its liquidity, management has reduced capital expenditures, completed a private placement with its majority shareholder subsequent to year end and continues to monitor additional financing opportunities to fund future prospects and commitments. No additional financing agreements have been signed nor can it be assured that further such agreements will be reached, however management believes that the action being taken will mitigate the conditions and events that give rise to liquidity risk. Based on its forecasts and considering the proceeds of the private placement completed in February 2009, the Company currently expects that sufficient liquidity is available to meet its obligations in 2009, however the Company may fail to meet certain of its financial debt covenants on its loan agreements during the year. Further declines in commodity prices could adversely impact Management’s assessment of its ability to meet liquidity requirements in 2009.

Management believes that as a result of increases in production and the reduction of lease operating costs from the capital program, in combination with current future strip commodity prices, that the independent reserves evaluation at the semi-annual borrowing base review, will justify the increase in the revolving borrowing base back to approximately \$18,000,000.

Nevertheless, there are risks involved with management's expectation that the borrowing base will be increased in the fall of 2009. Production volumes could drop, future commodity prices and thus netbacks could decrease, and global credit conditions could further deteriorate. In order to plan for these risks, the Company intends to delay the majority of the remainder of its capital program until adequate capital resources are secured.

Second Wave has budgeted \$8,000,000 of capital expenditures for 2009, of which approximately \$4,000,000 was expended in the first quarter of 2009. The Company expects to rely on internally generated cash flows to finance the remainder of the capital program and as such the program could be reduced if the business environment weakens further in the second half of 2009.

In addition to the above noted loans the Company also has a related party term loan of \$7,500,000 which matures in May 2010. Although the Company believes that this loan will be renegotiated or extended at that time, there is no certainty of that occurring or the potential costs associated with that type of agreement.

To secure adequate capital resources, the Company may raise funds during the year and/or dispose of certain non-core assets. Although the Company has a significant inventory of low risk prospects to develop, in light of the volatility of commodity prices, the impact of the global credit crisis, current market conditions suggest that the sale of equity at a reasonable price in relation to the Company's net asset value could be challenging. Management believes that the related party term loan that matures in May 2010 will also require renegotiation should we look to public markets for additional equity financing. Given the current market and expected oversupply of oil and gas properties available for acquisition, we believe that prices seen for asset acquisitions and dispositions will remain weak for some time. Given these circumstances, as one of management's goals is to increase cash flows, the Company also intends to continue to evaluate corporate acquisitions, and/or mergers.

On February 17, 2009, the Company closed a private placement equity financing for aggregate gross proceeds of approximately \$3,980,000. A total of 6,015,131 common shares were issued by the Company on a "flow through" basis. The Company's major shareholder subscribed for 5,757,575 flow through shares at \$0.66 per share for proceeds of \$3,800,000 while management subscribed for 257,556 flow through shares at \$0.70 per share for proceeds of \$180,289. Under the terms of the subscription agreement the Company is required to incur and to subscribers and renounce \$3,800,000 of eligible Canadian Development Expenditures on or before February 11, 2011 and an additional \$180,289 of eligible Canadian Exploration Expenditures on or before December 31, 2010.

The conversion of the \$9,000,000 convertible debenture by Brookfield, together with their exercise of \$4,700,000 in warrants during January 2008 resulted in the issuance of 11,960,682 common shares to Brookfield which together with their previous holdings resulted in them owning approximately 58% of the then issued and outstanding common shares of Second Wave.

On January 17, 2008, Second Wave closed a private placement to members of management and directors of Second Wave. In aggregate, Second Wave issued 600,489 Units, for aggregate proceeds of \$1,080,000.

To facilitate the financing for the acquisition of Milagro, Second Wave closed an equity private placement for 4,000,000 Units at \$2.50 per Unit for gross proceeds of \$10,000,000 and entered into a \$7,500,000 secured facility agreement, both with Brookfield. Each Unit was comprised of one Common Share and 0.6 Common Share purchase warrant. Each warrant is exercisable until May 8, 2010 at a price of \$3.125 per warrant. The facility bears interest at the bank's prime rate plus 2%, and has a two year term. Proceeds from these activities were used upon closing the acquisition of Milagro to repay its outstanding term facility and convertible debentures.

As at December 31, 2008, the Company expended all of its flow through commitments as a result of flow through monies raised in 2008.

Share Capital

On May 26, 2008, the Company exercised its right to convert all of its Class B shares into Class A shares, whereby for each Class B share outstanding 10 Class A shares were issued. On June 25, 2008, shareholders approved the consolidation of the Class A shares of the company on a one for ten basis, the cancellation of Class B shares, and the redesignation of the Class A shares into Common shares. Share numbers have been retroactively adjusted to reflect the share consolidation.

As of April 29, 2009, the Company has 36,932,340 common shares, 3,489,509 warrants, and 3,287,000 stock options outstanding.

Contractual Obligations, Commitments, and contingencies

We do not use off-balance sheet arrangements. We are committed to an operating lease for our office space and the future minimum rental payments and estimated operating costs to the end of lease are as follows:

Year	(\$000's)
2009	196
2010	196
2011	65
Total contractual obligations	457

In connection with an asset acquisition that closed in October 2007, the Company has an outstanding letter of guarantee in the amount of \$320,539 as security for a potential contingent liability associated with the acquisition. The claim is for entitlement ahead of the Company's acquisition of assets from the receiver. The Trial Justice found that the Plaintiffs were entitled to the guarantee, however the Company appealed the ruling on the basis that it greatly extended and was inconsistent with current law. The appeal was heard on March 11, 2009 and the Court's decision has been reserved. Settlement of the potential contingent liability will be treated as a purchase price adjustment in the period of settlement.

In connection with proposed asset acquisitions, the Company has committed to acquire certain oil and natural gas assets for \$255,000 and \$800,000 in 2009, respectively.

In connection with a flow through equity agreement during 2006, the Company was required under the income tax act to expend amounts renounced to subscribers prior to December 31, 2007. Due to weather related issues, the Company was temporarily delayed and did not complete activities related to \$982,906 in expenditures until February 2008. The Company has advised the Canada Revenue Agency ("CRA"), of the circumstances, paid appropriate interest and penalties and does not intend to re-file. In the event that the CRA reassessed the Company's treatment, the Company could potentially be liable for indemnities to flow through subscribers relating to the delayed expenditures for approximately \$383,333.

Related party transactions

During the year ended December 31, 2008, the Company has entered into the following related party transactions:

- a. Legal services, disbursements and regulatory costs totaling \$231,892 (2007 - \$297,609) payable to a legal firm of which a former director and officer of the Company is counsel. These fees are included in general and administrative expense, share issuance costs and acquisition costs.
- b. Financing and advisory fees of \$Nil, (2007 - \$339,730 cash and \$73,551 non-cash) payable to a Company of which a former director of the Company is an officer.
- c. Payments of \$822,469 (2007 - \$567,688) for financing related expenses were paid to the majority shareholder of the Company (see notes 5(b) and 9(c)).

All transactions have been completed on the basis of general market terms and conditions and have been recorded at exchange amount.

Quarterly Financial Summary

	2008				2007			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
<i>(\$000's except per boe and per share amounts)</i>								
Average production (boe/d)	1,042	933	783	504	451	244	243	220
Petroleum and natural gas sales	4,688	7,197	6,326	3,407	2,494	1,120	1,203	1,045
Royalties	(560)	(905)	(871)	(466)	(338)	(197)	(280)	(165)
Operating expenses	(2,468)	(2,588)	(1,558)	(829)	(1,047)	(246)	(153)	(273)
Transportation expenses	(163)	(90)	(77)	(54)	(50)	(29)	(27)	(21)
Operating netback (per boe) ⁽¹⁾	15.61	42.10	54.58	44.87	25.51	28.86	37.40	29.72
Funds from operations ⁽²⁾	1,069	2,249	2,596	1,617	(345)	(446)	18	(273)
Per share - basic	0.03	0.07	0.09	0.07	(0.03)	(0.06)	-	(0.05)
Per share - diluted	0.03	0.07	0.09	0.07	(0.02)	(0.06)	-	(0.05)
Net income (loss)	(1,587)	665	296	380	(1,640)	(1,102)	(1,200)	395
Per share - basic	(0.05)	0.02	0.01	0.01	(0.13)	(0.14)	(0.19)	0.07
Per share - diluted	(0.05)	0.02	0.01	0.01	(0.11)	(0.10)	(0.15)	0.05
Capital expenditures								
Cash	7,256	8,920	3,953	1,527	12,627	1,034	52	396
Non-cash	334	3,830	22,801	100	80	36	2,056	-
Total	7,590	12,750	26,754	1,627	12,707	1,070	2,108	396

⁽¹⁾ Operating netback is a non GAAP measure that does not have a standardized meaning as prescribed by GAAP. We consider it an important measure as it demonstrates our ability to generate the cash flow necessary to fund future growth through capital investment.

⁽²⁾ Funds from operations is a non-GAAP measure that does not have a standardized meaning as prescribed by GAAP and is therefore unlikely to be comparable to similar measures presented by other oil and gas companies. We consider it an important measure as it demonstrates our ability to generate the cash flow necessary to fund future growth through capital investment.

International Financial Reporting Standards (“IFRS”):

In 2008, the CICA confirmed that public entities will be required to adopt IFRS in place of Canadian GAAP for interim and annual reporting effective January 1, 2011. The Company continues to monitor, assess and develop its implementation plan for the convergence of Canadian GAAP to IFRS.

Risks and Uncertainties

Set forth below are risk factors that could materially adversely affect our funds from operations, operating results and financial condition.

Competition

The natural gas and oil industry is highly competitive. We experience competition in all aspects of our business, including acquiring reserves, leases, licenses and concessions, obtaining the equipment and labor needed to conduct operations and market natural gas and oil. Our competitors include multinational energy companies, other independent natural gas and oil companies and individual producers and operators. Because both natural gas and oil are fungible commodities, the principal form of competition with respect to product sales is price competition. Many competitors have financial and other resources substantially greater than those available to us and, accordingly, may be better positioned to acquire and exploit prospects, hire personnel and market production. In addition, many of our competitors may be better able to respond to factors such as changes in worldwide natural gas or oil prices, levels of production, the cost and availability of alternative fuels or the application of government regulations. Such factors, which are beyond our control, may affect demand for our natural gas and oil production. We expect a high level of competition to continue.

Exploration and development risks

Exploration and development of natural gas and oil involves a high degree of risk that no commercial production will be obtained or that the production will be insufficient to recover drilling and completion costs. The costs of drilling, completing, and operating wells are sometimes uncertain, and cost overruns in exploration and development operations can adversely affect the economics of a project. Our drilling operations may be curtailed, delayed or canceled as a result of numerous factors, including mineral lease title deficiencies, equipment failures, weather conditions, shortages or delays in sourcing qualified personnel, shortages or delays in the delivery of equipment, ability to access surface topography, compliance with government requirements, and fires and explosions. Furthermore, completion of a well does not ensure a profit on the investment or a recovery of the drilling, completion and tie-in costs.

We cannot be certain that the exploratory or development wells we drill will be productive or that we will recover all or any portion of our investments. In order to increase the chances for success, we often invest in seismic or other geoscience data to assist us in identifying potential drilling candidates. Additionally, the cost of drilling, completing and testing wells is often uncertain at the time of our initial investment. Depending on complications encountered while drilling, the final cost of the well may significantly exceed that which we originally estimated.

Commodity price fluctuations

Our products, including natural gas, natural gas liquids and crude oil, and other hydrocarbon products, are commodities. Because our contracts do not fix a long-term price for the products we purchase or sell, market changes in the price of such products can have a direct and immediate effect (whether favorable or adverse) upon our revenues and profitability. Prices for products may be subject to material change in response to relatively minor changes in supply and demand, general economic conditions and other market conditions over which we have no control. As the majority of our production is from natural gas sales, the price of crude oil does not have a large impact on our profitability. Other conditions affecting our business include the level of domestic oil and gas production, the availability and prices of competing commodities and of alternative energy sources, the availability of local, intraprovincial and interprovincial transportation systems with adequate capacity, the proximity of gas production to gas pipelines and facilities, the availability of pipeline capacity, government regulation, the seasons, the weather and the impact of energy conservation efforts.

Estimating reserves and future net cash flows risk

Estimating natural gas, natural gas liquids, crude oil reserves, and future net cash flows include numerous uncertainties, many of which may be beyond our control. Such estimates are essential in our decision-making, as to

whether further investment is warranted. These estimates are derived from several factors and assumptions, some of which are:

- reservoir characteristics based on variable geological, geophysical and engineering assessments;
- future rates of production based on historical production draw-down rates;
- future net cash flows based on commodity price/quality assumptions, production costs, taxes and investment decisions;
- recoverable reserves based on estimated future net cash flows; and
- compliance expectations based on assumed federal, provincial and environmental laws and regulations.

Ultimately, actual production rates, reserves recovered, commodity prices, production costs, government regulations or taxation may differ materially from those assumed in earlier reserve estimates. Higher or lower differences could materially impact our production, revenues, production costs, depletion expense, taxes and capital expenditures.

Reserve estimates and net present values reported by us elsewhere in this document are based on independent third party estimated escalated commodity prices and associated production costs that are assumed for the life of the reserves. Actual future prices and costs may be materially higher or lower.

Replacement of reserves

In general, the rate of production from natural gas and oil properties declines as reserves are depleted. The rate of decline depends on reservoir characteristics and other factors. Except to the extent we acquire properties containing proved reserves or conduct successful exploration and development activities, or both, our estimated proved reserves will decline as reserves are produced. Our future natural gas and oil production, and therefore cash flow from operations and net earnings, are highly dependent upon our level of success in finding or acquiring additional economically recoverable reserves. The business of exploring for, developing and acquiring reserves is capital intensive. To the extent cash flow from operations is reduced and external sources of capital become limited or unavailable, our ability to make the necessary capital investment to maintain or expand our asset base of natural gas and oil reserves could be materially impaired.

Risks pertaining to acquisitions and joint ventures

As part of implementing our business strategy, we may consider expanding our business through the acquisition of oil and gas properties or companies. Our ability to expand in this manner would depend upon our ability to identify suitable acquisitions, complete the acquisitions, and effectively integrate any acquired assets or companies into our current business operations. Suitable acquisitions, on terms acceptable to us, may not be available in the future or may require us to assume certain liabilities, including, without limitation, environmental liabilities, known or unknown. Should suitable acquisition candidates be evaluated, we may require debt financing and/or additional equity to be raised to fund the acquisition. As we currently have no debt and have not raised equity during the past few years, it is not certain that we could obtain suitable financing to close an acquisition.

Potential variability in quarterly operating results

The exploration for and development of oil and natural gas reserves depends on access to areas where operations are to be conducted. Seasonal weather variations, including freeze-up and break-up affect access in certain circumstances. Natural gas is used principally as a heating fuel and for power generation. Accordingly, seasonal variations in weather patterns affect the demand for natural gas. Depending on prevailing conditions, the prices received for sales of natural gas are generally higher in winter than summer months, while prices are generally higher in summer than spring and fall months. Accordingly, any increase or decrease in our net operating revenues and their effects on profitability cannot be predicted. Because of the seasonality of our business and continuous fluctuations in the prices of our products, our operating results for any past quarterly period may not necessarily be indicative of results for future periods and there can be no assurance that we will be able to maintain steady levels of profitability on a quarterly or annual basis in the future.

Operating hazards and uninsured risks

The oil and gas business involves a variety of operating risks, including fire, explosion, pipe failure, casing collapse, abnormally high pressured formations, adverse weather conditions, governmental and political actions, native rights,

surface topography, limited or no access during summer months, premature reservoir declines, and environmental hazards such as oil spills, gas leaks and discharges of toxic gases. The occurrence of any of these events with respect to any property operated or owned (in whole or in part) by us could have a material adverse impact on us. We, and the operators of our properties, maintain insurance in accordance with customary industry practices and in amounts that we believe to be reasonable. However, insurance coverage is not always economically feasible and is not obtained to cover all types of operational risks. The occurrence of a significant event that is not fully insured could have a material adverse effect on our financial condition.

Drilling plans subject to change

A prospect is a property on which our geoscientists have identified what they believe, based on available seismic and geological information, to have indications of hydrocarbons. Our prospects are in various stages of review. Whether or not we ultimately drill a prospect may depend on the following factors: receipt of additional seismic data or reprocessing of existing data and interpretation; material changes in oil or gas prices; the costs and availability of drilling equipment; success or failure of wells drilled in similar formations, availability of capacity in existing facilities and pipelines; availability and cost of capital; changes in the estimates of costs to drill or complete wells; our ability to attract other industry partners to acquire a portion of the working interest to reduce exposure to costs and drilling risks; decisions of our joint working interest owners; and restrictions imposed by governmental agencies. We will continue to gather data about our prospects, and it is possible that additional information may cause us to alter our drilling schedule or determine that a prospect should not be pursued at all.

Shortage of supplies and equipment

Our ability to conduct operations in a timely and cost effective manner is subject to the availability of natural gas and crude oil field services, such as rigs, equipment and service crews. Shortage of certain types of equipment and supplies could result in delays in our operations as well as in higher operating and capital costs.

Restoration, safety and environmental risk

Certain laws and regulations exist that require companies engaged in petroleum activities to obtain necessary safety and environmental permits to operate. Such legislation may restrict or delay us from conducting operations in certain geographical areas. Further, such laws and regulations may impose liability on us for remedial and clean-up costs, personal injuries related to safety and environmental damages.

While our safety and environmental activities have been prudent and have enabled us to operate successfully in managing such risks, there can be no assurance that we will always be successful in protecting ourselves from the impact of all such risks. Consistent with our growth in other areas, we seek opportunities for performance improvement in our operating practices.

Government regulation and environmental matters

We are subject to various federal and provincial laws and regulations including environmental laws and regulations. We believe that we are in substantial compliance with such laws and regulations, however, such laws and regulations may change in the future in a manner that will increase the burden and cost of compliance. In addition, we could incur significant liability for damages, cleanup costs and penalties in the event of certain discharges into the environment.

Certain laws and governmental regulations may impose liability on us for personal injuries, clean-up costs, environmental damages and property damages, as well as administrative, civil and criminal penalties. We maintain limited insurance coverage for sudden and accidental environmental damages, but do not maintain insurance coverage for the full potential liability that could be caused by sudden and accidental environmental damage. Accordingly, we may be subject to liability or may be required to cease production from properties in the event of such damages.

Kyoto Protocol risk

The Kyoto Protocol treaty (Protocol) was established in 1997 to reduce emissions of greenhouse gases (GHG) that are believed to be responsible for increasing the Earth's surface temperatures and affecting the global climate

change. Canada ratified the Protocol in December 2002. Since the implementation of the Protocol, approximately 160 countries have committed to reduce GHG internationally. Canada has committed to meet a 6% reduction of emission over base-year 1990 during the period 2008 to 2012. Canadian government assurances of cost and volume limits suggest that incremental risks and liabilities attributable to addressing Protocol related policies are manageable. It is not possible to predict the impact of how Protocol-related policies will ultimately be resolved and to what extent their impact will affect our future unit operating costs and capital expenditures.

Critical Accounting Estimates

Management is required to make judgments in the application of generally accepted accounting principals that may have a significant effect on the financial statements of the Company.

Use of estimates

Inherent in the preparation of financial statements is the use of estimates and assumptions regarding certain assets, liabilities, revenues and expenses. Such estimates primarily relate to unsettled transactions and events as of the date of the financial statements. Accordingly actual results may differ from the estimated amounts. Areas that involve the use of significant estimates critical to an understanding of our accounts are outlined below.

While management believes that its estimates have been reasonable in the circumstances, the global credit market crisis, the volatility in the price of oil and natural gas, the recession in Canada and the slowdown of economic growth in the rest of the world has created a substantially more volatile business environment. These conditions will limit certain of the Company's previously planned business development activities and it will continue to provide risk for the Company's future. To prepare its consolidated financial statements, management has recorded adjustments and included disclosures based on their best estimates of projected business activity and future cash flows.

Full cost accounting

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

Full cost ceiling test calculations

The full cost method requires us to calculate, whenever there is an indication of impairment, a "ceiling test" or limitation of the amount of properties that can be capitalized on the balance sheet.

The ceiling test is a cost recovery test that compares the expected future net revenues from our oil and gas assets (adjusted for certain items) with the net book value on the balance sheet. If the capitalized costs on the balance sheet are in excess of the calculated ceiling, the excess must be immediately written off as an impairment loss.

The expected future net revenues of proved oil, natural gas, and natural gas liquids reserves is a major component of the ceiling test calculation. This component inherently contains many subjective judgments, such as projected future production rates, product prices, the timing of future expenditures, and the economic productive limit of our assets. We utilize the resources of an independent reserves evaluator to evaluate all of our reserves on an annual basis.

The passage of time provides additional qualitative information regarding our reserves that could result in reserve revisions. Significant decreases in proven reserves or product pricing could result in a full cost ceiling test write-down.

Significant changes in proven reserves will also impact the calculation of depletion.

Asset retirement obligations

The determination of the amount of asset retirement obligations, asset retirement costs, reclamation, and other similar activities is subject to the use of significant estimates and assumptions. Such estimates include the remaining economic reserve life of a property as discussed above, the timing of abandonment, the costs related to the abandonment, and others. Significant changes in any of the assumptions could alter the amount of asset retirement obligations and related accretion and depletion.

The asset retirement obligation liabilities are carried on the balance sheet at their discounted present value and are accreted over time for the change in their present value.

Stock-based compensation

In accordance with CICA Handbook Section 3870, “Stock-based Compensation and Other Stock-based Payments”, we follow the fair value method for valuing stock option grants. Under this method, compensation cost attributable to stock options is measured at fair value at the grant date and expensed over the vesting period with a corresponding increase to contributed surplus. Upon the exercise of the stock options, consideration paid and the associated cost recorded in contributed surplus is recorded as an increase to total capital.

Revenue recognition

Revenue is recorded in the period when the proceeds become receivable and measurable and collection is reasonably assured. Under certain agreements, we receive oil and natural gas revenues net of operating and capital costs incurred by the working interest participants. The time that the net revenues become receivable and collection is reasonably assured depends on the terms and conditions of the relevant agreements and the practices followed by the operator.

Income taxes

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

Additional information

Additional information relating to Second Wave may be found on our website at www.secondwavepetroleum.com, or on the Canadian Securities Administrators’ website at www.sedar.com.

Financial Statements of
Second Wave Petroleum Inc.
Year Ended December 31, 2008



KPMG LLP
Chartered Accountants
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Calgary AB T2P 4B9

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AUDITORS' REPORT TO THE SHAREHOLDERS

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

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

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

KPMG LLP

Chartered Accountants
Calgary, Canada
April 29, 2009

Second Wave Petroleum Inc.
Consolidated Balance Sheets

	As at December 31, 2008	As at December 31, 2007
ASSETS		
Current assets:		
Accounts receivable	\$ 2,341,161	\$ 1,982,292
Prepaid expenses	626,775	134,400
	2,967,936	2,116,692
Property and equipment (note 4)	70,680,994	29,000,831
	\$ 73,648,930	\$ 31,117,523
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 5,278,977	\$ 2,889,217
Loans payable (note 5)	15,675,606	5,551,042
	20,954,583	8,440,259
Loans payable (note 5)	7,365,205	-
Convertible debenture (note 6)	-	8,585,844
Asset retirement obligation (note 8)	6,156,862	2,374,826
	34,476,650	19,400,929
Shareholders' equity:		
Share capital (note 9b)	32,043,284	40,991,342
Warrants (note 9g)	3,199,698	1,957,057
Contributed surplus (note 9i)	4,175,145	1,265,096
Equity component of convertible debenture (note 6)	-	506,481
Deficit	(245,847)	(33,003,382)
	39,172,280	11,716,594
Contingencies and commitments (note 10)		
Future operations (note 15)		
Subsequent events (note 16)		
	\$ 73,648,930	\$ 31,117,523

See accompanying notes to consolidated financial statements.

Approved by the Board:

Signed "Colin Witwer" Director

Signed "Alan Steele" Director

Second Wave Petroleum Inc.

Consolidated Statements of Loss, Comprehensive Loss and Deficit For the years ended December 31, 2008 and 2007

	2008	2007
REVENUE		
Crude oil, natural gas, and natural gas liquids sales	\$ 21,617,788	\$ 5,861,528
Royalties	(2,800,831)	(979,085)
Realized loss on financial derivatives	(361,334)	-
Other income	-	34,616
	18,455,623	4,917,059
EXPENSES		
Operating	7,443,336	1,718,692
Transportation	383,767	127,256
General and administrative	2,529,299	2,104,060
Depletion, depreciation and accretion	6,809,283	2,318,191
Financing expense (note 11)	356,153	2,356,547
Stock based compensation	1,214,349	565,218
Accretion of convertible debenture	12,683	101,310
Write-off of goodwill	-	514,228
	18,748,870	9,805,502
Loss before income taxes	(293,247)	(4,888,443)
Income taxes		
Future income tax (reduction)	-	(1,341,650)
Loss before non-controlling interest	(293,247)	(3,546,793)
Non-controlling interest in loss of Milagro	47,400	-
Net loss and comprehensive loss	(245,847)	(3,546,793)
Deficit, beginning of year	(33,003,382)	(29,456,589)
Reduction of stated capital (note 9j)	33,003,382	-
Deficit, end of year	\$ (245,847)	\$ (33,003,382)
Net loss and comprehensive loss per share		
Basic (note 9e)	\$ (0.01)	\$ (0.39)
Diluted (note 9e)	(0.01)	(0.31)

See accompanying notes to financial statements.

Second Wave Petroleum Inc.
Consolidated Statements of Cash Flow
For the years ended December 31, 2008 and 2007

	2008	2007
Cash provided by (used in):		
OPERATIONS:		
Net loss and comprehensive loss	\$ (245,847)	\$ (3,546,793)
Add (deduct) items not involving cash:		
Depletion, depreciation and accretion	6,809,283	2,318,191
Stock based compensation	1,214,349	565,218
Non-controlling interest in Milagro loss	(47,400)	-
Accretion of convertible debenture	12,683	101,310
Write-off of goodwill	-	514,228
Warrants issued on loan extensions	-	401,030
Future income taxes	-	(1,341,650)
Cash expenditures on asset retirements	(212,542)	(55,766)
	<u>7,530,526</u>	<u>(1,044,232)</u>
Change in non-cash working capital (note 13)	(1,751,314)	(493,679)
	<u>5,779,212</u>	<u>(1,537,911)</u>
FINANCING:		
Issue of shares and warrants	11,080,880	9,005,000
Share and warrant issuance costs	(364,648)	(555,560)
Issue of shares on exercise of warrants	4,939,770	1,723,125
Long term loan advances	7,500,000	-
Loan repayment	(7,825,950)	(10,000,000)
Repurchase and cancellation of shares	(198,078)	-
Exercise of stock options	12,337	-
Convertible debenture	-	8,991,015
Short term loan advances	-	5,551,042
Change in non-cash working capital (note 13)	(658,637)	697,275
	<u>14,485,674</u>	<u>15,411,897</u>
INVESTING:		
Property and equipment expenditures	(21,025,935)	(13,958,363)
Corporate acquisitions (note 3)	(629,535)	(151,110)
Change in non-cash working capital (note 13)	1,390,584	93,435
	<u>(20,264,886)</u>	<u>(14,016,038)</u>
Decrease in cash and cash equivalents	-	(142,052)
Cash and cash equivalents, beginning of year	-	142,052
Cash and cash equivalents, end of year	\$ -	\$ -

See accompanying notes to financial statements.

Supplementary Cash Flow Information

Interest received	\$ -	\$ 34,616
Interest paid	862,075	1,225,478

Second Wave Petroleum Inc.

Notes to the Consolidated Financial Statements

For the years ended December 31, 2008 and 2007

1. Nature of business:

The accompanying consolidated financial statements, include the accounts of Second Wave Petroleum Inc. ("Second Wave" or "the Company"), its wholly-owned subsidiaries, Second Wave Holdings Ltd. ("Holdings"), and Milagro Energy Inc. ("Milagro"). On June 25, 2008, the Company changed its name from Second Wave Petroleum Ltd. to Second Wave Petroleum Inc. Second Wave, Holdings and Milagro are incorporated under the laws of the Province of Alberta. The Company's common shares trade under the symbol "SCS" on the TSX Venture Exchange. The Company is engaged in the acquisition, development and exploration of petroleum and natural gas in Western Canada.

2. Significant accounting policies:

The financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles, and have, in management's opinion, been properly prepared within reasonable limits of materiality and within the framework of the accounting policies summarized below:

(a) Joint operations:

A portion of the Company's exploration, development and production activities are conducted jointly with others and accordingly, the Company reflects its proportionate interest in such activities.

(b) Cash and cash equivalents:

Cash and cash equivalents are comprised of cash and investments with an original maturity date of three months or less.

(c) Petroleum and natural gas properties:

i) Capitalization of costs:

The Company follows the full cost method of accounting for petroleum and natural gas properties. All costs of exploring for and developing petroleum and natural gas properties and related reserves are capitalized. Such costs include lease acquisition, geological and geophysical activities, lease rental costs on non-producing properties, drilling of productive and non-productive wells, tangible production equipment, and that portion of overhead costs directly attributable to exploration and development 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 greater than 20%. Where depletion rate changes are greater than 20% gains or losses on disposition of petroleum and natural gas properties are recognized.

Office equipment is recorded at cost and amortized using the declining balance method at rates of 20% to 30% per year, with a full year's amortization taken in the year of acquisition.

Second Wave Petroleum Inc.
Notes to the Consolidated Financial Statements
For the years ended December 31, 2008 and 2007

2. Significant accounting policies (continued):

ii) Depletion and depreciation:

Depletion of petroleum and natural gas properties and depreciation of production equipment are calculated using the unit-of production method based upon estimated proved reserves, before royalties, as determined by independent engineers. For purposes of the calculation, natural gas reserves and production are converted to equivalent volumes of petroleum based upon relative energy content, where 6 mcf of natural gas is equivalent to 1 barrel of oil.

Costs of acquiring unproved properties are initially excluded from the amount subject to depletion and are assessed periodically to ascertain whether impairment has occurred. When proved reserves are assigned to a property or a property is considered to be impaired, the cost of the property or the amount of impairment is added to the amount subject to depletion.

iii) Ceiling test:

The Company applies a cost recovery impairment test to capitalized costs to ensure they do not exceed the costs of unproved properties plus undiscounted future net revenues from production of proved petroleum and natural gas reserves. Future net revenues are estimated using expected future product prices and costs, less asset retirement obligations. When the carrying value of capitalized costs is determined to be not recoverable, an impairment loss is recognized as increased depletion and depreciation in the period. The carrying value of capitalized costs is reduced to the value of discounted future net revenues from production of proved and probable reserves plus the cost of unproved properties net of any impairment allowance.

(d) Asset retirement obligations:

The Company has obligations to retire petroleum and natural gas assets and restore land to its original state at the end of the useful lives of assets upon abandonment. Expected future asset retirement costs, discounted at the Company's credit adjusted risk-free rate, are recorded as liabilities and the carrying value of petroleum and natural gas assets is increased. Costs are estimated by management based on current regulations, technology and industry standards. The assets are subject to depletion and depreciation and the liabilities increase as accretion expense is recognized over time.

(e) Income taxes:

The Company uses the asset and liability method of tax allocation accounting. Temporary differences arising from the differences between the tax basis of an asset or liability and the carrying amount on the balance sheet are used to calculate future income taxes or liabilities. Future income tax assets or liabilities are calculated using substantively enacted tax rates anticipated to apply in the periods that the temporary differences are expected to reverse. A valuation allowance is recorded against any future income tax assets if it is more likely that the assets will not be realized.

Second Wave Petroleum Inc.
Notes to the Consolidated Financial Statements
For the years ended December 31, 2008 and 2007

2. Significant accounting policies (continued):

(f) Flow-through shares:

From time to time, the Company finances a portion of its exploration and development activities through the issuance of flow-through common shares. Under the terms of the flow-through share agreements, the income tax attributes of the related expenditures are renounced to the subscribers. In accordance with income tax legislation, the Company renounces deductions related to resource expenditures to the extent they have been financed through the issuance of flow-through shares. Future tax liabilities and share capital are adjusted by the estimated cost of the renounced tax deductions when they are renounced.

(g) Stock-based compensation plans:

The Company has a stock option plan for its directors, officers, employees, and consultants. The fair value of options granted are estimated using the Black-Scholes valuation model, is measured at the date of grant and charged to earnings using the graded method over the vesting period with a corresponding increase in contributed surplus. Consideration paid to the Company on the exercise of stock options or warrants is credited to share capital.

(h) Measurement uncertainty:

The amounts recorded for depletion, depreciation and amortization of petroleum and natural gas properties and equipment and the provision for future asset retirement obligations are based on estimates of proved reserves, production rates, oil and gas prices, future prices and costs and other relevant assumptions. Computation of stock-based compensation expense includes estimates of future stock price volatility and dividend policies. 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.

While management believes that its estimates have been reasonable in the circumstances, the global credit market crisis, the volatility in the price of oil and natural gas, the recession in Canada and the slowdown of economic growth in the rest of the world has created a substantially more volatile business environment. These conditions will limit certain of the Company's previously planned business development activities and it will continue to provide risk for the Company's future. To prepare these consolidated financial statements, management has recorded adjustments and included disclosures based on their best estimates of projected business activity and future cash flows.

Second Wave Petroleum Inc.

Notes to the Consolidated Financial Statements

For the years ended December 31, 2008 and 2007

2. Significant accounting policies (continued):

(i) Per share amounts:

Basic per share amounts are calculated using the weighted average number of common shares outstanding during the period. Diluted per share amounts are calculated using the treasury stock method, which assumes that any proceeds from the exercise of stock options, and warrants in addition to the unrecognized amount of stock-based compensation expense are used to purchase common shares of the Company at the average market price during the reporting period. The weighted average number of shares outstanding is then adjusted by the net change.

(j) Revenue recognition:

Revenue from the sale of petroleum and natural gas is recognized at the time title passes to an external party.

(k) Financial instruments:

Financial instruments must be classified into one of five categories: held-for-trading, held to maturity, receivables, available for sale financial assets or other financial liabilities. All financial instruments, including all derivatives, are required to be recognized on the balance sheet initially at fair market value. Subsequent measurement of all financial assets and liabilities except those held-for-trading and available for sale are measured at amortized cost using the effective interest rate method. Held-for-trading financial assets are measured at fair value with changes in fair value recognized in earnings. Available for sale financial assets are measured at fair value with changes in fair value recognized in comprehensive income until the instrument is derecognized or impaired at which time the amounts would be recorded in net earnings. The Company classified its cash as held for trading; accounts receivable are classified as loans and receivables, and accounts payable and loans payable are classified as other financial liabilities.

In 2008, Second Wave commenced using derivative financial instruments to manage economic exposure to market risks relating to commodity prices. The Company elected not to use hedge accounting for its crude oil derivative contract under its risk management program. Financial contracts are recorded following the fair value method whereby instruments are recorded in the balance sheet as either an asset or liability with changes in fair value recognized in net earnings. Realized gains or losses from financial derivatives related to commodity prices are recognized in revenues as related sales occur. Unrealized gains or losses are recognized in revenues at the end of each respective reporting period. The estimated fair value of derivative instruments is based on quoted forward price curves.

The Company elected to recognize, as separate assets and liabilities, only those embedded derivatives in hybrid instruments issued, acquired or substantially modified after January 1, 2003. The Company did not identify any material embedded derivatives, which require separate recognition and measurement.

Second Wave Petroleum Inc.
Notes to the Consolidated Financial Statements
For the years ended December 31, 2008 and 2007

2. Significant accounting policies (continued):

A new statement of comprehensive income is required, which is comprised of net earnings and other comprehensive income which may report the changes in fair value in, derivatives designated as cash flow hedges and available-for-sale investments and foreign exchange translation. Second Wave had no “other comprehensive income or loss” transactions during the year ended December 31, 2008 and no opening or closing balances for the accumulated other comprehensive income or loss.

(l) Basis of presentation:

Certain amounts from prior year have been reclassified to conform to the current years presentation.

(m) Changes in accounting policies:

The Company adopted new Canadian accounting standards for “Capital Disclosures,” “Financial Instruments – Disclosures”, and “Financial Instruments – Presentation”. These standards became effective for the Company in the first quarter of 2008.

The new Capital Disclosure standard requires the disclosure objectives, policies and processes for managing capital. This includes qualitative information regarding the Company’s objectives, policies and processes for managing capital and summary quantitative data about what the Company manages as capital.

The new Financial Instrument standards outline disclosures and presentation for financial instruments. They place greater emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the Company manages those risks.

(n) International Financial Reporting Standards (“IFRS”):

In 2008, the CICA confirmed that for public entities IFRS will become Canadian GAAP for interim and annual reporting effective January 1, 2011. The Company continues to monitor, assess and develop its implementation plan for the convergence of Canadian GAAP to IFRS.

3. Acquisitions

(a) Acquisition of Milagro Energy Inc:

During the year ended December 31, 2008, the Company acquired all of the outstanding shares of Milagro Energy Inc. (“Milagro”) for total consideration of \$2,514,294. On May 8, May 23, June 6, June 24, July 16, July 30, and August 28, 2008 the Company acquired 68.8%, 6.2%, 8.4%, 3.0%, 1.9%, 0.6%, 1.7% of the outstanding shares of Milagro respectively for a total of 90.6%. As the offer for Milagro was accepted by the holders of more than 90% of the Milagro shares, on August 29, 2008 the Company immediately exercised its right to acquire the remaining Milagro shares pursuant to the compulsory acquisition provisions of the Business Corporations Act (Alberta).

Second Wave Petroleum Inc.
Notes to the Consolidated Financial Statements
For the years ended December 31, 2008 and 2007

3. Acquisitions (continued)

Under the terms of the agreement, the Company issued a total of 4,995,300 Class A shares and 4,995,300 Class A share purchase warrants for the shares of Milagro tendered into the offer. Each whole warrant was exercisable into one Class A share of the Company at \$0.40 per warrant until they expire on May 8, 2009. As a result of a 1 for 10 share consolidation that occurred on June 25, 2008, the company issued 499,530 common shares and 499,530 warrants which are exercisable into common shares at \$4.00 per warrant. The acquisition has been recorded using the purchase method and the estimated fair value of the assets and liabilities acquired have been allocated as follows:

The purchase price consists of:	
Units consisting of 1 share and 1 warrant	\$ 1,684,276
Acquisition costs	830,018
	\$ 2,514,294
Fair value of assets and liabilities:	
Property and equipment	\$ 26,264,782
Current assets (including cash of \$200,483)	1,356,252
Accounts payable	(3,699,262)
Debt	(17,950,514)
Asset retirement obligation	(3,456,964)
	\$ 2,514,294

The Company has not finalized the valuation of the assets and liabilities; therefore the allocation of the purchase price is subject to revision.

An additional 260,714 Class A shares (26,071 post consolidated common shares) of Second Wave valued at \$73,000 were issued to executive management of Milagro for severance.

Milagro's results are included in the results of the Company subsequent to May 8, 2008 which is the date that it acquired control of Milagro.

(b) Acquisition of Stone Castle Exploration Ltd:

On May 7, 2007, the Company acquired all of the issued and outstanding shares of Stone Castle Exploration Ltd. ('Stone Castle') a private oil and gas company, for total consideration of \$1,042,830. Under the terms of the agreement the Company issued a total of 12,385,000 units valued at \$0.084 per unit to shareholders of Stone Castle. Each unit is comprised of 0.5 Class A common shares and 0.5 Class A common share purchase warrants. A whole warrant is exercisable into one Class A share at a price of \$0.20 per share until June 30, 2007, thereafter at \$0.30 per share until December 31, 2007 and thereafter \$0.40 per share until expiry on December 31, 2008. The acquisition has been recorded using the purchase method and the estimated fair value of the assets and liabilities acquired have been allocated as follows:

Second Wave Petroleum Inc.
Notes to the Consolidated Financial Statements
For the years ended December 31, 2008 and 2007

3. Acquisitions (continued)

The purchase price consists of:	
Units consisting of 0.5 Class A shares and 0.5 warrants	\$ 1,037,426
Acquisition costs	151,110
	\$ 1,188,536
Fair value of assets and liabilities:	
Property and equipment	\$ 2,055,984
Future income taxes	770,000
Goodwill	514,228
Current assets	3,243
Loan	(1,600,000)
Asset retirement obligation	(209,279)
Accounts payable	(345,640)
	\$ 1,188,536

The accounts payable are a direct offset to the receivables held by the Company from Stone Castle. During 2007, the value of goodwill was determined to be impaired and was written off as a charge to income.

(c) Acquisition of assets:

On October 26, 2007, the Company closed the acquisition of certain oil and natural gas assets and working capital for approximately \$9,100,000, subject to normal closing adjustments. Included in the acquisition was \$520,000 of current and other assets. In addition the Company posted a letter of credit in the amount of \$2,300,000 (subsequently reduced to approximately \$320,600) as security for potential contingent liabilities associated with the acquisition. Settlement of potential contingent liabilities will be treated as purchase price adjustments in the period of settlement. The assets were acquired from a company which is a significant shareholder in the Company; however the transaction was completed on the basis of fair market value and general market terms and conditions.

4. Property and equipment

	December 31, 2008		
	Cost	Accumulated Depletion, Depreciation and amortization	Net Book Value
Petroleum and natural gas properties	\$115,940,728	\$45,310,002	\$70,630,726
Office equipment	131,128	80,860	50,268
	\$116,071,856	\$45,390,862	\$70,680,994

Second Wave Petroleum Inc.
Notes to the Consolidated Financial Statements
For the years ended December 31, 2008 and 2007

4. Property and equipment (continued)

December 31, 2007			
	Cost	Accumulated Depletion, Depreciation and amortization	Net Book Value
Petroleum and natural gas properties	\$67,856,468	\$38,918,002	\$28,938,466
Office equipment	124,526	62,161	62,365
	\$67,980,994	\$38,980,163	\$29,000,831

At December 31, 2008, \$8,055,232 (2007 - \$1,025,025) of undeveloped land costs have been excluded from the depletion base. Future development costs of \$7,484,000 (2007 – \$2,185,375) were included in the calculation of depletion. During 2008, \$661,118 (2007 – \$Nil) of stock based compensation costs and \$663,469 (2007 – \$NIL) of general and administrative costs have been capitalized.

The Company has performed a ceiling test calculation at December 31, 2008 to assess the recoverable value of the petroleum and natural gas properties. The commodity prices used in the calculation are based on December 31, 2008 benchmark commodity price forecasts of an independent reserve evaluator adjusted for commodity price differentials of the Company, and are as follows:

	Medium Oil		Light Oil		Natural Gas	
	Company Average (CDN \$/bbl)	Medium Crude Cromer (CDN\$/bbl)	Company Average (CDN \$/bbl)	Edmonton Par Light Crude (CDN \$/bbl)	Company Average (CDN\$/mcf)	AECO – C Hub (CDN \$/mcf)
2009	56.56	59.00	52.80	68.61	7.26	7.58
2010	64.67	68.68	60.30	78.94	7.62	7.94
2011	68.81	73.52	65.09	83.54	8.01	8.34
2012	71.40	80.01	71.19	90.92	8.36	8.70
2013	75.19	84.40	75.36	95.91	8.59	8.95
2014	76.66	86.10	76.88	97.84	8.78	9.14
2015	78.16	87.84	78.33	99.82	8.95	9.34
2016	79.69	89.61	79.50	101.83	9.12	9.54
2017	81.26	91.42	80.00	103.89	9.30	9.75
2018	82.85	93.27	81.23	105.99	9.51	9.95
2019	84.46	95.14	82.23	108.11	9.70	10.15

Thereafter, the estimated market prices increase by an average annual percentage change of 2%.

Second Wave Petroleum Inc.
Notes to the Consolidated Financial Statements
For the years ended December 31, 2008 and 2007

4. Property and equipment (continued)

Based on these assumptions the undiscounted value of the future net revenues from Second Wave's proved reserves exceeded the carrying value of the petroleum and natural gas properties.

5. Loans payable

	December 31, 2008	December 31, 2007
Cheques issued in excess of balance in accounts (cash in account net of revolving loan facility)	\$ 2,475,606	\$ 216,892
Revolving operating loan facility (note 5a)	13,200,000	3,334,150
Term loan payable (note 5b)	7,365,205	-
Non-revolving term loan payable (note 5c)	-	2,000,000
Balance, end of year	\$ 23,040,811	\$ 5,551,042
Current portion	15,675,606	5,551,042
Long term portion	7,365,205	-
	\$23,040,811	\$ 5,551,042

(a) Revolving operating and term loan facility

As at December 31, 2008 the Company's facility was comprised of an \$18,000,000 demand revolving operating line with a Canadian financial institution. The line is subject to annual review, bears interest at the institution's prime rate plus 0.4% and is secured by the assets of the Company. The facility also includes a letter of guarantee posted for potential contingent liabilities in connection with a previous asset acquisition. On April 3, 2009, the Company signed an indicative term sheet with the institution for a new \$18,000,000 facility. The new facility consists of a \$12,500,000 demand revolving operating line and up to a \$5,500,000 non-revolving term loan. Within 15 days of receiving the institution's commitment letter, the Company has the one-time option to draw on the term loan. Any amount not drawn on the term loan will be cancelled. The revolving line bears interest at the institution's prime rate plus 1.5% while the non-revolving portion bears interest at the bank's prime rate plus 5%. A re-determination of the borrowing base for the facility will occur on or before September 30, 2009.

On May 8, 2008, the Company increased its credit facility from \$6,000,000 to \$18,000,000. The facility is a demand revolving operating line which is reviewed annually and includes a \$320,539 letter of guarantee posted for potential contingent liabilities in connection with a previous asset acquisition. The operating line bears interest at the institution's prime rate plus 0.4% and is secured by the assets of the Company. The letter of guarantee has a one year term and includes a fee of 2% per annum.

Second Wave Petroleum Inc.
Notes to the Consolidated Financial Statements
For the years ended December 31, 2008 and 2007

5. Loans payable (continued)

(b) Term loan payable:

In connection with the acquisition of Milagro Energy Inc. on May 8, 2008, the Company obtained a \$7,500,000 credit facility from its major shareholder. The loan is due on May 8, 2010 and bears interest at the bank's prime rate plus 2%, and is secured by assets of the Company. Unamortized loan service fees amounting to \$134,795 were offset against the \$7,500,000 principal amount of the loan outstanding.

(c) Non-revolving term loan:

On October 26, 2007, the Company entered into a \$2,000,000 term loan with its principal lender due January 31, 2008. The term loan, bearing interest at the institution's prime rate plus 2% was repaid in full on January 15, 2008.

6. Convertible debenture

The Company classifies convertible debentures as debt with a portion of the proceeds allocated to equity to represent the inherent value of the conversion option. In the event that the debentures are converted into common shares of the Company, the debt and equity components are reclassified into share capital. The debt balance associated with the convertible debentures accretes over time to the amount owing at maturity with the accretion reflected as non-cash interest expense in the statement of operations.

	December 31, 2008		December 31, 2007	
	Equity Component	Debt Component	Equity Component	Debt Component
Convertible debenture				
Balance, beginning of year	\$ 506,481	\$ 8,585,844	\$ -	\$ -
Conversion of debenture	(506,481)	(8,493,519)	-	-
Transfer of excess of carrying amount of debenture to contributed surplus	-	(105,008)	-	-
Debenture issued	-	-	-	9,000,000
Equity portion	-	-	515,466	(515,466)
Issue costs (net of future income taxes of \$3,850)	-	-	(8,985)	-
Accretion of non-cash interest expense	-	12,683	-	101,310
Balance, end of year	\$ -	\$ -	\$ 506,481	\$ 8,585,844

On July 30, 2007, the Company issued a secured convertible debenture ("the Debenture") in the amount of \$9,000,000. The Debenture bore interest at bank prime rate plus 2% per annum, had a fixed charge on all the assets of the Company and was due on July 30, 2009.

On January 17, 2008, Brookfield Bridge Lending Fund Inc., the debenture holder, exercised its option to convert its \$9,000,000 convertible debenture into 81,818,182 Class A Shares of Second Wave (8,181,818 post one for ten consolidation).

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7. Future income taxes

The provision for income taxes in the financial statements differs from the result which would be obtained by applying the federal and provincial tax rate to the Company's loss before income taxes. This difference results from the following items:

	2008	2007
Net loss and comprehensive loss before income taxes and minority interest	\$ (293,247)	\$ (4,888,443)
Combined federal and provincial tax rate	29.74%	32.12%
Calculated "expected" income tax expense (recovery)	(87,200)	(1,570,100)
Increase (decrease) resulting from:		
Non-deductible goodwill	-	165,000
Other non-deductible items	366,100	206,100
Change in tax rate	236,800	239,100
Valuation allowance	(679,600)	(523,850)
Other	163,900	141,900
Future income tax reduction	\$ -	\$ (1,341,650)

The components of the Company's net future income tax asset are as follows:

Property and equipment, and asset retirement obligation	\$ 1,107,600	\$ (1,840,000)
Share issuance costs	562,200	545,000
Non capital losses	7,841,400	2,408,000
Valuation allowance	(9,511,200)	(1,113,000)
Net future income tax asset	\$ -	\$ -

The Company has accumulated non-capital losses for income tax purposes of approximately \$31,000,000 which are available against future taxable income. Unless sufficient taxable income is earned, these losses will expire between 2014 and 2028.

8. Asset retirement obligation

The Company's asset retirement obligations result from net ownership interest in petroleum and natural gas properties. A credit adjusted risk free rate of 7.5% and an inflation rate of 2% (2007 - 2%) were used to calculate the fair value of the asset retirement obligation. Undiscounted estimated cash flow of \$8,382,000 (2007 - \$3,475,000) are required to settle the obligation at estimated dates in the future ranging from 2009 to 2025.

Second Wave Petroleum Inc.
Notes to the Consolidated Financial Statements
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8. Asset retirement obligation (continued)

	December 31, 2008	December 31, 2007
Balance, beginning of year	\$ 2,374,826	\$ 522,765
Liabilities incurred	101,238	115,948
Accretion expense	398,583	54,991
Acquired on asset acquisitions	57,589	1,766,750
Acquired on business acquisitions (note 3a and 3b)	3,456,964	209,279
Changes in accounting estimates	(19,796)	(239,141)
Abandonments	(212,542)	(55,766)
Balance, end of year	\$ 6,156,862	\$ 2,374,826

9. Share capital

(a) Authorized:

The authorized share capital currently consists of an unlimited number of common shares. On May 26, 2008, the Company exercised its right to convert all of its Class B shares into Class A shares, whereby for each Class B share outstanding 10 Class A shares were issued. On June 25, 2008, shareholders approved the consolidation of the Class A shares of the company on a one for ten basis, the cancellation of Class B shares, and the redesignation of the Class A shares into Common shares. Share numbers have been retroactively adjusted to reflect the share consolidation.

Second Wave Petroleum Inc.
Notes to the Consolidated Financial Statements
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9. Share capital (continued)

(b) Issued and outstanding:

Common Shares	December 31, 2008		December 31, 2007	
	Number of Shares	Value	Number of Shares	Value
Balance, beginning of year	12,956,913	\$ 35,873,910	3,211,863	\$ 28,261,895
Issued for cash (note 9c)	600,489	1,080,880	7,750,000	7,266,393
Issued on conversion of convertible debenture (note 6)	8,181,818	9,000,000	-	-
Issued on private placement to related party (note 9c)	4,000,000	10,000,000	-	-
Black Scholes value transferred to warrants	-	(2,931,553)	-	-
Issued on corporate acquisitions (note 3)	525,601	1,488,318	619,250	891,720
Warrants exercised (note 9g)	3,780,372	4,708,170	1,195,800	1,499,125
Transfer of carrying value on exercise of warrants (note 9g)	-	1,062,856	-	290,938
Flow through shares issued on exercise of warrants (note 9d)	193,000	231,600	20,000	24,000
Exchange of Class B shares	935,616	5,117,432	-	-
Stock options exercised (note 9f)	10,000	19,003	-	-
Reduction of stated capital (note 9j)	-	(33,003,382)	-	-
Broker warrants exercised (note 9g)	-	-	160,000	200,000
Future tax effect of flow-through shares	-	-	-	(2,282,200)
Share issue costs (net of future income taxes of Nil (2007 - \$128,040))	-	(364,648)	-	(277,961)
Shares acquired under the normal course issuer bid	(230,100)	(239,302)	-	-
Balance, end of year	30,953,709	\$ 32,043,284	12,956,913	\$ 35,873,910
Class B Shares				
Balance, beginning of year	93,562	\$ 5,117,432	93,562	\$ 5,117,432
Transfer to Common shares	(93,562)	(5,117,432)	-	-
Balance, end of year	-	-	93,562	5,117,432
Balance, end of year - Common shares	30,953,709	\$ 32,043,284	13,050,475	\$ 40,991,342

Second Wave Petroleum Inc.
Notes to the Consolidated Financial Statements
For the years ended December 31, 2008 and 2007

9. Share capital (continued)

(c) Issued for cash:

On May 8, 2008, the Company issued 4,000,000 Units at \$2.50 per unit for gross proceeds of \$10,000,000 to the majority shareholder. Each unit consisted of one share and 0.6 share purchase warrant exercisable at \$3.125 per warrant. The Company used the Black-Scholes option pricing model to determine the values of the share purchase warrants in connection with the issuance. The Black-Scholes value attributed to the warrants was \$2,673,823.

On January 17, 2008, the Company issued 600,489 Units at \$1.80 per unit for gross proceeds of \$1,080,880. Each Unit consisted of one flow through share and one share purchase warrant. The warrant is exercisable at \$2.00 until January 17, 2010. The Company used the Black-Scholes option pricing model to determine the values of the share purchase warrants in connection with the issuance. The Black-Scholes value of the warrants was \$257,730. In connection with the private placement, during the year ended December 31, 2008, Second Wave has expended the entire \$1,080,880 in eligible flow through expenditures during 2008.

On January 15, 2007, the Company issued 3,200,000 Units at \$1.25 per unit for gross proceeds of \$4,000,000 and in September 2007, the Company issued an additional 4,550,000 Units at \$1.10 per unit for gross proceeds of \$5,005,000. In both placements the Units consisted of one share and one share purchase warrant. The Company used the Black-Scholes option pricing model to determine the values of the share purchase warrants in connection with these issuances. The Black-Scholes value attributed to the warrants was \$1,738,607.

(d) Flow-through warrant shares issued:

During the year ended December 31, 2008, 193,000 shares of the Company were issued on exercise of \$1.20 flow through warrants. The Company expended 100% of these funds on qualifying exploration and development expenditures during 2008.

In November 2007, 20,000 shares of the Company were issued on exercise of \$1.20 flow through warrants. The Company expended 100% of these funds on qualifying exploration and development expenditures during 2008.

(e) Per share data:

The basic weighted average number of shares outstanding during the year ended December 31, 2008 was 28,557,017 (2007 - 9,079,073). During the year ended December 31, 2008 and 2007, all warrants and options would have an anti-dilutive effect as the Company was in a loss position.

Second Wave Petroleum Inc.
Notes to the Consolidated Financial Statements
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9. Share capital (continued)

Diluted weighted average number of shares outstanding during the year ended December 31, 2008 was 29,966,727 (2007 - 11,380,069). During the year ended December 31, 2008 and 2007 all warrants and options would have an anti-dilutive effect on the loss per share as the Company was in a loss position. The dilutive effect of outstanding options and warrants is calculated using the treasury stock method.

(f) Stock option plan:

The Company has a stock option plan for directors, officers, employees and consultants. The Company may grant up to 10% of the aggregate number of Common shares outstanding and no one optionee is permitted to hold more than 5% of the total shares outstanding. Options granted prior to December 21, 2007 vest as to one third immediately and one third on the first and second anniversary dates of the grant. Options granted subsequent to the appointment of new management vest as to one third on the each of the first, second and third anniversary dates. All options expire five years from the date of grant. Option amounts have been retroactively adjusted to reflect the one for ten share consolidation.

	December 31, 2008		December 31, 2007	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Balance, beginning of year	1,267,500	\$ 2.30	164,533	\$ 6.00
Granted	1,752,500	2.76	1,330,000	2.00
Exercised	(10,000)	1.20	-	-
Forfeited	(502,500)	2.20	(227,033)	3.90
Balance, end of year	2,507,500	\$ 2.64	1,267,500	\$ 2.30
Exercisable – end of year	380,000	\$2.84	244,168	\$3.10

Second Wave Petroleum Inc.
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9. Share capital (continued)

December 31, 2008	Options outstanding		Options exercisable	
	Exercise Price	Number	Weighted Average Remaining Life (years)	Number
\$0.90	40,000	4.81	-	-
\$2.00	820,000	3.74	340,000	3.60
\$2.40	355,000	4.04	-	-
\$2.60	222,500	4.16	-	-
\$2.65	100,000	4.42	-	-
\$2.80	500,000	4.42	-	-
\$3.33	430,000	4.53	-	-
\$10.00	40,000	2.51	40,000	2.51
	2,507,500		380,000	

The weighted average grant date fair value of all options granted in 2008 was \$2.76 (2007 - \$1.25).

The fair value of options granted during the year ended December 31, 2008 of \$3,426,900 (2007 - \$1,662,528) was calculated using a risk free rate of between 3% and 4%, dividend yield of 0%, volatility factor of 75%, and an expected life of 5 years. The value of the options was recorded as stock based compensation expense, with an offsetting amount to contributed surplus based on the vesting terms. During 2008, \$661,118 (2007 - \$Nil) of stock based compensation costs have been capitalized.

Second Wave Petroleum Inc.
Notes to the Consolidated Financial Statements
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9. Share capital (continued)

(g) Warrants:

The number of warrants and exercise price has been retroactively adjusted to reflect the one for ten share consolidation.

	December 31, 2008		December 31, 2007	
	Number of Warrants	Value	Number of Warrants	Value
Balance, beginning of year	8,163,450	\$ 1,957,057	-	\$ -
Issued with shares, net of share issuance costs of Nil (2007 - \$103,490 and future taxes of \$31,054)	3,000,489	2,931,553	7,910,000	1,662,796
Issued on corporate acquisitions (note 3a)	499,530	268,958	619,250	145,706
Warrants exercised	(2,930,372)	-	(1,195,800)	-
Loan extension warrants exercised	(850,000)	-	-	-
Flow through warrants exercised	(193,000)	-	(20,000)	-
Issued to brokers	-	-	160,000	38,463
Broker warrants exercised	-	-	(160,000)	-
Issued on loan extensions	-	-	850,000	401,030
Transfer of carrying value on exercise of warrants	-	(1,062,856)	-	(290,938)
Warrants expired	(4,191,588)	(895,014)	-	-
Balance, end of year	3,498,509	\$ 3,199,698	8,163,450	\$ 1,957,057

Outstanding Warrant Expiry Table	Number of Warrants	Exercise Price	Warrant Expiry Date
Issued on May 2008 acquisition of Milagro Energy Inc.	498,020	\$4.00	May 8, 2009
Issued on January 2008 private placement	600,489	\$2.00	January 17, 2010
Issued on May 2008 private placement	2,400,000	\$3.125	May 8, 2010
	3,498,509	\$3.06	

All warrants issued by the Company have been valued using the Black-Scholes option pricing model calculated using a risk free rate of between 3% and 4%, dividend yield of 0%, volatility factor of 75%, and expected life equal to the life of warrant.

On December 31, 2008 a total of 4,191,588 warrants expired unexercised, with the related Black Scholes value of the expired warrants included in contributed surplus.

On May 8, 2008, the Company issued 4,000,000 Units at \$2.50 per unit for gross proceeds of \$10,000,000. Each unit consisted of one share and 0.6 share purchase warrant exercisable at \$3.125 per warrant. The Company used the Black-Scholes option pricing model to determine the values of the share purchase warrants in connection with the issuance. The Black-Scholes value of the warrants was \$2,673,823. The resulting 2,400,000 warrants expire on May 8, 2010.

Second Wave Petroleum Inc.

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9. Share capital (continued)

Under the terms of the agreement to acquire Milagro Energy Inc. the Company issued an aggregate of 499,530 warrants exercisable at \$4.00 per warrant. The Company used the Black-Scholes option pricing model to determine the values of the warrants in connection with the issuance. The Black-Scholes aggregate value of the warrants was \$268,958. A total of 1,508 of these warrants were exercised subsequent to their issue in 2008. The remaining outstanding warrants expire on May 8, 2009.

On January 17, 2008, the Company issued 600,489 Units at \$1.80 per unit for gross proceeds of \$1,080,880. Each Unit consisted of one flow through share and one share purchase warrant exercisable at \$2.00 per warrant. The Company used the Black-Scholes option pricing model to determine the values of the share purchase warrants in connection with the issuance. The Black-Scholes value of the warrants was \$257,730. These warrants expire on January 17, 2010.

On September 11, 2007, the Company issued 4,550,000 Units at \$1.10 per unit for gross proceeds of \$5,005,000. Each unit consisted of one share and one flow through warrant exercisable at \$1.20 until they expire on December 31, 2008. A total of 1,408,136 of these warrants expired unexercised on December 31, 2008.

On January 15, 2008, the holder of 2,928,864 of the \$1.20 per share flow through warrants exercised its warrants and elected not to take the related flow through deductions. During the period ended December 31, 2008 and 2007 a total of 193,000 and 20,000 respectively of the flow through warrants were exercised, for which expenditures were renounced to the flow through holder.

On January 15, 2007, the Company issued 3,200,000 Units at \$1.25 per unit for gross proceeds of \$4,000,000. The Units were comprised of one share and one warrant. Each warrant was exercisable into one share at a price of \$1.25 per share until March 31, 2007 (extended to April 3, 2007), thereafter at \$2.00 per share until June 30, 2007, thereafter at \$3.00 per share until December 31, 2007, and thereafter at \$4.00 per share until expiry on December 31, 2008. A total of 2,164,200 unexercised warrants expired on December 31, 2008.

In connection with the January 15, 2007 financing, the Company also issued 160,000 broker warrants to the financing agent. Each broker warrant was exercisable into one unit comprised of one share and one warrant at a price of \$1.25 per unit, with each warrant then being exercisable under the same terms as the non-broker warrants. In 2007, upon exercise of the broker's warrants, an additional 160,000 warrants were issued to the brokers. These warrants expired unexercised on December 31, 2008.

On January 15, 2007, the Company issued 350,000 warrants to its lender as consideration for the loan extension. Each warrant was exercisable into one share at a price of \$1.25 per share, before the Facility is fully paid, \$1.75 upon full repayment of the Facility, until expiry on January 15, 2009. These warrants were exercised during the first quarter of 2008.

Second Wave Petroleum Inc.

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For the years ended December 31, 2008 and 2007

9. Share capital (continued)

On May 7, 2007, the Company issued 1,238,500 units at \$0.84 per unit for total consideration \$1,037,426 to the shareholders of Stone Castle. The units consisted of 0.5 shares and 0.5 warrants. Each warrant was exercisable into one share at a price of \$2.00 per share until June 30, 2007, thereafter at \$3.00 per share until December 31, 2007 and thereafter at \$4.00 per share until expiry on December 31, 2008. All of the resulting 619,250 warrants expired on December 31, 2008.

Also on May 7, 2007, as a result of the acquisition of Stone Castle, the Company increased its debt facility with its principal lender by \$1,000,000 and extended the repayment of the debt facility to December 31, 2007. As consideration for the increased loan and extension, the Company issued 500,000 warrants to purchase 500,000 shares to its lender. The warrants had an exercise price of \$1.50 and were exercised in January 2008.

(h) Escrowed shares:

Pursuant to an Escrow Agreement dated October 28, 2004 a total of 617,900 shares of certain officers, directors, employees, and principal shareholders were being held in escrow. On January 7, 2005 when the shares of the Company were listed on the TSX Venture Exchange, 10% of the escrowed shares were released. The remaining 90% were released in 15% increments during consecutive 6 month periods following the listing. As of December 31, 2007, 91,109 shares were in escrow, and were released on January 11, 2008.

(i) Contributed surplus:

A summary of change in the Company's contributed surplus balance for the nine months ended September 30, 2008 and year ended December 31, 2007 is as follows:

	December 31, 2008	December 31, 2007
Balance, beginning of year	\$ 1,265,096	\$ 699,878
Stock based compensation related to fair value of options granted	1,875,467	565,218
Expiry of warrants (note 9g)	895,014	-
Conversion of convertible debenture (note 6)	105,008	-
Normal course issuer bid	41,226	-
Stock options exercised	(6,666)	-
Balance, end of year	\$ 4,175,145	\$ 1,265,096

(j) Reduction of stated capital:

On June 24, 2008, shareholders of the Company voted to reduce the Company's stated capital account by \$33,003,382. The reduction of the stated capital was offset by a corresponding elimination of the Company's deficit.

Second Wave Petroleum Inc.

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For the years ended December 31, 2008 and 2007

9. Share capital (continued)

(k) Shares repurchased and cancelled:

In October 2008, the Company received approval from the TSX Venture Exchange to purchase and cancel up to a maximum of 1,559,000 shares under its normal course issuer bid. The issuer bid terminates on October 6, 2009.

During 2008, the Company purchased and cancelled 230,100 shares for total consideration of \$198,078. The amount was recorded as a \$239,302 reduction to share capital and a \$41,226 increase to contributed surplus.

(l) 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 expenditure program, which includes expenditures in oil and gas activities which may or may not be successful. Therefore, the Company endeavors 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.

In the management of capital, the Company includes share capital and net debt (defined as current assets less current liabilities less bank debt) in the definition of capital.

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 investments; the efficiencies of forecasted investments and the desired pace of investment; current and forecasted debt levels; current and forecasted energy commodity prices and other factors that influence commodity prices and funds generated from operations, such as foreign exchange and quality basis differential.

In order to maintain or adjust the capital structure, the Company will consider; its forecasted net debt to forecasted funds generated by operations ratio while attempting to finance an acceptable capital spending program including incremental capital spending and acquisition opportunities; the current level of bank credit available from the commercial bank; the level of bank credit that may be attainable from its commercial bank as a result of oil and 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 capital spending programs and new common equity if available on favorable terms.

The Company's share capital is not subject to external restrictions; however the bank debt facility is based on petroleum and natural gas reserves. The Company has not paid or declared any dividends since the date of incorporation, nor are any contemplated in the foreseeable future.

Second Wave Petroleum Inc.
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10. Contingencies and commitments

In connection with an asset acquisition that closed in October 2007, the Company has an outstanding letter of guarantee in the amount of \$320,539 as security for a potential contingent liability associated with the acquisition. The claim is for entitlement ahead of the Company's acquisition of assets from the receiver. The Trial Justice found that the Plaintiffs were entitled to the guarantee, however the Company appealed the ruling on the basis that it greatly extended and was inconsistent with current law. The appeal was heard on March 11, 2009 and the Court's decision has been reserved. Settlement of the potential contingent liability will be treated as a purchase price adjustment in the period of settlement.

In connection with proposed asset acquisitions, the Company has committed to acquire certain oil and natural gas assets in 2009 for \$255,000 and \$800,000, respectively.

In connection with a flow through equity agreement during 2006, the Company was required under the income tax act to expend amounts renounced to subscribers prior to December 31, 2007. Due to weather related issues, the Company was temporarily delayed and did not complete activities related to \$982,906 in expenditures until February 2008. The Company has advised the Canada Revenue Agency ("CRA"), of the circumstances, paid appropriate interest and penalties and does not intend to re-file. In the event that the CRA reassessed the Company's treatment, the Company could potentially be liable for indemnities to flow through subscribers relating to the delayed expenditures for approximately \$383,333.

The Company has the following office rental commitments, which expires April 30, 2011:

2009	\$	195,750
2010		195,750
2011		65,250
<hr/>		

11. Financing expense

	2008	2007
Interest on short term debt	\$ 326,812	\$ 634,600
Interest on long term debt	381,199	-
Interest on convertible debenture	31,475	590,878
Finance charges on flow through share obligation (note 10)	(383,333)	730,039
Loan extension fees (note 9g)	-	401,030
	<hr/> \$ 356,153	<hr/> \$ 2,356,547

Second Wave Petroleum Inc.
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12. Related party transactions

During the year ended December 31, 2008, the Company has entered into the following related party transactions:

- a. Legal services, disbursements and regulatory costs totaling \$231,892 (2007 - \$381,011) payable to a legal firm of which a former director and officer of the Company is counsel. These fees are included in general and administrative expense, share issuance costs and acquisition costs.
- b. Financing and advisory fees of \$Nil, (2007 – \$413,281 of which \$339,730 was cash and \$73,551 was non-cash) payable to a Company of which a former director of the Company was an officer.
- c. Payments of \$822,469 (2007 - \$567,688) for financing related expenses were paid to the majority shareholder of the Company (see notes 5(b) and 9(c)).

All transactions have been completed on the basis of general market terms and conditions and have been recorded at exchange amount.

13. Changes in non-cash working capital

	2008	2007
Decrease (increase) in non-cash working capital		
Accounts receivable	\$ 732,250	\$ (740,992)
Prepaid expenses	(427,725)	(46,847)
Accounts payable and accrued liabilities	(1,323,892)	1,084,870
Net change in non-cash working capital	\$ (1,019,367)	\$ 297,031
Relating to:		
Operations	\$ (1,751,314)	\$ (493,679)
Financing	(658,637)	697,275
Investments	1,390,584	93,435
	\$ (1,019,367)	\$ 297,031

14. Financial instruments

The Company's financial instruments recognized in the balance sheet include cash and cash equivalents, accounts receivable, accounts payable, bank and other loans and a convertible debenture.

Second Wave Petroleum Inc.
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For the years ended December 31, 2008 and 2007

14. Financial instruments (continued)

The carrying value and estimated fair market value of the financial instruments is summarized in the table below:

	December 31, 2008		December 31, 2007	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets				
Accounts receivable	\$ 2,341,161	\$ 2,341,161	\$ 1,982,292	\$ 1,982,292
Financial liabilities				
Accounts payable and accrued liabilities	\$ 5,278,977	\$ 5,278,977	\$ 2,889,217	\$ 2,889,217
Bank indebtedness	15,675,606	15,675,606	5,551,042	5,551,042
Long term debt/convertible debenture with the major shareholder	7,365,205	7,365,205	8,585,844	8,585,844

The fair values of these instruments approximate their carrying value due to their short term to maturity of these instruments. Substantially all of the Company's accounts receivable relate to crude oil and natural gas sales and amounts due from joint venture partners which are exposed to typical industry credit risks. The Company attempts to reduce its credit risk by entering into sales contracts with only credit worthy entities. Account receivable from joint venture partners on properties that the Company operates are adequately secured by provisions of various joint operating agreements.

The holder of the convertible debenture elected to convert its debenture into equity on January 17, 2008. Bank and other debt bears interest at floating market rates; the revolving loan is due on demand and the term loans are due at the end of their respective terms. Accordingly their fair value approximates the carrying value.

From April 1 to October 31 2008, Second Wave entered into a costless collar whereby it hedged 100 barrels of oil per day between US\$80 and US\$101 per day. During the year the Company recorded a hedging loss of \$361,334. Other than the above hedge, the Company did not undertake any hedging activities for the period between January 1, 2008 to date, with respect to its crude oil, natural gas liquids, and natural gas sales. During periods where the Company does not undertake any hedging activities, it is exposed to fluctuations in commodity prices.

Financial risk management

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

- a. Credit risk
- b. Liquidity risk
- c. Market risk

Second Wave Petroleum Inc.

Notes to the Consolidated Financial Statements

For the years ended December 31, 2008 and 2007

14. Financial risk management (continued)

This note provides information about the Company's exposure to each of the above risks, the Company's objectives, policies and processes for managing risk, and the Company's management of capital. Further quantitative disclosures are included throughout these financial statements.

The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework. The Board has implemented and monitors compliance with risk management policies.

The Company's risk management policies are established to identify and analyze the risks faced by the Company, to set appropriate risk limits and controls, and to monitor risks and adherence to market conditions and the Company's activities.

Credit risk:

Credit risk is the risk of financial loss to the Company if a customer to a financial instrument fails to meet its contractual obligations, and arises principally from the Company's receivables from petroleum and natural gas marketers and joint venture partners.

Substantially all of the Company's petroleum and natural gas production is marketed under standard industry terms. The industry has a pre-arranged monthly settlement day for payment of revenues from all buyers of crude oil and natural gas. This occurs on the 25th day of the following month in which the production is sold. The Company's policy to mitigate capital risk associated with these balances is to establish marketing arrangements with large purchasers. The Company has historically not experienced any collection issues with its petroleum and natural gas marketers. Where Second Wave has activities with joint venture partners it collects Company share of net revenues, and partners share of capital expenditures. Collection of joint venture receivables are typically received one to three months subsequent to the date of billing to partners. These amounts are typically subject to normal industry risk. Second Wave attempts to mitigate risk from joint venture receivables by partnering with and obtaining partner approval prior to expenditure and collects in advance for significant amounts related to partners' share of capital expenditures in accordance with normal operating procedures. Collection of outstanding balances from joint venture partners is dependant on industry factors such as commodity price fluctuations, escalating costs and the risk of unsuccessful drilling, in addition further risk exist with joint venture partners as disagreements occasionally arise that increase the potential for non-collection. The Company does not typically obtain collateral from petroleum and natural gas marketers or joint venture partners; however the Company does have the ability to withhold production from joint venture partners in the event of non-payment.

The Company's credit risk is limited to the carrying value of its accounts receivable, which are primarily due from entities involved in the oil and gas industry. At December 31, 2008, the Company had no material accounts receivable deemed uncollectible, and did not provide for any doubtful accounts nor was it required to write-off any receivables during the periods ended December 31, 2008 and 2007.

Second Wave Petroleum Inc.

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14. Financial risk management (continued)

Liquidity risk:

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

The Company prepares an annual budget for operations and capital, which is monitored and updated as considered necessary.

The financial liabilities on its balance sheet consist of accounts payable and loans payable. Accounts payable consist of invoices to trade suppliers relating to the Company's capital expenditure program, field operations and office expenses.

Market risk:

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

Second Wave uses financial derivatives to manage market risk. All such transactions are conducted in accordance with the risk management policy that has been approved by the Board of Directors.

(i) Commodity price risk:

Commodity price risk is the risk that the fair value or future cash flows will fluctuate as a result of changes in commodity prices. Commodity prices for petroleum and natural gas are impacted not only by the relationship between the Canadian and United States dollar, as outlined below, but also global economic events that dictate the levels of supply and demand. During 2008, the Company has attempted to mitigate commodity price risk through the use of a financial derivative contract as indicated above. If commodity prices were \$1.00 per barrel and \$0.10 per mcf higher with all other variables held constant, net loss for the year ended December 31, 2008 would have been \$251,000 (2007 - \$88,000) lower due to higher revenues.

(ii) Foreign currency exchange rate risk:

Foreign currency exchange rate risk is the risk that the fair value of future cash flows will fluctuate as a result of changes in foreign exchange rates. The Company does not sell or transact in any foreign currency, however the United States dollar influences the price of petroleum and natural gas sold in Canada. The Company's financial assets and liabilities are not affected by a change in currency rates. The Company had no foreign exchange contracts in place at December 31, 2008.

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14. Financial risk management (continued)

(iii) Interest rate risk:

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. The Company is exposed to interest rate risk to the extent that changes in market interest rates will impact the Company's debts that have a floating interest rate. The Company had no interest rate swaps or hedges as at and during the period ended December 31, 2008. If interest rates had been 100 basis points lower with all other variables held constant, net loss for the year ended December 31, 2008 would have been \$108,000 (2007 - \$97,000) lower due to lower interest expense.

15. Future operations

In June 2007, Section 1400 of the CICA Handbook was amended to require management to assess and disclose an entity's ability to continue as a going concern. This section applies for interim and annual periods beginning on or after January 1, 2008. The Company has adopted this section on January 1, 2008. Recent market events, including disruptions in credit markets and other financial systems and the deterioration of global economic conditions have resulted in significant declines in commodity prices. As at December 31, 2008, the Company had a working capital deficiency of \$2,311,041 and had drawn \$15,675,606 on its \$18,000,000 demand revolving operating line. Subsequent to year end, the senior lender re-determined the borrowing base and maintained the facility at \$18,000,000 but assigned \$5,500,000 of this total as a term loan due September 30, 2009 at which time the senior lender will again re-determine the borrowing base. As the available lending limits under the facility are based on the senior lender's interpretation of the Company's reserves and future commodity prices, there can be no assurance as to the amount of the facility that will be available as at September 30, 2009. To help manage its liquidity, management has reduced capital expenditures, completed a private placement with its majority shareholder subsequent to year end (note 16(b)) and continues to monitor additional financing opportunities to fund future prospects and commitments. No additional financing agreements have been signed nor can it be assured that further such agreements will be reached, however management believes that the action being taken will mitigate the conditions and events that give rise to liquidity risk. Based on its forecasts and considering the proceeds of the private placement completed in February 2009, the Company currently expects that sufficient liquidity is available to meet its obligations in 2009, however the Company may fail to meet certain of its financial debt covenants on its loan agreements during the year. Further declines in commodity prices could adversely impact Management's assessment of its ability to meet liquidity requirements in 2009.

The accompanying consolidated financial statements have been prepared assuming the Company will continue to operate as a going concern which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. The consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded assets amounts and the amount and classification of liabilities that might be necessary should the Company be unable to continue as a going concern.

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16. Subsequent events

- (a) On February 6, 2009, the Company entered into an option agreement that extended a previous commitment to acquire certain assets from January 2009 until no later than June 30, 2009. In addition to \$300,000 previously paid as a deposit in October 2008, the Company paid \$200,000 in connection with the execution of the option agreement, thereby increasing the total deposit to \$500,000. The consideration for executing the option agreement was \$10,000, and the estimated remaining cost to close the acquisition is expected to be approximately \$810,000.
- (b) On February 17, 2009, the Company closed a private placement equity financing for aggregate gross proceeds of approximately \$3,980,000. A total of 6,015,131 common shares were issued by the Company on a “flow through” basis. The Company’s major shareholder subscribed for 5,757,575 flow through shares at \$0.66 per share for proceeds of \$3,800,000 while management subscribed for 257,556 flow through shares at \$0.70 per share for proceeds of \$180,289. Under the terms of the subscription agreement the Company is required to incur and renounce to subscribers \$3,800,000 of eligible Canadian Development Expenditures on or before February 11, 2011 and an additional \$180,289 of eligible Canadian Exploration Expenditures on or before December 31, 2010.
- (c) On February 19, 2009, the Company granted stock options to certain directors, officers and employees to purchase an aggregate of 1,507,000 shares of the Company at an exercise price of \$0.70 per share. In conjunction with the new grants, options to purchase an aggregate of 552,500 common shares previously granted to employees who are neither directors nor officers of the Company were cancelled.
- (d) Subsequent to December 31, 2008, the Company acquired through its normal course issuer bid share buyback plan a total of 36,500 common shares to April 29, 2009 on the open market at an average cost, including commissions, of \$0.57 per share. All of the shares acquired were returned to treasury and cancelled.