

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 interim unaudited consolidated financial statements for the three and nine months ended September 30, 2008 and the audited financial statements and notes of the Company for the year ended December 31, 2007. This MD&A incorporates information up to and including November 25, 2008. 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. 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 November 25, 2008.

Overview

	Three months ended September 30, %			Nine months ended September 30, %		
	2008	2007	Change	2008	2007	Change
<i>(\$000s, except share amounts)</i>						
Petroleum and natural gas sales	7,197	1,120	543	16,929	3,368	403
Royalties	(905)	(197)	359	(2,174)	(558)	290
Lease operating costs	(2,588)	(246)	952	(4,975)	(672)	640
Transportation	(90)	(29)	210	(221)	(76)	191
Operating netback⁽³⁾	3,614	648	458	9,559	2,062	364
Realized loss on financial derivatives	(162)	-	-	(373)	-	-
Other income	-	13	-	-	21	-
General and administrative	(826)	(482)	71	(2,117)	(1,631)	30
Financing expenses	(249)	(569)	(56)	(479)	(1,097)	(56)
Asset retirement expenditures	(128)	(56)	129	(128)	(56)	129
Funds from operations⁽¹⁾	2,249	(446)	604	6,462	(701)	1,022
Unrealized gain (loss) on financial derivatives	471	-	-	(22)	-	-
Depletion, depreciation and accretion	(1,692)	(491)	245	(4,311)	(1,420)	204
Write-off of goodwill	-	-	-	-	(369)	-
Future income taxes	-	(77)	-	-	1,353	-
Non-cash portion of financing expense	-	(17)	-	-	(397)	-
Accretion of convertible debenture	-	(41)	-	(13)	(41)	(68)
Stock-based compensation	(504)	(86)	486	(950)	(387)	145
Asset retirement expenditures	128	56	129	128	56	129
Net income (loss) before non-controlling interest	652	(1,102)	159	1,294	(1,906)	168
Non-controlling interest in loss of Milagro	13	-	-	47	-	-
Net income (loss) and comprehensive income (loss)	665	(1,102)	160	1,341	(1,906)	170
Funds from operations per share ⁽¹⁾ :						
Basic (\$)	0.07	(0.05)	240	0.23	(0.09)	356
Diluted (\$)	0.07	(0.05)	240	0.22	(0.09)	344
Net income (loss) and comprehensive income (loss) per share:						
Basic (\$)	0.02	(0.12)	117	0.05	(0.25)	120
Diluted (\$)	0.02	(0.12)	117	0.05	(0.25)	120
Average number of shares outstanding (000s):						
Basic ²	31,127	9,208	238	27,707	7,758	257
Diluted ²	32,451	9,208	252	29,553	7,758	281

(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. We consider it an important measure as it demonstrates our ability to generate the cash flow necessary to fund future growth through capital investment.

As of the reporting date of November 27, 2008, Second Wave had 31,084,809 common shares outstanding. Of this amount 59,600 common shares have been acquired by Second Wave in its normal course issuer bid in November 2008 and will be cancelled in due course.

	Three months ended September 30,			Nine months ended September 30,		
	2008	2007	% Change	2008	2007	% Change
<i>(\$000s)</i>						
Cash flow from (used in) operating activities (GAAP) ⁽²⁾	2,545	(470)	641	3,334	(602)	654
Change in non-cash working capital (GAAP)	(296)	24	1,333	3,128	(99)	3,260
Funds from operations (non-GAAP)	2,249	(446)	604	6,462	(701)	1,022

Funds from Operations and Net Income (Loss) and Comprehensive Net Income (Loss)

<i>(\$000s, except per share)</i>	Three months ended September 30, %			Nine months ended September 30, %		
	2008	2007	Change	2008	2007	Change
Funds from operations ⁽¹⁾	2,249	(446)	604	6,462	(701)	1,022
Per share:						
Basic (\$)	0.07	(0.05)	240	0.23	(0.09)	356
Diluted (\$)	0.07	(0.05)	240	0.22	(0.09)	344

⁽¹⁾ 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.

⁽²⁾ Basic cash flow from (used in) operating activities (GAAP) per share for the three and nine months periods ended September 30, 2008 was \$0.08 and \$0.12 respectively (2007: (\$0.05) and \$0.08), and fully diluted cash flow from (used in) operating activities (GAAP) per share for the three and nine months ended September 30, 2008 was \$0.08 and \$0.11 per share (2007: (\$0.05) and (\$0.08)).

Funds from operations for the three months ended September 30, 2008 totalled \$2,249,000 or \$0.07 per share, compared to a loss of (\$446,000) for the same period in 2007. This increase is primarily due to the additional production volumes from a property acquisition in the third quarter of 2007, the Milagro Energy Inc. acquisition in May 2008 and increased volumes in the Provost area as a result of an active capital and workover program.

For the nine months ended September 30, 2008, funds from operations were \$6,462,000 or \$0.23 per share, compared to a loss of \$(701,000) for the same period of 2007.

<i>(\$000s, except per share)</i>	Three months ended September 30, %			Nine months ended September 30, %		
	2008	2007	Change	2008	2007	Change
Net income (loss) and comprehensive income (loss)	665	(1,102)	160	1,341	(1,906)	170
Per share:						
Basic (\$)	0.02	(0.12)	117	0.05	(0.25)	120
Diluted (\$)	0.02	(0.12)	117	0.05	(0.25)	120

Net income and comprehensive income for the three month period ended September 30, 2008 was \$665,000 or \$0.02 per basic share compared to a loss of \$1,102,000, or \$0.25 per share, for the same period in 2007. Almost all metrics improved during the three months ended September 30, 2008 when compared with the third quarter of 2007 resulting in a significant increase in income before income taxes of \$1,899,000 period over period.

For the nine months ended September 30, 2008, net income and comprehensive income was \$1,341,000 or \$0.05 per share, 170% higher compared to the net loss and comprehensive loss for the first nine months of 2007. Net income and comprehensive loss from the comparative period of 2007 included a \$1,353,000 net income tax recovery.

Petroleum and natural gas sales

Sales volumes		Three months ended September 30, %			Nine months ended September 30, %		
		2008	2007	Change	2008	2007	Change
Oil	<i>bbl/d</i>	515	107	381	418	98	327
Natural gas liquids	<i>bbl/d</i>	36	23	56	32	21	52
Natural gas	<i>mcf/d</i>	2,293	682	236	1,743	695	151
Combined (6:1)	<i>boe/d</i>	933	244	283	741	236	214

Oil versus natural gas weighting (%)

Oil & liquids	59	53	11	61	50	22
Natural Gas	41	47	(13)	39	50	(22)
Total	100	100	-	100	100	-

Sales volumes, on a boe basis, averaged 933 boe per day during the third quarter of 2008, up 283% from the 244 boe per day average in the third quarter of 2007, and up by 85% over the first quarter of 2008. The increase in sales volumes for both liquids and natural gas is primarily the result of the acquisition of producing properties that occurred in the third quarter of 2007, the Milagro acquisition in May 2008 and increased volumes in the Provost area as a result of an active capital and workover program. Second Wave has included Milagro sales volumes in its results subsequent to the May 8, 2008 date of acquisition. Actual production volumes for the month of September were approximately 952 boe/d.

Oil sales volumes increased 381% to 515 bbl/d in the three months ended September 30, 2008 from 107 bbl/d for the same period in 2007.

Natural gas liquids (“NGL”) sales volumes increased 56% to 36 bbl/d in the three months ended September 30, 2008 from 23 bbl/d for the same period in 2007.

Natural gas sales volumes increased 236% during the third quarter 2008 as compared to the same period in 2007.

With the addition of production from two horizontal oil wells in the Provost area brought on production in late third quarter and the fourth quarter, management expects sales volumes for the remainder of 2008 to increase over the average levels experienced during the first nine months of the year.

For the first three quarters of the year, sales volumes averaged 741 boe/d, an increase of 214% from the 236 boe/d achieved in the comparable period of 2007. As a result of the acquisition in October 2007 and May 2008, the 2008 versus 2007 year to date comparison is not representative of the full year impact.

Revenues (\$000s)	Three months ended September 30, %			Nine months ended September 30, %		
	2008	2007	Change	2008	2007	Change
Oil	5,076	666	662	11,899	1,742	583
Natural gas liquids	310	116	167	751	315	138
Natural gas	1,811	338	436	4,279	1,311	226
Total oil and gas	7,197	1,120	543	16,929	3,368	403

Gross revenue from the sale of petroleum and natural gas in the third quarter of 2008 totaled \$7,197,000 up by 543% from the same quarter last year, and up 111% from the first quarter of 2008. Increase in total revenues was a result of increased production volumes from acquisitions, an extensive capital and workover program, and higher product prices year-over-year.

Oil revenue rose 662% to \$5,076,000 in the three months ended September 30, 2008 from \$666,000 in the same period of 2007.

Natural gas liquids revenue rose 167% to \$310,000 in the three months ended September 30, 2008 from \$116,000 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 - \$101/bbl. As a result of the hedging activity, during the third quarter Second Wave realized a loss of \$162,000 (\$1.89/boe) and recognized an unrealized gain of \$471,000 (\$5.49/boe) for the period.

Overall natural gas sales were \$1,811,000 for the three months ended September 30, 2008, 436% higher than the \$338,000 received in the third quarter of 2007, and up 165% from the first quarter of 2008.

Revenues for the nine month period ended September 30, 2008, were \$16,929,000, a 403% increase over the \$3,368,000 in the comparable period of 2007.

Near the end of the third quarter commodity prices commenced a steep decline and based upon the current market conditions the Company's revenue will be negatively impacted during the fourth quarter of 2008.

Average Sales Prices ⁽¹⁾		Three months ended September 30,			Nine months ended September 30,		
		2008	2007	Change %	2008	2007	Change %
Oil	<i>\$/bbl</i>	107.18	67.69	58	103.98	64.96	60
Natural gas liquids	<i>\$/bbl</i>	92.69	54.21	71	84.40	53.78	57
Natural gas	<i>\$/mcf</i>	8.58	5.39	59	8.96	6.91	30
Combined (6:1)	<i>\$/boe</i>	83.82	49.92	68	83.41	52.37	59

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

Benchmark Pricing		Three months ended September 30,			Nine months ended September 30,		
		2008	2007	Change %	2008	2007	Change %
WTI crude oil (<i>US\$/bbl</i>)		118.21	75.38	57	113.34	66.10	72
WTI crude oil (<i>Cdn\$/bbl</i>)		123.15	78.74	56	115.45	73.03	58
AECO natural gas (<i>Cdn\$/mcf</i>) ¹		7.81	5.19	51	8.72	6.60	32
Exchange rate (<i>US\$/Cdn\$</i>)		1.0418	1.0446	-	1.0186	1.1048	(8)

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

The overall average price received from sale of oil and gas products in the third quarter of 2008 was up 68%, to \$83.82/boe, from the \$49.92/boe received during the third quarter last year.

Oil prices continued to remain strong for most of the third quarter of 2008, with Second Wave's oil price averaging 58% higher than the third quarter last year

Natural gas prices have strengthened in the third quarter of 2008 up 59% to \$8.58 versus the \$5.39 in the comparative period of 2007.

At the end of the third quarter commodity prices commenced a steep decline and based upon the current market conditions the Company's average sales prices will be negatively impacted during the fourth quarter of 2008.

Royalties

(\$000s)	Three months ended September 30, %			Nine months ended September 30, %		
	2008	2007	Change	2008	2007	Change
Crown royalties	409	157	161	1,148	460	150
Freehold	416	8	-	814	20	-
Gross overriding	80	32	150	212	78	172
Total	905	197	359	2,174	558	290
As % of oil and gas revenues	13	18	(28)	13	17	(24)
Per boe (\$)	10.54	8.82	19	10.71	8.68	23

Total royalties increased significantly in the third quarter of 2008, totaling \$905,000 versus \$197,000 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 volumes achieved through workover programs and new wells brought on in the period from the Company's capital program. Royalties as a percentage of working interest revenues amounted to 13% during the third quarter of 2008, compared to 18% during the same quarter last year. The royalty rates declined due 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 governments proposals for Alberta's new royalty regime, which is scheduled to be effective on January 1, 2009. Given that the NRF has only recently been announced, it is not possible at this time to determine the full impact of the NRF on Second Wave's future operations. Based on oil and gas properties held at the end of the third quarter (in conjunction with current oil prices), the increased royalties payable to the Alberta government pursuant to its NRF will not materially negatively impact our net cash flow. In addition, we cannot provide any assurance that the NRF will be implemented in the form proposed. If changes are made to the NRF before it is implemented and legislated by the Alberta government, such changes could result in the implementation of a new royalty regime that may impact us in a different manner as than described.

On November 19, 2008, the Alberta government released a new transitional royalty regime. Given that the new transitional royalty regime has only recently been announced, it is not possible at this time to determine the full impact of the regime on Second Wave's future operations.

Lease Operating Costs

(\$000s, except per boe)	Three months ended September 30, %			Nine months ended September 30, %		
	2008	2007	Change	2008	2007	Change
Lease operating costs	1,746	246	610	3,755	672	459
Workovers, repairs and maintenance	842	-	-	1,220	-	-
Total operating costs	2,588	246	952	4,975	672	640
Lease operating costs per boe (\$)	20.33	10.96	85	18.50	10.45	77
Workovers, repairs and maintenance per boe (\$)	9.80	-	-	6.01	-	-
Total operating costs per boe (\$)	30.13	10.96	175	24.51	10.45	135

Total lease operating costs increased from \$246,000 or \$10.96/boe in the third quarter last year to \$2,588,000 or \$30.13/boe in the third quarter of 2008. Absolute operating costs have increased due to the increase in production volumes, however a material amount of the increase was as a result of non-recurring workovers, repairs and maintenance of \$842,000 or \$9.80/boe and annual property taxes incurred in the quarter of \$321,000 or \$3.74/boe.

During the third quarter the Company has completed a substantial amount of operational projects to maintain and upgrade recently purchased assets. Although the Company's asset acquisition in the fourth quarter of 2007 and the corporate acquisition of Milagro Energy in May of 2008 have provided substantial drilling upside, these properties were historically undercapitalized and under maintained. In the third quarter alone Second Wave has expended \$842,000 or \$9.80/boe on operational projects to meet regulatory operational standards and to improve efficiencies at these properties.

The Company completed a two week turnaround at its Provost facility in the third quarter to expand capacity and to address certain operational deficiencies. Production curtailments during this turnaround reduced corporate production for the quarter by 45 boe/d net and non capitalized costs associated with this turnaround amounted to \$225,000 or \$2.62 per boe for the quarter

The Company's workover and maintenance program in the third quarter on the acquired assets accounted for \$617,000 in operating expenditures or \$7.18 per boe for the quarter. As these acquired assets were historically undercapitalized we expect that the majority of these costs were one time items.

In 2008, the Company has incurred costs in excess of \$2,000,000 for certain capital expenditures and facility improvements, primarily in the Provost area. The Company expects to complete its capital improvements in the Provost area in 2008 and expects to see tangible results in the fourth quarter of 2008 and moving into 2009. To date the 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.

For the nine month period ended September 30, 2008 and 2007, lease operating costs increased by 640% from the comparable period of 2007. On a boe basis, lease operating costs increased 135% from 2007, due to the amount of workover, repairs and maintenance required on the acquired properties.

Transportation

<i>(\$000s, except per boe)</i>	Three months ended September 30, %			Nine months ended September 30, %		
	2008	2007	Change	2008	2007	Change
Transportation	90	29	210	221	77	187
Per boe (\$)	1.05	1.29	(19)	1.09	1.20	(9)

Transportation costs for the three months ended September 30, 2008 amounted to \$90,000 with the transportation costs for the comparative period in 2007, amounting to \$29,000.

On a boe basis, transportation costs decreased 19% in the three months ended September 30, 2008 to \$1.05 per boe from \$1.29 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 and the Milagro acquisition.

For the nine months ended September 30, 2008 and 2007, transportation costs were \$221,000 and \$77,000 respectively.

Operating Netback

(\$/boe)	Three months ended September 30, %			Nine months ended September 30, %		
	2008	2007	Change	2008	2007	Change
Petroleum and natural gas sales	83.82	49.92	68	83.41	52.37	59
Royalties	(10.54)	(8.82)	19	(10.71)	(8.68)	23
Lease operating costs	(30.13)	(10.96)	175	(24.51)	(10.45)	135
Transportation	(1.05)	(1.29)	(19)	(1.09)	(1.20)	(9)
Operating netback ⁽¹⁾	42.10	28.85	46	47.10	32.04	47

⁽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.

Operating netbacks were significantly higher for the three months ended September 30, 2008, when compared to the prior year period, due mainly to the increase in commodity prices. Higher sales revenues were only partially offset by higher royalties and lease operating costs.

Second Wave expects netbacks to drop in the fourth quarter of 2008 due to the current lower level commodity price environment for crude oil.

Operating netbacks were higher for the nine months ended September 30, 2008, when compared to the prior year period, due mainly to the significant increase in commodity prices. Higher sales revenues were offset by higher royalties and lease operating costs.

General and Administrative (“G&A”)

(\$000s, except per boe)	Three months ended September 30, %			Nine months ended September 30, %		
	2008	2007	Change	2008	2007	Change
G&A expenses	954	482	98	2,480	1,631	52
Capitalized G&A expenses	(128)	-	-	(363)	-	-
Net G&A expenses	826	482	71	2,117	1,631	30
Per boe (\$)	9.62	21.48	(55)	10.43	25.36	(59)
Per boe (\$) Excluding non-recurring charges	8.30	21.48	(61)	8.59	25.36	(66)

General and administrative expenses, net of capitalized G&A, increased 71% in the third quarter of this year, to \$826,000 from \$482,000 in the same period last year. The overall increase in G&A expenses in the quarter is related to an increase in personnel from 7 to 13 employees and non-recurring corporate restructuring costs of \$113,000 (\$1.32/boe). On a boe basis, general and administrative expenses, net of capitalized G&A, were 55% lower in the comparative quarter due to the increase in production volumes.

Management expects that G&A costs on a per unit basis will continue to trend downward as a result of increased production volumes from both the acquisition of Milagro during the second quarter of 2008, and the benefits of Second Wave’s capital program for the remainder of the year.

For the nine months ended September 30, 2008, general and administrative expenses, net of capitalized G&A, increased 30% 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 \$374,000 (\$1.84/boe).

Stock-Based Compensation

Stock-based compensation expense, net of capitalized stock-based compensation, for the three months ended September 30, 2008 was \$504,000, as compared to stock-based compensation expense of \$86,000 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 \$187,000 were capitalized during the third quarter of 2008 (2007 – Nil).

For the nine months ended September 30, 2008 and 2007, stock-based compensation expense, net of capitalized stock-based compensation, was \$950,000 and \$387,000 respectively. Stock-based compensation expenses of \$404,000 were capitalized during the nine months ended September 30, 2008 (2007 – Nil).

Financing Expenses

(\$000s, except per boe)	Three months ended September 30,			Nine months ended September 30,		
	2008	2007	Change %	2008	2007	Change %
Interest on current portion of debt	94	207	(55)	213	735	(71)
Interest on convertible debenture	-	363	-	31	363	(91)
Interest on long term portion of debt	154	-	-	234	-	-
Total cash component	248	570	(56)	479	1,098	(56)
Non cash component						
Loan extension fees - warrants	-	16	-	-	396	-
Total financing expenses	248	586	(58)	478	1,494	(68)
Per boe (\$)	2.89	26.12	(89)	2.36	23.23	(90)

Financing expenses decreased by 57% from \$586,000 in 2007 to \$248,000 in the third quarter of 2008. The majority of the decrease related to lower debt levels in 2008 and loan extension and other lender fees on the Company's debt facilities expenses in 2007.

For the nine months ended September 30, 2008, financing expenses decreased by 68% to \$478,000 as compared with \$1,494,000 in 2007.

With the acquisition of Milagro Energy Inc. and commencement of the Company's drilling program during the second quarter of 2008, the Company expects to utilize its outstanding credit facilities and incur higher debt carrying costs throughout the remainder of the year.

Depletion, Depreciation and Accretion

(\$000s, except per boe)	Three months ended September 30,			Nine months ended September 30,		
	2008	2007	Change %	2008	2007	Change %
Depletion	1,569	477	229	4,053	1,382	193
Depreciation	5	4	25	13	12	8
Accretion of asset retirement obligations	119	10	1,090	245	26	842
Total	1,693	491	245	4,311	1,420	204
Per boe (\$)	19.72	21.26	(7)	21.24	22.08	(4)

Depletion, depreciation and accretion expense increased 245% in the third quarter of 2008 to \$1,693,000 from \$491,000 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 and the Milagro acquisition. On a boe basis depletion, depreciation and accretion expense decreased by 7% to \$19.72/boe compared to \$21.26/boe in the same period of 2007.

Depletion, depreciation and accretion expense increased 204% in the nine month period ended September 30, 2008 to \$4,311,000 from \$1,420,000 in the same period of 2007. On a boe basis depletion, depreciation and accretion expense decreased by 4% to \$21.24/boe compared to \$22.08/boe in the same period of 2007.

Accretion of Convertible Debenture

Accretion of convertible debenture was \$13,000 during the nine months ended September 30, 2008 and nil during the comparative period in 2007. As the Company entered into the convertible debenture during the third quarter of 2007, the comparable balance for 2007 was nil.

Income Taxes

The income tax provision for the three months ended September 30, 2008 was Nil, compared to an expense of \$77,000 in the comparative period of 2007.

The income tax provision for the nine months ended September 30, 2008 was Nil, compared to a recovery of \$1,353,000 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 quarter ended September 30, 2008, \$8,920,000 (2007 - \$1,034,000), and for the nine months ended September 30, 2008 \$14,400,000 (2007 - \$1,482,000) was expended on capital additions as summarized below:

Capital Expenditures (\$000s)	Three months ended September 30,			Nine months ended September 30, %		
	2008	2007	% Change	2008	2007	Change
Land and acquisitions	3,273	31	-	3,880	154	-
Geological and geophysical	86	5	-	214	17	-
Drilling and completion	3,311	893	271	6,868	1,099	525
Facilities and equipment	2,120	105	-	3,068	212	-
Other	2	-	-	7	-	-
Capitalized G&A	128	-	-	363	-	-
Total cash portion	8,920	1,034	763	14,400	1,482	872
Non-cash portion						
Asset retirement obligations incurred	62	-	-	62	-	-
Capitalized stock-based compensation	187	-	-	404	-	-
Total capital expenditures	9,169	1,034	787	14,866	1,482	903

The increase in capital expenditures in the three months ended September 30, 2008 was the result of the execution of the 2008 capital program including the drilling of 4 gross wells (4 net) of which included, 3 (3 net) oil wells and 1 (1 net) D&A well for a 75% 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 nine months ended September 30, 2008, Second Wave has drilled 8 gross wells (7.65 net), which included 5 (5 net) oil wells and 3 (2.65 net) D&A wells for a 63% success rate.

Liquidity and Capital Resources

The oil and gas business is inherently risky and capital intensive and can require significant capital and cash resources to expand by growing reserves, production and cashflow. Given the nature of the oil and gas business, and the size of Second Wave, it must be able to continue to access capital markets to raise additional monies to grow.

Second Wave has budgeted \$20,400,000 of capital expenditures for 2008 and expects to rely on internally generated cash flows and available lines of credit to fund its capital program.

Financing activities from raising equity in the nine months ended September 30, 2008 resulted in cash inflows of \$16,000,000. A majority of the cash inflows from financing activities were used for the company's investment activities which of \$14,400,000 pertained to capital expenditures. As a result of the activities in the nine months of 2008, the company's unused line of credit increased from \$400,000 as at December 31, 2007, to \$10,400,000 as at September 30, 2008.

The previously disclosed conversion of the \$9,000,000 Convertible debenture by Brookfield Bridge Lending Fund Inc. ("Brookfield"), together with their exercise of \$4,700,000 in warrants during January 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 \$1,100,000.

In order to finance 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 revolving facility agreement, both with Brookfield. Each Unit was comprised of one Common Share and 0.6 Common Share purchase warrant. Each warrant is exercisable for two years from the closing date 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 November 25, 2008, Brookfield owns approximately 61% of the issued and outstanding common shares of Second Wave.

On May 8, 2008, upon successful closing of the Milagro acquisition, Second Wave negotiated with its senior lender to increase its borrowing base from \$6,000,000 to \$18,000,000 on its existing credit facility. On May 8, 2008, Second Wave had a combined maximum credit facility of \$25,500,000, up from \$6,000,000 at December 31, 2007.

As at September 30, 2008, the Company has expended all of its flow through commitments as a result of flow through monies raised in 2007 and 2008 to date. The company has approximately \$1,700,000 of flow through warrants currently outstanding, which expire on December 31, 2008. Should these warrants get exercised by the warrant holders the company would incur an additional amount of flow through obligation.

Quarterly Financial Summary

	2008			2007				2006
	Q3	Q2	Q1	Q4	Q3	Q2	Q1	Q4
<i>(\$000's except per boe and per share amounts)</i>								
Average production (boe/d)	933	783	504	451	244	243	220	267
Petroleum and natural gas sales	7,197	6,326	3,407	2,494	1,120	1,203	1,045	1,248
Royalties	(905)	(803)	(466)	(338)	(197)	(196)	(165)	(161)
Operating expenses	(2,588)	(1,558)	(829)	(1,047)	(275)	(153)	(273)	(372)
Operating netback (per boe) ⁽¹⁾	42.10	54.58	44.87	25.51	28.86	37.40	29.72	28.31
Funds from operations ⁽²⁾	2,249	2,596	1,617	(344)	(446)	18	(273)	(86)
Per share - basic	0.07	0.09	0.07	(0.03)	(0.06)	-	(0.05)	(0.03)
Per share - diluted	0.07	0.09	0.07	(0.03)	(0.06)	-	(0.05)	(0.03)
Net income (loss)	665	296	380	(1,640)	(1,102)	(1,200)	395	(3,641)
Per share - basic	0.02	0.01	0.01	(0.13)	(0.10)	(0.19)	0.07	(1.13)
Per share - diluted	0.02	0.01	0.01	(0.13)	(0.10)	(0.19)	0.05	(1.13)
Capital expenditures	9,169	4,070	1,627	14,303	1,034	52	396	1,506

⁽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.

Consolidated Financial Statements of

Second Wave Petroleum Inc.

Three and Nine Months Ended September 30, 2008

Second Wave Petroleum Inc.

Consolidated Balance Sheets

As at September 30, 2008 and December 31, 2007

Unaudited

	As at September 30, 2008	As at December 31, 2007
ASSETS		
Current assets:		
Accounts receivable	\$ 3,342,890	\$ 1,982,292
Prepaid expenses	208,303	134,400
	3,551,193	2,116,692
Property and equipment (note 5)	66,148,181	29,000,831
	\$ 69,699,374	\$ 31,117,523
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 8,223,289	\$ 2,889,217
Financial derivatives contract (note 15)	22,309	-
Loans payable (note 6)	7,588,430	5,551,042
	15,834,028	8,440,259
Loans payable (note 6)	7,340,000	-
Convertible debenture (note 7)	-	8,585,844
Asset retirement obligation (note 9)	6,022,414	2,374,826
	29,196,442	19,400,929
Shareholders' equity:		
Share capital (note 10)	32,349,345	40,991,342
Warrants (note 10g)	4,094,808	1,957,057
Contributed surplus (note 10i)	2,717,736	1,265,096
Equity component of convertible debenture (note 7)	-	506,481
Retained earnings (deficit)	1,341,043	(33,003,382)
	40,502,932	11,716,594
Contingencies (note 11)		
Subsequent events (note 17)		
	\$ 69,699,374	\$ 31,117,523

See accompanying notes to consolidated financial statements.

Second Wave Petroleum Inc.

Consolidated Statements of Operations, Comprehensive Income (Loss) and Retained Earnings (Deficit)

For the three and nine month periods ended September 30, 2008 and 2007

Unaudited

	Three months ended September 30,		Ninc months ended September 30,	
	2008	2007	2008	2007
Revenues				
Petroleum and natural gas sales	\$7,196,886	\$ 1,119,935	\$16,929,503	\$ 3,368,084
Royalties	(905,441)	(197,072)	(2,174,450)	(557,918)
Realized loss on financial derivatives	(162,029)	-	(373,381)	-
Unrealized gain (loss) on financial derivatives (note 15)	471,235	-	(22,309)	-
	6,600,651	922,863	14,359,363	2,810,166
Expenses				
Lease operating costs	2,587,657	245,707	4,975,291	671,493
Transportation	89,894	28,873	221,087	76,624
General and administrative	825,546	482,438	2,117,218	1,631,287
Depletion, depreciation and accretion	1,692,677	490,699	4,310,665	1,420,241
Stock-based compensation	504,094	86,038	950,062	387,133
Financing expense (note 12)	248,861	572,956	478,714	1,473,091
Accretion of convertible debenture	-	40,524	12,683	40,524
Write-off goodwill	-	-	-	368,522
	5,948,729	1,947,235	13,065,720	6,068,915
Income (loss) before income taxes	651,922	(1,024,372)	1,293,643	(3,258,749)
Income tax expense (recovery) (note 8)	-	77,450	-	(1,352,550)
Income (loss) before non-controlling interest	651,922	(1,101,822)	1,293,643	(1,906,199)
Non-controlling interest in loss of Milagro	12,918	-	47,400	-
Net income (loss) and comprehensive income (loss)	664,840	(1,101,822)	1,341,043	(1,906,199)
Retained earnings (deficit) – beginning of period	676,203	(30,260,966)	(33,003,382)	(29,456,589)
Restatement of stated capital (note 10j)	-	-	33,003,382	-
Retained earnings (deficit) – end of period	\$1,341,043	\$ (31,362,788)	\$1,341,043	\$ (31,362,788)
Net income (loss) and comprehensive income (loss) per share:				
Basic	\$ 0.02	\$ (0.12)	\$ 0.05	\$ (0.25)
Diluted	\$ 0.02	\$ (0.12)	\$ 0.05	\$ (0.25)
Average number of shares outstanding ¹ :				
Basic	31,126,595	9,208,192	27,706,757	7,757,721
Diluted	32,450,686	9,208,192	29,552,555	7,757,721

¹ 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.

Consolidated Statements of Cash Flow

For the three and nine month periods ended September 30, 2008 and 2007

Unaudited

	Three months ended September 30, 2008		Nine months ended September 30, 2008	
	2008	2007	2008	2007
Cash flow from operating activities:				
Net income (loss) and comprehensive income (loss)	\$664,840	\$(1,101,822)	\$1,341,043	\$(1,906,199)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:				
Depletion, depreciation and accretion	1,692,677	490,699	4,310,665	1,420,241
Stock-based compensation	504,094	86,038	950,062	387,133
Unrealized loss (gain) on financial derivatives	(471,235)	-	22,309	-
Non-controlling interest in Milagro loss	(12,918)	-	(47,400)	-
Convertible debenture accretion (note 7)	-	40,524	12,683	40,524
Write off goodwill	-	-	-	368,522
Financing expenses	-	16,485	-	396,380
Future income tax expense (reduction)	-	77,450	-	(1,352,550)
Asset retirement expenditures	(127,615)	(55,766)	(127,615)	(55,766)
	2,249,843	(446,392)	6,461,747	(701,715)
Change in non-cash working capital	295,105	(23,247)	(3,127,792)	99,969
	2,544,948	(469,639)	3,333,955	(601,746)
Cash flow used in investing activities:				
Expenditures on property and equipment	(8,920,394)	(1,034,167)	(14,399,976)	(1,481,990)
Corporate acquisitions (note 4)	(152,266)	-	(639,511)	(150,534)
Change in non-cash working capital	1,484,396	222,195	4,610,903	(685,029)
	(7,588,264)	(811,972)	(10,428,584)	(2,317,553)
Cash flow from financing activities:				
Issuance of shares and warrants	44,332	5,005,000	16,019,944	10,496,625
Share and warrant issue costs	-	(258,114)	(297,084)	(489,584)
Exercise of stock options	-	-	12,337	-
Long term loan advances	-	-	7,500,000	-
Short term loan advances (repayments)	4,628,805	-	(15,913,126)	(2,600,000)
Restricted cash	-	-	-	(500,000)
Change in non-cash working capital	370,179	(64,371)	(227,442)	(32,540)
	5,043,316	4,682,515	7,094,629	6,874,501
Increase in cash and cash equivalents	-	3,400,904	-	3,955,202
Cash and cash equivalents - beginning of period	-	696,350	-	142,052
Cash and cash equivalents - end of period	\$ -	\$ 4,097,254	\$ -	\$ 4,097,254

See accompanying notes to financial statements.

Supplementary Cash Flow Information

Interest paid	\$ 193,566	\$ 374,126	\$ 608,624	\$ 902,247
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Second Wave Petroleum Inc.

Notes to the Consolidated Financial Statements

For the three and nine month periods ended September 30, 2008 and 2007

Unaudited

1. Nature of business

The accompanying unaudited interim 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 symbols 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. Basis of Presentation

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles and followed the same accounting policies as the audited financial statements for the year ended December 31, 2007, except as disclosed in note 3. Certain information and disclosures normally required to be included in the notes to the annual consolidated financial statements have been omitted or condensed. These interim financial statements should be read in conjunction with the financial statements and footnotes as at and for the year ended December 31, 2007.

3. Changes in Accounting Policies

(a) Accounting changes:

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.

(b) Basis of presentation:

Certain amounts from the prior period have been reclassified to conform to the current year’s presentation.

Second Wave Petroleum Inc.

Notes to the Consolidated Financial Statements

For the three and nine month periods ended September 30, 2008 and 2007

Unaudited

4. Acquisitions

(a) Acquisition of Milagro Energy Inc.

During the period ended September 30, 2008, the Company acquired all of the outstanding shares of Milagro Energy Inc. ("Milagro") for total consideration of \$2,524,270. 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).

Under the terms of the agreement, during the period ended September 30, 2008 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 Class A share and 1 warrant	\$ 1,684,276
Acquisition costs	839,994
	<hr/>
	\$ 2,524,270
Fair value of assets and liabilities:	
Property and equipment	\$ 26,364,040
Current assets (including cash of \$200,483)	1,307,106
Accounts payable	(3,728,226)
Debt	(17,950,514)
Asset retirement obligation	(3,468,136)
	<hr/>
	\$ 2,524,270

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.

Second Wave Petroleum Inc.

Notes to the Consolidated Financial Statements

For the three and nine month periods ended September 30, 2008 and 2007

Unaudited

4. Acquisitions (continued)

(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') 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 was 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:

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.

5. Property and equipment

	September 30, 2008		
	Cost	Accumulated Depletion, Depreciation and Amortization	Net Book Value
Petroleum and natural gas properties	\$111,190,469	\$45,098,616	\$66,091,853
Office equipment	131,188	74,860	56,328
	\$111,321,657	\$45,173,476	\$66,148,181

Second Wave Petroleum Inc.

Notes to the Consolidated Financial Statements

For the three and nine month periods ended September 30, 2008 and 2007

Unaudited

5. 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 September 30, 2008, \$10,711,415 (December 31, 2007 - \$1,025,025) of undeveloped land costs have been excluded from the depletion base. Future development costs of \$12,267,000 (December 31, 2007 - \$2,185,375) were included in the calculation of depletion. In 2008, \$404,236 of stock based compensation (December 31, 2007 - \$Nil) and \$363,201 (December 31, 2007 - \$Nil) of general and administrative costs have been capitalized.

6. Loans payable

	September 30, 2008	December 31, 2007
Cheques issued in excess of balance in accounts (cash in account net of revolving loan facility)	\$ (11,570)	\$ 216,892
Revolving operating loan facility (note 6a)	7,600,000	3,334,150
Term loan payable (note 6b)	7,340,000	-
Non-revolving term loan payable (note 6c)	-	2,000,000
Balance, end of period	\$ 14,928,430	\$ 5,551,042
Current portion	7,588,430	5,551,042
Long term portion	7,340,000	-
	\$ 14,928,430	\$ 5,551,042

(a) Revolving operating loan facility

On May 8, 2008, the Company increased its credit facility from \$6,000,000 to \$18,000,000 with a Canadian chartered bank. The facility is a demand revolving operating line which is reviewed annually and includes a \$320,539 letter of guarantee that was posted for potential contingent liabilities in connection with an asset acquisition. The operating line bears interest at the bank'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 three and nine month periods ended September 30, 2008 and 2007

Unaudited

6. 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 \$160,000 was 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 due January 31, 2008. The term loan, bearing interest at the bank's prime rate plus 2% was repaid in full on January 15, 2008.

7. 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.

Convertible debenture	September 30, 2008		December 31, 2007	
	Equity Component	Debt Component	Equity Component	Debt Component
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
End of period	\$ -	\$ -	\$ 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.

Second Wave Petroleum Inc

Notes to the Consolidated Financial Statements

For the three and nine month periods ended September 30, 2008 and 2007

Unaudited

7. Convertible debenture (continued)

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).

8. 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 net income (loss) before income taxes. This difference results from the following items:

	Nine Months Ended September 30,	
	2008	2007
Net income (loss) and comprehensive income (loss) before income taxes	\$ 1,341,043	\$ (3,258,749)
Combined federal and provincial tax rate	29.69%	32.12%
Calculated "expected" income tax expense	398,200	(1,046,710)
Increase (decrease) resulting from:		
Non-deductible items	288,000	367,730
Change in tax rate	(108,400)	(35,800)
Other	-	72,360
Valuation allowance	(577,800)	(710,130)
Future income tax	\$ -	\$ (1,352,550)

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

	As at September 30,	
	2008	2007
Property, plant and equipment	\$ 2,829,100	\$ (953,560)
Share issuance costs and other	405,800	642,050
Non capital losses	6,758,900	1,244,790
Valuation allowance	(9,993,800)	(933,280)
Net future income tax asset (liability)	\$ -	\$ -

The Company has accumulated non-capital losses for income tax purposes of approximately \$27,036,000 which are available against future taxable income. Unless sufficient taxable income is earned, these losses will expire between in 2011 and 2028.

Second Wave Petroleum Inc.

Notes to the Consolidated Financial Statements

For the three and nine month periods ended September 30, 2008 and 2007

Unaudited

9. Asset retirement obligation

The Company's asset retirement obligations result from net ownership interest in petroleum and natural gas assets. 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 flows of \$8,209,000 (2007 - \$3,475,000) are required to settle the obligations at estimated dates in the future ranging from 2008 to 2025.

	September 30, 2008	December 31, 2007
Beginning of year	\$ 2,374,826	\$ 522,765
Liabilities incurred	62,102	115,948
Accretion expense	244,965	54,991
Acquired on business acquisitions (note 4)	3,468,136	209,279
Acquired on asset acquisition	-	1,766,750
Changes in accounting estimates	-	(239,141)
Abandonment's	(127,615)	(55,766)
End of period	\$ 6,022,414	\$ 2,374,826

10. 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

For the three and nine month periods ended September 30, 2008 and 2007

Unaudited

10. Share capital (continued)

(b) Issued and outstanding:

	September 30, 2008		December 31, 2007	
	Number of Shares	Value	Number of Shares	Value
Common Shares				
Beginning of year	12,956,913	\$ 35,873,910	3,211,863	\$ 28,261,895
Issued for cash (note 10c)	600,489	1,080,880	7,750,000	7,266,393
Issued on conversion of convertible debenture (note 7)	8,181,818	9,000,000	-	-
Issued on private placement to related party (note 10c)	4,000,000	10,000,000	-	-
Black Scholes value transferred to warrants	-	(2,931,556)	-	-
Issued on corporate acquisitions (note 4)	525,601	1,488,318	619,250	891,720
Warrants exercised (note 10g)	3,780,194	4,707,464	1,195,800	1,499,125
Transfer of carrying value on exercise of warrants (note 10g)	-	1,062,760	-	290,938
Flow through shares issued on exercise of warrants (note 10d)	193,000	231,600	20,000	24,000
Exchange of Class B shares	935,616	5,117,432	-	-
Stock options exercised	10,000	19,003	-	-
Reduction of stated capital (note 10j)	-	(33,003,382)	-	-
Broker warrants exercised (note 10g)	-	-	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))	-	(297,084)	-	(277,961)
End of period	31,183,631	\$ 32,349,345	12,956,913	\$ 35,873,910
Class B Shares				
Beginning of year	93,562	\$ 5,117,432	93,562	\$ 5,117,432
Transfer to Common shares	(93,562)	(5,117,432)	-	-
End of period	-	-	93,562	5,117,432
End of period - Common shares	31,183,631	\$ 32,349,345	13,050,475	\$ 40,991,342

Second Wave Petroleum Inc.

Notes to the Consolidated Financial Statements

For the three and nine month periods ended September 30, 2008 and 2007

Unaudited

10. 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 of 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 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 period, Second Wave has expended \$1,080,880 in eligible flow through expenditures.

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 of the warrants was \$1,738,607.

(d) Flow-through shares issued on warrant exercise:

During the nine months ended September 30, 2008, 193,000 shares of the Company were issued on exercise of \$1.20 flow through warrants. To the date of this report, the Company has expended 100% of the funds on qualifying exploration and development expenditures.

In November 2007, 20,000 shares of the Company were issued on exercise of \$1.20 flow through warrants. To the date of this report, the Company has expended 100% of the funds on qualifying exploration and development expenditures.

(e) Per share data:

The basic weighted average number of shares outstanding during the three and nine month periods ended September 30, 2008 was 31,126,595 and 27,706,757 respectively. During the three and nine month periods ended September 30, 2007, all warrants and options would have an anti-dilutive effect on the loss per share as the Company was in a loss position.

Second Wave Petroleum Inc.

Notes to the Consolidated Financial Statements

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Unaudited

10. Share capital (continued)

Diluted weighted average number of shares outstanding during the three and nine month periods ended September 30, 2008 was 32,450,686 and 29,592,555 respectively. During the three and nine month periods ended September 30, 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 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 one third on the each of the first, second and third anniversary dates. All options expire in five years from the date of grant. Option amounts have been retroactively adjusted to reflect the one for ten share consolidation.

	September 30, 2008		December 31, 2007	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Beginning of year	1,267,500	\$ 2.30	164,533	\$ 6.00
Granted	1,712,500	2.81	1,330,000	2.00
Exercised	(10,000)	1.20	-	-
Forfeited	(163,333)	1.82	(227,033)	3.90
Outstanding – end of period	2,806,667	\$ 3.68	1,267,500	\$ 2.30
Exercisable – end of period	447,501	\$2.85	244,168	\$3.10

Second Wave Petroleum Inc.

Notes to the Consolidated Financial Statements

For the three and nine month periods ended September 30, 2008 and 2007

Unaudited

10. Share capital (continued)

Exercise Price	Options outstanding		Options exercisable	
	Number	Weighted Average Remaining Life (years)	Number	Weighted Average Remaining Life (years)
\$1.50	6,667	3.57	6,667	3.57
\$2.00	1,056,667	3.86	370,000	3.36
\$2.40	368,333	4.29	13,334	4.29
\$2.60	222,500	4.41	-	-
\$2.65	100,000	4.67	-	-
\$2.80	565,000	4.67	-	-
\$3.33	430,000	4.79	-	-
\$4.00	15,000	1.27	15,000	1.27
\$10.00	40,000	2.76	40,000	2.76
\$20.04	2,500	1.86	2,500	1.86
	2,806,667		447,501	

The weighted average grant date fair value of all options granted in 2008 was \$2.81 (2007 - \$2.00).

The fair value of options granted during the nine month period ended September 30, 2008 of \$2,912,000 (2007 - \$673,418) was calculated using a risk free rate of approximately 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.

Second Wave Petroleum Inc.

Notes to the Consolidated Financial Statements

For the three and nine month periods ended September 30, 2008 and 2007

Unaudited

10. Share capital (continued)

(g) Warrants:

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

	September 30, 2008		December 31, 2007	
	Number of Warrants	Value	Number of Warrants	Value
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 4)	499,530	268,958	619,250	145,706
Warrants exercised	(2,930,194)	-	(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	-	(1,062,760)	-	(290,938)
End of period	7,690,275	\$ 4,094,808	8,163,450	\$ 1,957,057

Outstanding Warrant Expiry Table	Number of Warrants	Exercise Price	Warrant Expiry Date
Issued on January 2007 private placement	2,164,200	\$4.00	December 31, 2008
Issued on May 2007 acquisition of Stone Castle Exploration Ltd.	619,250	\$4.00	December 31, 2008
Issued on September 2007 private placement (flow through warrants)	1,408,137	\$1.20	December 31, 2008
Issued on May 2008 acquisition of Milagro Energy Inc.	498,199	\$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
	7,690,275		

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

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 resulting 2,400,000 warrants expire on May 8, 2010. The Company used the Black-Scholes option pricing model to determine the values of the Class A share purchase warrants in connection with the issuance. The Black-Scholes value of the warrants was \$2,673,823.

Second Wave Petroleum Inc.

Notes to the Consolidated Financial Statements

For the three and nine month periods ended September 30, 2008 and 2007

Unaudited

10. Share capital (continued)

In connection with the acquisition of Milagro Energy Inc. on May 8, May 26, June 6, June 24, July 16, July 30, August 28, 2008, the Company issued an aggregate of 499,530 warrants exercisable at \$4.00 per warrant that expire on May 8, 2009. 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 aggregate value of the warrants was \$268,958.

On January 15, 2008, the holder of 2,928,864 of \$1.20 per share flow through warrants exercised its warrants and elected not to take the related flow through deductions. If all remaining flow through warrants that arose from the September 2007 private placement are exercised prior to their expiry on December 31, 2008, the Company would be committed to expend an additional \$1,690,000 of eligible expenditures.

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.

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. In connection with the 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. Upon exercise of the broker's warrants, an additional 160,000 warrants were issued to the brokers.

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.

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

Second Wave Petroleum Inc.

Notes to the Consolidated Financial Statements

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10. Share capital (continued)

In 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.

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 a share and a flow through warrant exercisable at \$1.20 until they expire on December 31, 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:

	September 30, 2008	December 31, 2007
Beginning of year	\$1,265,096	\$ 699,878
Stock based compensation related to fair value of options granted	1,354,298	565,218
Conversion of convertible debenture	105,008	-
Stock options exercised	(6,666)	-
End of period	\$2,717,736	\$ 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.

Notes to the Consolidated Financial Statements

For the three and nine month periods ended September 30, 2008 and 2007

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11. Contingencies

In connection with an asset acquisition that closed in October 2007, the Company currently has an outstanding letter of credit in the amount of \$320,539 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.

In connection with a proposed asset acquisition the Company has committed to acquire certain assets for \$1 million in January 2009.

12. Financing expense

	Three months ended September 30,		Nine months ended September 30,	
	2008	2007	2008	2007
Interest on current debt	\$ 94,436	350,572	\$ 213,256	868,812
Interest on long term debt	154,425		233,983	-
Convertible debenture interest	-		31,475	-
Loan extension fees	-	16,485	-	396,380
Interest on flow through share obligation	-	205,899	-	205,899
	\$ 248,861	572,956	\$ 478,714	1,471,091

13. Related party transactions

During the period ended September 30, 2008, the Company has entered into the following related party transactions:

- 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.
- Financing and advisory fees of \$Nil, (2007 - \$339,730) payable to a Company of which a former director of the Company is an officer.
- Payments of \$708,983 (2007 - \$128,870) for financing related expenses were paid to the majority shareholder of the Company (see notes 6(b) and 10(c)).

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

Second Wave Petroleum Inc.

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14. Changes in non-cash working capital

	Three months ended September 30,		Nine months ended September 30,	
	2008	2007	2008	2007
Decrease (increase) in non-cash working capital				
Accounts receivable	\$ 621,704	19,058	\$ (318,625)	619,153
Prepaid expenses	272,194	8,175	(9,253)	3,200
Accounts payable and accrued liabilities	1,255,782	107,344	1,583,547	(1,239,953)
Net change in non-cash working capital	\$ 2,149,680	134,577	\$ 1,255,669	(617,600)
Relating to:				
Operations	\$ 295,105	(23,247)	\$ (3,127,792)	99,969
Financing	370,179	(64,371)	(227,442)	(32,540)
Investments	1,484,396	222,195	4,610,903	(685,029)
	\$ 2,149,680	134,577	\$ 1,255,669	(617,600)

15. Financial instruments

In January 2008, Second Wave entered into a costless collar on a portion of its oil production for the period from April 1, 2008 to October 31, 2008. During 2007, the Company did not undertake any financial instrument activities with respect to its crude oil, natural gas liquids, and natural gas sales. The Company was exposed to fluctuations in commodity prices.

Volume (bbl/d)	Remaining Term	Costless Collar (WTI) per bbl	Fair market value
100	October 1 – 31, 2008	US \$80.00 – \$101.00	\$ (22,309)

16. Financial Risk Management

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

- Credit risk
- Liquidity risk
- Market risk

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.

Second Wave Petroleum Inc.

Notes to the Consolidated Financial Statements

For the three and nine month periods ended September 30, 2008 and 2007

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16. Financial Risk Management (continued)

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 September 30, 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 September 30, 2008 and December 31, 2007.

Second Wave Petroleum Inc.

Notes to the Consolidated Financial Statements

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16. 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 bank debt. Accounts payable consist of invoices payable to trade suppliers relating to capital expenditure program, field operations and office expenses. At September 30, 2008, Second Wave's bank debt is on a revolving reserve based credit facility that is reviewed annually by the lender. The next scheduled review date has been set for May 31, 2009 but may be set at an earlier or later date at the sole discretion of its lender.

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. The Company has attempted to mitigate commodity price risk through the use of a financial derivative contract as indicated in Note 15.

(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 September 30, 2008.

Second Wave Petroleum Inc.

Notes to the Consolidated Financial Statements

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16. 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 September 30, 2008.

Fair value of financial instruments

The Company's financial instruments recognized in the balance sheet include cash and cash equivalents, accounts receivable, accounts payable, and bank loans. The fair values of these instruments approximate their carrying value due to their short term to maturity of these instruments and the market rate of interest applied to the loan.

The fair value of derivative contracts is determined by discounting the difference between the contracted price and published forward price curves as at the balance sheet date, using the remaining contracted petroleum and natural gas volumes.

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

Capital management

The Company manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of the underlying petroleum and natural gas assets. The Company considers its capital structure to include shareholder's equity, bank debt, and working capital. In order to maintain or adjust the capital structure, the Company may from time to time issue shares and adjust its capital spending to manage current and projected debt levels.

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.

17. Subsequent events

Subsequent to September 30, 2008, the Company initiated a normal course issuer bid share buyback plan and acquired a total of 158,600 common shares to November 25, 2008 on the open market at an average cost, including commissions, of \$0.96 per share. All of the shares acquired will be returned to treasury and cancelled.