

## **Bucking Horse Energy Inc. (formerly known as NRG Investments Inc.)**

Management's Discussion and Analysis

August 31, 2008

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The following management's discussion and analysis ("**MD&A**") for Bucking Horse Energy Inc. was prepared by management based on information available as at December 1, 2008. It should be reviewed together with the audited annual consolidated financial statements for the year-ended August 31, 2008 and the MD&A and the audited consolidated financial statements for the year ended August 31, 2007. The Company's Prospectus, quarterly unaudited interim financial statements and year end audited annual financial statements are filed on SEDAR and are available for review at [www.sedar.com](http://www.sedar.com).

As used in this MD&A, the terms "we", "us", "our", "Bucking Horse" and "the Company" mean Bucking Horse Energy Inc. and our subsidiaries, NRG Holdings Corp.(doing business as GRN Holdings Corp. in the province of British Columbia, Canada), N Holdings Inc., Gemini Energy Corp. ("**Gemini**") and Arrowhead Resources (U.S.A.) Ltd. ("**Arrowhead**").

Unless otherwise noted, all dollar amounts are expressed in US dollars ("**US\$**" or "**\$**") and any references to common shares are to common shares in the capital of Bucking Horse Energy Inc., unless the context clearly requires otherwise.

Barrels of oil equivalent ("**boe**") and natural gas equivalent ("**Mcf**") amounts have been calculated using a conversion rate of six thousand cubic feet ("**Mcf**") of natural gas per barrel ("**bbl**") of oil or natural gas liquids ("**6:1**"). A conversion ratio of six Mcf to one bbl is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent equivalency at the wellhead. Boe and Mcfe disclosure may be misleading, particularly if used in isolation.

### **Forward-Looking Statements**

This MD&A contains forward-looking statements. Forward-looking statements are statements that relate to future events or to our future financial performance. In some cases, you can identify forward-looking statements by terminology such as "may", "should", "expects", "plans", "anticipates", "believes", "estimates", "predicts", "potential" or "continue" or the negative of these terms or other comparable terminology. These statements are only predictions and involve known and unknown risks, uncertainties and other factors, including:

- the risks of the oil and gas industry, such as operational risks in exploring for, developing and producing oil and natural gas, and market demand
- the risks and uncertainties involving geology of oil and gas deposits
- the uncertainty of reserve estimates
- the uncertainty of estimates and projections relating to exploration, development and production, costs and expenses
- potential delays or changes in plans with respect to exploration or development projects or capital expenditures
- fluctuations in oil and gas prices, foreign currency exchange rates and interest rates
- health, safety and environmental risks
- uncertainties as to the availability and cost of financing
- risks in conducting foreign operations (for example, political and fiscal instability or the possibility of civil unrest)
- general economic conditions

- the effect of acts of, or actions against, international terrorism
- the possibility that government policies or laws may change or governmental approvals may be delayed or withheld
- the risks enumerated in the section of this MD&A entitled "Risk Factors", beginning on page 19.

These risks may cause our actual results or the actual results in our industry, or our levels of activity, performance, or achievement, to be materially different from any projected future results, levels of activity, performance or achievements that are expressed or implied in these forward-looking statements.

These forward-looking statements are based on the estimates and opinions of our management at the time they are made. Although we believe that the expectations reflected in these forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. Readers of this MD&A are cautioned not to rely on these forward-looking statements. Except as required by applicable law, we do not intend to update any of the forward-looking statements in this MD&A to conform these statements to actual results.

### **Overall Performance and Description of Business**

The Company is engaged in the business of acquiring natural gas exploration, development and production properties. The Company generates almost all of its consolidated revenues from the production and sales of natural gas and natural gas liquids from its Pinedale properties in southwest Wyoming. The Pinedale properties were acquired by Plan of Arrangement on March 4, 2008 and are owned by the Company's wholly owned subsidiary Arrowhead. The Company also has minor properties located in central Washington and eastern Alberta. The Company's properties are described as follows:

#### Pinedale Properties, Wyoming, USA

The Pinedale properties comprise three discrete leaseholds totaling 14,022 gross acres (4,034 net acres) situated in the Warbonnet, Mesa, and Bull Draw areas of Sublette County, southwest Wyoming. The Warbonnet property comprises 2,480 gross (1,032 net acres), the Mesa property comprises 9,512 gross acres (2,328 net acres), and the Bull Draw property 2,380 gross acres (674 net acres). The Company does not operate its properties and the properties are operated by the Company's operating partners.

The Warbonnet and Mesa properties host the Company's commercial reserves of natural gas and natural gas liquids that are produced from the Pinedale natural gas field. The Warbonnet and Mesa properties are located on or proximal to the Pinedale Anticline geological structure situated from six to 30 miles southwest of the town of Pinedale. As of August 31, 2008 the Company's interests included 35 producing wells (11.38 net wells) that have been developed primarily on a combination of 80-acre and 40-acre spacing in the Warbonnet area (average working interest 42%) and 40-acre and 20-acre spacing in the Mesa area (average working interest 24%). Both the Warbonnet and Mesa properties are approved for 10-acre spacing and plan of well development. Management anticipates that current 5-acre pilot testing by area operator's peripheral to the Warbonnet and Mesa property will ultimately support 5-acre development on Company lands.

Delineation drilling at Warbonnet is expected to add to the amount of the Company's acreage that falls within the productive area boundaries of the Pinedale natural gas field. Additional opportunities to expand natural gas reserves and resources include increased well density drilling and development of low quality sand zones.

The Company has been shipping its gas on the Rocky Mountain Express Pipeline ("**REX Pipeline**") since January 2008, when the REX Pipeline began shipping on the REX West Pipeline segment. The Company has a 10 year agreement to ship 10,000 million British thermal units ("**MMBTU**") per day of gas through the REX Pipeline. Currently, the REX Pipeline ships gas to Audrain County, Missouri, near the Panhandle Eastern ("**PEPL**") Gas Hub. Upon completion of the final phase of the REX Pipeline, estimated to be late-2009, gas will be shipped to Clarington, Ohio. Natural gas in the Clarington region is currently marketed at a premium to Henry Hub prices. Henry Hub is the pricing point for natural gas futures contracts traded on the New York Mercantile Exchange.

Given the Company's long-term shipping contract on the REX Pipeline, the Company is positioned to benefit from potentially higher realized prices in the mid-continent and eastern regions of the United States upon full completion of the REX Pipeline.

#### Wainwright Property, Alberta, Canada

The Company owns a 68.75% working interest in oil and gas mineral rights associated with 640 gross developed acres (440 net developed acres) located in the Wainwright area of east central Alberta, Canada. The property hosts one producing natural gas well (0.6875 net wells) in which the Company owns a 68.75% working interest. Natural gas production is derived from the Colony Formation and the associated mineral rights are held by production.

#### Columbia River Basin Properties, Washington, USA

The Company owns a 100% interest in 68 individual undeveloped oil and gas leases in Washington State totaling approximately 36,437 gross acres (36,437 net acres). The leases were issued by the Washington State Department of Natural Resources in February 2007 and have seven-year terms. The properties are located in six separate counties in central Washington State, within a 100 mile radius of the city of Yakima, Washington, USA. No wells have been drilled or exist upon the leases and there are no reserves or resources attributable to the properties nor has there been any attempt to estimate any reserves or resources in relation to the properties.

### **Management Outlook**

The Pinedale properties have yielded a production compounded annual growth rate ("**CAGR**") of 47% since 2000 however the properties have seen a decline in production levels since 2004 with only six new gross wells drilled in the last three years. A Supplemental Environmental Impact Statement Record of Decision issued by the Bureau of Land Management on September 12, 2008 allows for year round development drilling on lands previously subjected to seasonal drilling stipulations, including our Warbonnet and Mesa properties. Management anticipates working closely with its operators to increase the pace of development drilling in both the Mesa and the Warbonnet areas.

The Company's objective is to focus on the development of its Pinedale properties and increase the Company's cash flow and producing reserves base.

### **Selected Annual Financial Information**

The following table sets forth a summary of our financial results for the years ended August 31, 2008 and August 31, 2007:

(US\$)	Year Ended	Year Ended
	31-Aug-08	31-Aug-07
Total Revenue	15,693,354	738,830
Net Income (Loss)	154,825	(327,156)
Basic Income (Loss) per Share	0.01	(0.04)
Total Assets	177,252,337	3,331,847
Total Long-term Financial Liabilities	92,096,122	1,428,197

Our revenue performance and the income that we realize will vary from period to period in relation to the number of wells that we have in production, our production volumes and the prices that we receive for our commodities from time-to-time. The number of successfully developed wells turned to sales, if any, varies from quarter to quarter. Historically, peak commodity pricing for natural gas produced occurs in the fourth and first quarter periods. Our operations, if profitable, are also subject to taxes in the jurisdictions in which we conduct our business.

The discussion and analysis of our financial condition and results of operations is based on our consolidated financial statements, which have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). Application of GAAP requires the use of estimates, judgements and assumptions that affect the reported amounts of assets and liabilities as of the date of the financial statements as well as the revenues and expenses reported during the period. Changes in these estimates, judgements and assumptions will occur as a result of future events, and accordingly, actual results could differ from amounts estimated.

## Results of Operations

### **Twelve-month period ended August 31, 2008 compared to the twelve-month period ended August 31, 2007:**

Net U.S. production from Arrowhead's interests incurred March 2008 through August 31, 2008 totaled approximately 1,453 million cubic feet ("MMcf") of natural gas and 12 thousand barrels of natural gas liquids, or 1,526 million cubic feet of natural gas equivalent ("MMcfe") averaging 8.3 MMcfe/day compared to nil for the same period in 2007. The U.S. production is attributable to the Pinedale Properties acquired under the Plan of Arrangement. Prices realized by the Company in the U.S. averaged \$9.43 per Mcf of natural gas and \$111.89 per barrel of natural gas liquids.

Canadian production for the twelve-month period ended August 31, 2008 totaled approximately 83 MMcf of natural gas averaging 228 Mcf/day compared to 129 MMcf averaging 352 Mcf/day for the same period in 2007, a decrease of 36%. The decrease in production in the twelve-month period ended August 31, 2008 is primarily a result of production declines associated with the producing Wainwright well. Natural gas prices realized from the Company's Canadian properties for the twelve-month period ended August 31, 2008 increased 18% to C\$7.63 per Mcf compared to C\$6.44 per Mcf in the same period in 2007.

Net income for the twelve months ended August 31, 2008 increased to \$154,825 compared to a net loss of \$327,156 for the twelve months ended August 31, 2007. The increase in net revenue is attributable to the Plan of Arrangement and acquisition of Gemini Energy Corp. referred to above and further described below in this MD&A whereby we indirectly acquired the Pinedale producing properties in March 2008. Operating income increased to \$6,840,731 compared to \$31,496 for the twelve months ended August 31, 2007.

Production revenues for the twelve-month period ended August 31, 2008 totaled \$15,693,354 compared to \$738,830 for the same period in 2007. Of these revenues, \$15,061,834 were derived from the Company's U.S. properties and \$631,520 was derived from the Company's Canadian properties.

Production expenses for the twelve-month period ended August 31, 2008 totaled \$8,852,623 consisting of \$4,248,956 in non-cash accretion and depletion costs, \$2,845,718 in direct operating expenses, \$1,651,499 in state resource taxes and \$106,450 in Canadian production royalties compared to production expenses for the twelve-month period ending August 31, 2007 of \$707,334 consisting of \$378,938 in non-cash accretion and depletion costs, \$131,984 in direct operating expenses and \$196,412 in Canadian production royalties.

Other expenses and income, including non-cash items for the twelve-month period ended August 31, 2008 resulted in a net expense of \$3,909,634 and consisted of administration and office expenses of \$901,529, interest expenses of \$3,648,260, professional fees of \$685,870, a non-cash gain on derivative instruments of \$2,839,736, non-cash accretion expense on the Company's debentures of \$929,216, financing fees of \$325,000, a loss on the sale of investments of \$474,265, interest income of \$388,520 and a foreign exchange loss of \$173,751 compared to other expenses and income for the twelve-month period ended August 31, 2007 of \$358,652 consisting of general and administration expenses of \$69,402, interest expenses of \$162,109, professional fees of \$148,962 and interest income of \$21,821. The increase in professional fees is primarily due to the Plan of Arrangement referred to above and due to our legal expenses relating to a lawsuit filed in 2006 against Arrowhead and others by plaintiffs who allege that they are entitled to receive 5% of net profits realized by our Company from revenue derived from operations. The lawsuit is further described below.

Interest expense increased to \$3,648,260 for the twelve-month period ended August 31, 2008 compared to \$162,109 for the same period in 2007. The increase in interest expenses was primarily due to the First, Second, and Third Debentures established as part of the Plan of Arrangement and bank debt referred to in further detail below.

A loss on foreign exchange of \$173,751 was recorded in the twelve-month period ended August 31, 2008 compared to a loss of \$nil for the same period in 2007.

During the second quarter of 2006, Arrowhead and other unrelated defendants were served with a lawsuit alleging that certain properties, including some of the properties owned by Arrowhead, are subject to a 5% net profits interest owned by the plaintiffs and that all of the defendants, including Arrowhead, are in default of their obligations under this 5% net profits interest to pay money to the plaintiffs. On May 25, 2007, Arrowhead obtained a declaratory order from the trial court quieting title with respect to some of the property owned by Arrowhead. After we obtained this order quieting title, Arrowhead leases that remain encumbered by this lawsuit consist of five Warbonnet leases totaling 2,040 gross acres (867 net) and at the time 13 developed wells (5.5 net). On August 6, 2007, the trial court granted partial summary judgment in favor of the Plaintiffs, holding that the net profits contract did not terminate with the Pinedale Unit, a federal exploration unit formed in 1953 and terminated in 1981, and that the obligation to pay the net profits is a "lease based" obligation which runs with the land. On August 10, 2007, the trial court granted another partial summary judgment in favor of the plaintiffs, holding that they owned the net profits contract. Trial on the issue of whether the defendants owe any compensatory damages and on our affirmative defenses was held in October 2007. At trial, the Judge dismissed the plaintiffs' claim that the defendants, including Arrowhead, had breached any implied covenant of good faith and he dismissed the plaintiffs' claims against Arrowhead brought under the Wyoming Royalty Payment Act (a Wyoming statute providing for interest on unpaid royalty payments). On April 14, 2008, the Judge entered a Judgment in the amount of \$4,896,589 against the Defendants, jointly and severally. The Judge denied the Defendants' Motions to Alter or Amend the Judgment on May 21, 2008. The Company filed its Notice of Appeal with the Wyoming Supreme Court on June 16, 2008. On July 1, 2008, the Judge issued an order granting the Plaintiffs' Motion for Attorney Fees and entered a judgment in the amount of \$3,917,289.00 against the operator Defendants. Arrowhead is not an operator and therefore not subject to this judgment. We will continue to update our disclosure with respect to this lawsuit as events require.

### **Plan of Arrangement ("Arrangement")**

On August 27, 2007, the Company entered into an Arrangement to acquire all of the outstanding shares and options of Gemini.

On October 2, 2007, the Company held its annual and special general meeting of shareholders. All resolutions, including the approval of the Arrangement, placed before the shareholders were approved by majority vote.

On November 30, 2007, the British Columbia Supreme Court granted final order approving the Arrangement.

On March 4, 2008, the Company closed the Arrangement pursuant to which it has acquired 100% of the issued and outstanding shares of Gemini, as contemplated in the arrangement agreement between the Company, Gemini, John Hislop ("**Hislop**") and J. Bradley Windt ("**Windt**"). Gemini survived as a wholly owned subsidiary of the Company and Gemini's shares have been delisted from the TSX.

Under the Arrangement made between the Company and Gemini, the Company paid \$19,376,829 (C\$19,291,944) and issued 12,836,713 common shares totaling \$51,572,778 (C\$51,346,852) at a deemed value of C\$4.00 per share to former Gemini shareholders, issued convertible debentures totaling \$47,508,293 (C\$47,300,172), and reduced a promissory note receivable by \$9,537,381 (C\$9,495,000) to acquire all the outstanding shares of Gemini and incurred \$290,007 (C\$288,737) in transaction costs. The Company also paid the aggregate sum of \$582,200 (C\$579,650) in exchange for the surrender and cancellation of existing Gemini stock options.

Prior to closing the Arrangement, the Company changed its name to "Bucking Horse Energy Inc." and closed a private placement of 2,000,000 common shares at C\$4.00 per share, for gross proceeds of \$8,094,709 (C\$8,000,000). The proceeds from the private placement were used to provide a portion of the funds required to complete the Arrangement. The shares issued pursuant to the private placement were subject to a standard four month hold period under applicable securities law, which expired on July 4, 2008.

In connection with the Arrangement, Arrowhead, as "Borrower", the Company, as "Guarantor", and Gemini, as "Guarantor", entered into a credit agreement (the "**Credit Agreement**") dated March 4, 2008 with a senior bank, as administrative agent, and each of the lenders from time to time party thereto (collectively, the "**Lenders**") whereby the Lenders have agreed to make a five year senior revolving credit facility in the aggregate principal amount of up to \$100,000,000, with an initial borrowing base of \$30,000,000 (the "**Facility**"), available to the Borrower pursuant to the terms set out in the Credit Agreement. The Facility will be made available to provide working capital to Arrowhead and to enable Arrowhead to make distributions to Gemini which may then be further distributed to the Company for general corporate purposes. Pursuant to the Credit Agreement, the obligations and liabilities of the Borrower to the Lenders will be joint and severally guaranteed by the Company and by Gemini. The facility has an interest that floats, based on both the bank prime rate and a spread which will increase based on the percentage of availability drawn, resulting in a current interest rate of approximately 5.5%. As a result of the Credit Facility, the Company is now well in position to execute its operational business plan. The Company currently has drawn \$13,500,000 from the Credit Facility and has \$16,500,000 left available.

Prior to closing, Gemini had four secured convertible debentures outstanding, the March Debentures and the August Debentures. Hislop and Windt each held one March Debenture and one August Debenture.

The March Debentures were convertible into units at a conversion price of C\$2.50 per unit, with each unit consisting of one Gemini common share and one share purchase warrant. Each of the March Debentures was converted prior to the closing of the Arrangement and the shares issued

upon conversion were sold to the Company, together with the share purchase warrants, for the total sum of \$19,083,600 (C\$19,000,000), as contemplated under the Arrangement. The \$19,083,600 (C\$19,000,000) was paid by the issuance of two new convertible debentures by the Company, one to each of Hislop and Windt. Each new convertible debenture is in the principal amount of \$9,541,800 (C\$9,500,000), has a term of ten years, earns interest at a rate of 10% during the first six years and 15% during the last four years and is convertible into units during the first five years at a conversion price of C\$4.875 per unit. Each unit consists of one common share of the Company and one share purchase warrant. Each share purchase warrant entitles the holder to purchase one additional common share of the Company for C\$4.875 until the fifth anniversary of the date of issuance, at which date these share purchase warrants will expire.

The August Debentures were cancelled and replaced with two new convertible debentures for a total sum of \$10,044,000 (C\$10,000,000) having the same terms as the August Debentures except that they are convertible into units of the Company.

At the closing of the Arrangement, Hislop delivered an additional 2,500,000 common shares of Gemini to the Company at C\$4.00 per share and Windt delivered an additional 2,075,043 common shares of Gemini at C\$4.00 per share together with \$1,707,307 (C\$1,699,828) in cash. As consideration, the Company issued to Hislop a new convertible debenture in the principal sum of \$10,044,000 (C\$10,000,000) and the Company issued to Windt two new convertible debentures totaling the principal sum of \$10,044,000 (C\$10,000,000). These new convertible debentures have a term of ten years, earn interest at the rate of 10% during the first six years and 15% during the last four years and are convertible into units of the Company during the first five years at a conversion price of C\$4.875 per unit. Each unit consists of one common share of the Company and one share purchase warrant. Each share purchase warrant entitles the holder to purchase one additional common share of the Company for C\$4.875 until the fifth anniversary of the closing date, at which date the share purchase warrants will expire.

As a result of the foregoing transactions and a share purchase transaction between Gemini and Q Investments Ltd. ("**Q Investments**") (QI. TSX-V), Gemini is now a wholly owned subsidiary of the Company and as a result of the issuance of the new debentures and the assumption of the August Debentures, the Company has outstanding convertible debentures in the aggregate principal amount of \$49,215,600 (C\$49,000,000), held in equal amounts by Hislop and Windt.

As of March 4, 2008, the Company's shares have been listed for trading on the Toronto Stock Exchange ("**TSX**") under the trading symbol BUC. The Company's shares were delisted from the Canadian Trading and Quotation System ("**CNQ**") at the close on March 4, 2008.

The Company's Board of Directors (the "**Board**") was reconstituted in connection with the closing of the Arrangement. As of March 4, 2008, the reconstituted Board consisted of Gordon Nielsen (President and Chief Executive Officer), Michael Schoen, Lorne Hanson and Raymond Deere. Daniel Weisbeck retains the office of Chief Financial Officer and has been appointed Secretary and Treasurer.

In a related transaction referred to above, Gemini sold to Q Investments 12,000,000 common shares of Exxel for total consideration of \$15,106,980 (C\$15,040,800). The purchase price was initially paid by Q Investments' issuance of a promissory note in favour of Gemini. The amount owing under the promissory note was then reduced by \$9,537,381 (C\$9,495,600) by Q Investments delivering 2,373,900 common shares of Gemini at C\$4.00 per share pursuant to the Arrangement. The amount owing was further reduced by Q Investments surrendering a promissory note that it held that had been issued by the Company, in the principal sum of \$1,506,600 (C\$1,500,000) together with accrued interest. The promissory note had a term of one year and bore interest at the rate of 15% per annum.

The effect of the Arrangement on the Company is discussed in detail in the Company's Management Information Circular dated August 29, 2007, distributed in connection with the

shareholders' meeting held October 2, 2007, at which the Arrangement was considered and approved by the Company's shareholders.

### Other Events

During the year ended August 31, 2007, 7,500,000 common shares of the Company were put into escrow in accordance with National Policy 46-201, Escrow for Initial Public Offering. On December 20, 2007, 1,125,000 shares were released from escrow.

Effective May 14, 2008, the shares held in escrow are subject to a new escrow release schedule due to the Company's change in status from an "emerging issuer" to an "established issuer".

Also on May 14, 2008, 2,625,000 common shares of the Company were released from escrow.

Effective May 20, 2008, the Company entered into a management services agreement ("**MSA**") with Giant Energy Limited ("**Giant**") a privately held oil and gas management and consulting company. Giant has been retained to provide oil and gas consulting, operational, technical and business management services to the Company. Giant has been engaged to advance the Company's natural gas development and exploration properties. Giant is headquartered in Houston, Texas and has offices in Denver, Colorado and Vancouver, British Columbia.

Pursuant to the MSA, Bucking Horse will pay for services provided by Giant monthly in connection with Bucking Horse's assets based on hourly employee rate schedules under the agreement. Giant was also to receive performance options described as follows:

Bucking Horse was to grant stock options, subject to certain conditions described below (the "**Options**") to acquire 1,000,000 shares at a price of C\$4.00 per share to Giant. The Options were to be exercisable for a period of five years from the date of grant. The Options were to vest over a 24 month period beginning from the date that is six months from the date of issuance with  $\frac{1}{4}$  of the Options vesting and another  $\frac{1}{4}$  of the Options vesting after each additional six month period thereafter.

In addition, Giant's ability to exercise the Options was to be subject to a second vesting requirement based on Bucking Horse achieving specific company-wide daily net production targets:

- (1)  $\frac{1}{4}$  of the Giant Options shall vest only upon Bucking Horse meeting or exceeding the second vesting requirement of producing net marketed natural gas equivalents of twelve and one half (12.5) million cubic feet equivalent ("MMcfe") per day on a six month (calendar) average basis;
- (2) An additional  $\frac{1}{4}$  of the Giant Options shall vest only upon Bucking Horse producing additional (from the last requirement level) marketed natural gas equivalents of two and one half (2.5) million cubic feet equivalent ("MMcfe") per day (total 15 MMcfe) on a six month (calendar) average basis;
- (3) An additional  $\frac{1}{4}$  of the Giant Options shall vest only upon Bucking Horse producing additional (from the last requirement level) marketed natural gas equivalents of two and one half (2.5) million cubic feet equivalent ("MMcfe") per day (total 17.5 MMcfe) on a six month (calendar) average basis; and
- (4) The remaining  $\frac{1}{4}$  of the Giant Options shall vest only upon Bucking Horse producing additional (from the last requirement level) marketed natural gas equivalents of two and one half (2.5) million cubic feet equivalent ("MMcfe") per day (total 20 MMcfe) on a six month (calendar) average basis. All Options shall vest and become exercisable upon a Change in Control.

The stock option grant was subject to Bucking Horse's stock option plan, shareholder approval and regulatory approval. On November 27, 2008, the Company held its annual general meeting

of shareholders. The proposed issuance of stock options to Giant was not approved by the shareholders. See subsequent events for details.

On May 21, 2008, the Company appointed two new senior officers, Clifford V. Adams as the Company's new Chief Executive Officer and Chief Operations Officer and Tony Gale, as Senior Vice President of Operations. Gordon Nielsen will remain as President and Director of the Company.

Also on May 21, 2008, the Company announced its participation in a private placement conducted by Giant pursuant to which the Company acquired 1,000,000 common shares of Giant at a price of C\$0.25 per shares for a total cost of \$235,272 (C\$250,000). This is a non-arm's length transaction as Mr. Adams is an officer of both companies and both companies have a common major shareholder.

On May 26, 2008, the TSX accepted Bucking Horse's Notice of Intention to Make a Normal Course Issuer Bid (the "**Notice**") pursuant to which the Company indicated that it intends to make a normal course issuer bid for certain of its outstanding common shares ("**Common shares**") on the terms set forth in the Notice. At the time of filing the Notice, the Board of Directors of the Corporation was of the belief, and continues to be of the belief, that the purchase of Common shares from time to time at appropriate prices is an advantageous use of the Corporation's funds.

As of May 22, 2008, 23,061,713 Common shares were outstanding. Under the rules of the TSX, in the period commencing on May 28, 2008 and ending on May 27, 2009, the Company may acquire up to 1,153,086 Common shares of the Company, being 5% of the Common shares outstanding as at May 22, 2008. If market conditions permit, the directors of the Company presently anticipate that the Company will acquire up to 1,153,086 Common shares, which represents 5% of the Common shares outstanding as at May 22, 2008 that may be purchased pursuant to the Notice. The average daily trading volume for the period since the March 4, 2008 amalgamation of NRG and Gemini which created Bucking Horse to the acceptance of the Notice was 578 Common shares.

Any shares purchased pursuant to the Notice will be cancelled. Shares will be purchased at the market price of the shares at the time of purchase and will be purchased on behalf of the Company by a registered investment dealer through the facilities of the TSX. The funding for any purchase of Common shares pursuant to the normal course issuer bid will be financed out of working capital of the Company.

Other than as described in the information circular regarding the Arrangement described above, Bucking Horse has not purchased any of its issued and outstanding common shares within the 12 months preceding the normal course issuer bid.

### Summary of Quarterly Results

The following table presents selected unaudited consolidated financial information for the last seven quarters:

(US\$)	2008				2007		
	Q4	Q3	Q2	Q1	Q4	Q3	Q2
Total Revenue	8,311,241	7,122,673	139,356	120,084	163,692	224,909	262,368
Net Income (Loss)	(5,832,117)	6,356,404	(145,571)	(223,891)	(483,516)	236,103	30,642
Basic per Share	(0.37)	0.28	(0.02)	(0.03)	(0.06)	0.05	0.01

### Liquidity

Cash and cash equivalents at August 31, 2008 totaled \$5,391,123 compared to \$733,265 as at August 31, 2007.

As of August 31, 2008, working capital increased to \$14,400,475 from \$867,749 at the prior period ended August 31, 2007.

Our objective is to meet our operating and capital requirements by a combination of cash flow from current and future well production, and re-investment of current capital. However, production volumes and the market price that we receive for natural gas and natural gas liquids that we produce and sell, determine our revenue from operations. As a consequence, our ability to obtain additional capital is substantially dependent on the price of natural gas. Future cash flows and the continued availability of financing are subject to a number of uncertainties including, by way of example, production rates, the price of natural gas, the results of our drilling programs and the eventual outcome of the litigation described above.

Contractual Obligations (US\$)	Payments Due by Period				
	Total	Less than 1 year	1 – 3 years	4 – 5 years	After 5 years
Long Term Debt <sup>(1)</sup>	46,113,307	nil	nil	nil	46,113,307
Capital Lease Obligations	nil	nil	nil	nil	nil
Operating Leases	nil	nil	nil	nil	nil
Purchase Obligations	nil	nil	nil	nil	nil
Other Long Term Obligations <sup>(2)</sup>	44,066	nil	nil	nil	44,066
Line of Credit	13,500,000	nil	nil	nil	13,500,000
<b>Total Contractual Obligations</b>	<b>59,657,373</b>	<b>nil</b>	<b>nil</b>	<b>nil</b>	<b>59,657,373</b>

<sup>(1)</sup> First, Second, and Third Convertible Debentures

<sup>(2)</sup> Asset retirement obligation

### Capital Resources

Our long term debt as at August 31, 2008 is comprised of six secured convertible debentures as described below:

On March 4, 2008, two convertible debentures (the "**First Debentures**") were issued by the Company, one to each Hislop and Windt (collectively, the "**Debenture Lenders**"). Each of the First Debentures is in the principal amount of \$8,940,335 (C\$9,500,000), has a term of ten years, earns interest at a rate of 10% during the first six years and 15% during the last four years and is convertible into units during the first five years at a conversion price of C\$4.875 per unit. Each unit consists of one common share of the Company and one share purchase warrant. Each share purchase warrant entitles the holder to purchase one additional common share of the Company for C\$4.875 until the fifth anniversary of the date of issuance, at which date these share purchase warrants will expire. Effective May 16, 2008, as a result of an interest rate acceleration provision, the interest rate applicable to the First Debentures increased from 10% to 15%.

On March 4, 2008, two additional convertible debentures (the "**Second Debentures**") were issued by the Company, one to each of the Debenture Lenders. The Second Debentures have the same terms as the August Debentures held by Gemini prior to the closing of the Arrangement, except that they are convertible into units of the Company rather than Gemini. Each of the Second Debentures is in the principal amount of \$4,705,439 (C\$5,000,000), has a term of ten years from the Gemini date of issue being August 4, 2004 and carries interest. Interest is payable monthly at a rate of 10% per annum for the first six years of the term and at a rate of 15% during the last four years. All or any portion of the amount outstanding under these Second Debentures from time-to-time is convertible into units at the option of the holder at a price of C\$4.00 per unit. Upon conversion, each unit consists of one common share in the capital of the Company and one non-transferable share purchase warrant. Each of these share purchase warrants entitles the holder to purchase one additional common share of the Company at a price

of C\$4.00 until the fifth anniversary of the Gemini date of issue, at which time these share purchase warrants, if issued, will expire. Effective May 16, 2008, as a result of an interest rate acceleration provision, the interest rate applicable to the Second Debentures increased from 10% to 15%.

Also on March 4, 2008, two more convertible debentures (the "**Third Debentures**") were issued by the Company, one to each of the Debenture Lenders. Each of the Third Debentures is in the principal amount of \$9,410,879 (C\$10,000,000), has a term of ten years, earns interest at a rate of 10% during the first six years and 15% during the last four years and is convertible into units of the Company during the first five years at a conversion price of C\$4.875 per unit. Each unit consists of one common share of the Company and one share purchase warrant. Each share purchase warrant entitles the holder to purchase one additional common share of the Company for C\$4.875 until the fifth anniversary of the closing date, at which date the share purchase warrants will expire. Effective May 16, 2008, as a result of an interest rate acceleration provision, the interest rate applicable to the Third Debentures increased from 10% to 15%.

In the event that the indebtedness resulting from credit agreement (the "**Credit Agreement**") described previously exceeds the aggregate amount of \$12,000,000, the rate of interest payable on the principal amount of the First, Second and Third Debentures shall increase to a rate of interest equal to the then applicable rate of interest payable plus 5% per annum for the period of time that the indebtedness exceeds the sum of \$12,000,000. Effective May 16, 2008, the indebtedness exceeded \$12,000,000 and the new interest rate of 15% per annum has taken effect.

In connection with the Arrangement with Gemini, Arrowhead as "Borrower", the Company, as "Guarantor", and Gemini as "Guarantor", entered into a credit agreement (the "**Credit Agreement**") dated March 4, 2008 with a senior bank, as administrative agent, and each of the lenders from time to time party thereto (collectively, the "**Lenders**") whereby the Lenders have agreed to make a five year senior revolving credit facility in the aggregate principal amount of up to \$100,000,000, with an initial borrowing base of \$30,000,000 (the "**Facility**"), available to the Borrower pursuant to the terms set out in the Credit Agreement. The Facility will be made available to provide working capital to Arrowhead and to enable Arrowhead to make distributions to Gemini which may then be further distributed to the Company for general corporate purposes.

Following the closing of the Arrangement with Gemini, the Company owned through Gemini a total of 5,000,000 Exxel Energy Corp. ("**Exxel**") shares. On May 30, 2008, Exxel change its name to XXL Energy Corp. ("**XXL**") and consolidated its shares on a ration of 20:1 (i.e. 20 pre-consolidation common shares for 1 post-consolidation share). As of May 30, 2008, the Company owned through Gemini a total of 250,000 common shares of XXL and 150,000 share purchase warrants at a price of \$20.00. Certain of our Officers and Directors are also Officers and/or Directors of XXL Energy Corp. The Company subsequently sold the shares of XXL resulting in a loss of \$421,144

We have sufficient cash to pay for our capital commitments and consequently do not anticipate any problems meeting existing capital commitments as they become due.

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

We do not have any off-balance sheet financing type arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to investors.

During the second quarter of 2006, the Company entered into three agreements pertaining to the Rockies Express Pipeline Project. Two of these agreements are Precedent Agreements entered into directly with Rockies Express Pipeline LLC, while the third agreement is an Assignment and Assumption Agreement in which the Wyoming Pipeline Authority has assigned to the Company

certain capacity rights originally granted to the Wyoming Pipeline Authority in a Precedent Agreement dated December 19, 2005 between the Wyoming Pipeline Authority and Rockies Express Pipeline LLC. The effect of these three agreements, all of which are dated for reference June 16, 2006, reserve for the Company 10,000 MMBTU/day natural gas transport capacity through the Rockies Express pipeline facilities for a period of 10 years. The Rockies Express Pipeline commenced interim service January 12, 2008 with full service to Audrain County, Missouri commencing May 2008. Eastward pipeline construction continues and the Rockies Express Pipeline is projected to commence deliveries to Lebanon, Ohio by mid-June 2009 with full in-service deliveries commencing to Clarington, Ohio by November, 2009.

### Commodity Hedge Contracts

In May 2008 the Company entered into the following open commodity derivative financial contracts to manage price risk on a portion of its natural gas production for the periods referenced below.

Type	Volume MMBTU/Day	Contract Period	Price US\$ / MMBTU
Swap (1)	2,000	June to December 2008	\$9.65 / MMBTU
Costless Collar (1)	2,000	June to December 2008	\$8.00 / MMBTU Floor \$12.14 / MMBTU Ceiling
Swap (2)	2,500	Calendar 2009	\$11.24 / MMBTU

- 1) Panhandle Eastern basis
- 2) Dominion South

As at August 31, 2008, the unrealized gain on outstanding derivative financial contracts is \$2,927,776. The realized loss on settlement of derivative financial contracts during the year was \$88,040. the net gain on derivative financial contracts for the year of \$2,839,736 has been included in other expenses for the year.

### Transactions with Related Parties

On August 31, 2006, the Company purchased petroleum and natural gas property assets in the Wainwright area of Alberta for the amount of C\$1,382,938 from Netco Energy Inc. ("**Netco**"), a non-arm's length party. At that time, Netco was considered a non-arm's length party as Hislop, was a director, President and controlling shareholder of the Company and was also a control person of Netco. Currently, Netco is still considered a related party as Gordon Nielsen, President and director of the Company, is also President, Chief Executive Officer and a director of Netco.

On November 10, 2006, the Company entered into a Loan Agreement with Q Investments pursuant to which Q Investments has provided the Company with a loan in the principal amount of \$1,327,434 (C\$1,500,000). On November 10, 2006, Hislop was, at the time, a director and a control person of Q Investments and the President, Chief Executive Officer and a director of the Company. As a condition to the closing of the Arrangement on March 4, 2008, Gemini sold 12,000,000 shares of the common stock of Exxel Energy Inc. (now XXL Energy Inc.) to Q Investments, for total consideration of \$15,106,980 (C\$15,040,800). The purchase price was initially paid by Q Investment's issuance of a promissory note for the full amount of the purchase price, having a term of one year and bearing interest at the rate of 15% per annum. The note was reduced to the extent of \$9,537,381 (C\$9,495,600) by Q Investments delivering 2,373,900 common shares of Gemini at C\$4.00 per share pursuant to the Arrangement. The note was further reduced by Q Investments surrendering a promissory note that it held in the Company, in the principal sum of \$1,506,600 (C\$1,500,000) together with accrued interest.

On August 29, 2007, the Company and Gemini entered into a formal agreement pursuant to which the Company proposed to acquire all of the issued and outstanding securities of Gemini by way of a Plan of Arrangement under the *Business Corporations Act* (British Columbia), which closed on March 4, 2008. The Arrangement Agreement is disclosed above in more detail under the heading "Plan of Arrangement".

On March 4, 2008, the Company issued six debentures to Hislop and Windt in connection with the acquisition of Gemini. The debentures are described above in more detail under the heading "Capital Resources".

#### **Fourth Quarter**

#### **Three-month period ended August 31, 2008 compared to the three-month period ended August 31, 2007:**

Net U.S. production for the three-month ended August 31, 2008 totaled approximately 722 million cubic feet of natural gas and six thousand barrels of natural gas liquids, or 758 million cubic feet of natural gas equivalent averaging 8.2 MMcfe/day compared to \$nil for the same period in 2007. Prices realized by the Company in the U.S. averaged \$9.79 per Mcf of natural gas and \$118.73 per barrel of natural gas liquids.

Canadian production for the three-month period ended August 31, 2008 totaled approximately 19 MMcf of natural gas averaging 211 Mcf/day compared to 28 MMcf averaging 306 Mcf/day for the same period in 2007, a decrease of 31%. The decrease in production in the three-month period ended August 31, 2008 is primarily a result of production declines associated with the producing Wainwright well. Natural gas prices realized from the Company's Canadian properties for the three-month period ended August 31, 2008 increased 84% to C\$10.77 per Mcf compared to C\$5.85 per Mcf in the same period in 2007.

Net loss for the three months ended August 31, 2008 was \$5,832,117 compared to a net loss of \$483,516 for the three months ended August 31, 2007. The loss was due largely to foreign exchange. Operating income increased to \$4,769,052. Other expenses increased to \$8,715,547 of which 7,246,523 was a foreign exchange loss.

Production revenues for the three-month period ended August 31, 2008 totaled \$8,311,241 compared to \$163,692 for the same period in 2007. Of these revenues, \$8,064,500 were derived from the Company's U.S. properties and \$246,741 was derived from the Company's Canadian properties.

Production expenses for the three-month period ended August 31, 2008 totaled \$3,542,189 consisting of \$2,853,694 in non-cash accretion and depletion costs, \$1,755,186 in direct operating expenses and \$29,251 in Canadian production royalties compared to production expenses for the three-month period ending August 31, 2007 of \$263,906 consisting of \$164,872 in non-cash accretion and depletion costs, \$47,692 in direct operating expenses and \$51,342 in Canadian production royalties.

General expenses including non-cash items for the three-month period ended August 31, 2008 resulted in expenses of \$8,715,547 and consisted of a credit of administration and office expenses of a credit of \$22,639 interest expenses of \$891,033, professional fees credit of \$284,090 and a foreign exchange loss of \$7,246,523 compared to general expenses for the three-month period ended August 31, 2007 of \$183,036 consisting of general and administration expenses of a credit of \$2,808, interest expenses of \$62,282 and professional fees of \$109,355. The increase in professional fees is primarily due to the Plan of Arrangement referred to above and further described above in this MD&A and increases in our legal expenses relating to a lawsuit filed in 2006 against our Company and others by plaintiffs who allege that they are entitled to receive 5% of net profits realized by our Company from revenue derived from operations on certain of our leasehold interests further described above.

Interest expense increased to \$891,033 for the three-month period ended August 31, 2008 compared to \$109,355 for the same period in 2007. The increase in interest expenses was primarily due to the First, Second, and Third Debentures established as part of the Plan of Arrangement and bank debt.

On June 24, 2008, 1,875,000 shares were released from escrow.

### Proposed Transactions and Subsequent Events

As of the date of this MD&A, the Company purchased a total of 59,300 of its common shares on the open market pursuant to the Normal Course Issuer Bid, of which 14,600 were purchased subsequent to August 31, 2008. On November 17, 2008, all 59,300 shares were returned to treasury and cancelled.

In October 2008, the Company initiated the process to obtain a quotation on the International OTCQX Exchange ("**OTCQX**") and has appointed Dahlman Rose & Company, LLC ("**Dahlman Rose**") to act as its Investment Bank Principal American Liaison ("**PAL**").

The OTCQX is a new listing service offered by Pink OTC Markets Inc. that provides a means for international companies that are already listed on qualified foreign stock exchanges (such as the Toronto Stock Exchange) to develop a presence in the U.S. securities markets. The OTCQX provides non-U.S. issuers with a platform on which to listed securities and access liquidity in the U.S.

Dalhman Rose is a full-service investment bank offering value-added research, trading, and advisory services for companies along the natural resources supply chain. The firm is headquartered in New York and has offices in Boston, Houston, New Orleans and San Francisco.

The Company welcomed the issuance of The Record of Decision ("**ROD**") for the Final Supplemental Environmental Impact Statement for the Pinedale Anticline Oil and Gas Exploration and Development Project by the Bureau of Land Management on September 12, 2008. This decision defines the parameters for expanded development of the Company's Pinedale properties in the Mesa and Warbonnet areas. The ROD now allows year-round drilling on the Company's productive acreage in the Mesa and Warbonnet areas. By using existing well pads in these areas, the operator of the Company's properties will be able to take advantage of the recent Wyoming state ruling allowing 10-acre development in these areas by drilling on a year round basis. This decision allows for continuous development of the Company's reserves, which will result in significant increases in production for the Company.

As a result of the ROD, management is preparing a multi-year operational and drilling plan for the Company's Pinedale assets. This plan is expected to better define and prioritize the areas of development within the Company's high-potential Warbonnet and Mesa areas. Management is currently in discussions with its partners and expects to finalize the Company's plan in the upcoming months.

On November 5, 2008 the Company canceled its Dominion South swap contract and replaced it with a Panhandle Eastern basis contract, tabled below.

Type	Volume MMBTU/Day	Contract Period	Price US\$ / MMBTU
Swap (1)	2,500	Calendar 2009	\$9.66 / MMBTU

1) Panhandle Eastern basis

On November 24, 2008 the Company contracted to purchase C\$6,113,000 during calendar 2009 at an exchange rate of C\$1.2226 per US\$.

The Company held its annual general and special meeting of shareholders on November 26, 2008. At the meeting, the Company's shareholders approved the increase of shares available for issuance under the Company's stock option plan from 822,500 to 2,306,000. Subject to receipt of final approval from the Toronto Stock Exchange, the Company will proceed with the increase of shares available for issuance under the Company's stock option plan.

The ratification of the grant of options to grant 1,000,000 common shares of the Company to Giant Energy Limited was not approved at the meeting. As such, the Company is not proceeding with this grant.

### **Significant Accounting Policies**

The significant accounting policies used by the Company are disclosed in the notes to the Company's annual audited consolidated financial statements. Certain accounting policies require that management make appropriate decisions with respect to the formulation of estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. The following discussion outlines such accounting policies and is included in the MD&A to aid the reader in assessing the significant accounting policies and practices of the Company and the likelihood of materially different results being reported. The Company's management reviews its estimates regularly.

The following significant accounting policies outline the major policies involving critical estimates.

### **Proved Oil and Gas Reserves**

Proved reserves are those reserves that can be estimated with a high degree of certainty to be recoverable. It is likely that the actual remaining quantities recovered will exceed the estimated proved reserves. The estimated quantities of proved crude oil, natural gas liquids and natural gas are derived from geological and engineering data that demonstrate with reasonable certainty the amounts that can be recovered in future years from known reservoirs under existing economic and operating conditions. Reserves are considered proved if they can be produced economically as demonstrated by either actual production or conclusive formation tests. The oil and gas reserve estimates are made using all available geological and reservoir data as well as historical production data. Estimates are reviewed and revised as appropriate. Revisions occur as a result of changes in prices, costs, fiscal regimes, reservoir performance or a change in the Company's plans. The effect of changes in proved oil and gas reserves on the financial position of the Company is described under the headings "Depletion Expense" and "Impairment of Long Lived Assets".

### **Depletion Expense**

The Company uses the full cost method of accounting for exploration and development activities. In accordance with this method of accounting, all costs associated with exploration and development, are capitalized whether successful or not. The aggregate of net capitalized costs and estimated future development costs less estimated salvage values is amortized using the units-of-production method based upon proved oil and gas reserves. With all other factors remaining constant, an increase in estimated proved oil and gas reserves would result in a corresponding reduction in depletion expense. With all other factors remaining constant, a decrease in estimated future development costs would result in a corresponding reduction in depletion expense.

### **Impairment of Long Lived Assets**

The Company is required to review the carrying value of all property, plant and equipment including the carrying value of oil and gas assets, for potential impairment. The carrying value of

the Company's petroleum and natural gas properties must not exceed their fair value. The fair value is equal to the estimated future cash flows from proved and probable reserves using future price forecasts and costs discounted at a risk-free rate.

If impairment is indicated, the amount by which the carrying value exceeds the estimated fair value of the long lived asset is charged to income.

### **Asset Retirement Obligation**

Asset retirement obligations are initially measured at fair value when they are incurred, which is the discounted future value of the estimated liability. This requires an estimate to be made of the future costs of retiring the asset at the point in time the asset is acquired.

### **Income Tax Accounting**

The determination of the Company's income and other tax liabilities requires interpretation of complex laws and regulations. All tax filings are subject to audit and potential reassessment after the lapse of considerable time. Accordingly, the actual income tax liability may differ significantly from that estimated and recorded by management.

### **Financial Instruments**

On September 1, 2007, the Company adopted the Canadian Institute of Chartered Accountants ("CICA") Handbook Section 1530, Comprehensive Income, Section 3251, Equity, Section 3855, Financial Instruments – Recognition and Measurement, Section 3861, Financial Instruments – Disclosure and Presentation, and Section 3865, Hedges. These new accounting standards provide comprehensive requirements for the recognition and measurement of financial instruments, as well as standards on when and how hedge accounting may be applied. These new standards were adopted on a prospective basis and, accordingly, the comparative amounts for prior periods have not been restated.

#### **(i) Section 1530 - Comprehensive income**

Section 1530 introduces comprehensive income, which consists of net income and other comprehensive income. Other comprehensive income represents changes in shareholders' equity during a period arising from transactions and other events and circumstances from non-owner sources and includes the tax effected amount of unrealized gains and losses on financial assets classified as available-for-sale, unrealized foreign currency translation gains or losses arising from self-sustaining foreign operations, and changes in the fair value of the effective portion of cash flow hedging instruments.

#### **(ii) Section 3251 - Equity**

Section 3251 replaces Section 3250, "Surplus" and describes standards for the presentation of equity and changes in equity for reporting periods as a result of the application of Section 1530, "Comprehensive Income".

#### **(iii) Section 3855 - Financial instruments - Recognition and Measurement Section 3861 – Financial instruments – Disclosure and Presentation**

Section 3855 establishes standards for recognizing and measuring financial assets, financial liabilities and derivatives, including derivatives embedded in non-financial contracts. Section 3861 establishes standards for presentation of financial instruments and non-financial derivatives, and identifies the information that should be disclosed about them. Under Section 3855, financial instruments must be classified into one of five categories and, depending on the category, will either be measured at amortized cost or fair value on the balance sheet. Held-to-maturity investments, loans and receivables and other financial liabilities are measured at amortized cost. Held for trading financial assets and liabilities and available for sale financial assets are measured on the balance sheet at fair value. Changes in fair value of held-for-trading financial

assets and liabilities are recognized in earnings while changes in fair value of available-for-sale financial assets are recorded in other comprehensive income until the investment is derecognized or impaired at which time the amounts would be recorded in earnings.

Derivative financial instruments are classified as held for trading and are recorded on the balance sheet at fair value unless exempted as a normal purchase and sale arrangement. Derivatives embedded in non-derivative host contracts are recorded separately from the host contract when their economic characteristics and risks are not clearly and closely related to those of the host contract, the terms of the embedded derivatives are the same as those of a freestanding derivative and the combined contract is not held for trading or designated at fair value.

The Company has classified its cash and cash equivalents as held-for-trading measured at fair value, accounts receivable as loans and receivables measured at amortized cost, accounts payable and accrued liabilities as other financial liabilities measured at amortized cost and long-term debt as other financial liabilities measured at amortized cost.

**(iv) Section 3855 - Hedges**

Section 3865 specifies the criteria for hedge accounting. The Company does not apply hedge accounting. The change in fair value of the hedge derivative is recognized in net income in the current period.

**(v) Recent accounting pronouncements**

The Company has assessed new and revised accounting pronouncements that have been issued that are not yet effective and determined that the following may affect the financial disclosures and results of operations of the Company:

- i) Financial Instruments – Disclosures (CICA Handbook Section 3862) and Financial Instruments – Presentation (CICA Handbook Section 3863): These new standards will replace Financial Instruments – Disclosure and Presentation (Section 3861). This new disclosure standard increases the emphasis on the risks associated with both recognized and unrecognized financial instruments and how those risks are managed. The new presentation standard carries forward the former presentation requirements. The Company will adopt the new standards for interim and annual periods beginning on or after September 1, 2008.
- ii) Capital Disclosures (CICA Handbook Section 1535): This new standard will require companies to disclose their objectives, policies and processes for managing capital. In addition, disclosures are to include whether companies have complied with externally imposed capital requirements. The Company will adopt the new standard for its interim and annual periods beginning on or after September 1, 2008.
- iii) Inventories (CICA Handbook Section 3031): In March 2007, the CICA issued the new Handbook Section 3031, "Inventories", which will replace Section 3030, "Inventories." The new Section mentions that inventories shall be measured at the lower of cost and the net realizable value. It provides guidelines on determining cost, prohibiting going forward the use of the last-in, first-out method ("LIFO"), and requires the reversal of a previous write-down when the value of inventories increases. The new standard is not expected to have an effect on the Company's Financial Statements.
- iv) General Standards on Financial Statements Presentation (CICA Handbook Section 1400): This amended standard includes the requirement to assess and disclose an entity's ability to continue as a going concern. The Company will adopt this new standard for its interim and annual financial statements beginning on or after September 1, 2008.
- v) Goodwill and Intangible Assets (CICA Handbook Section 3062): Section 3064 replaces Handbook Section 3062, "Goodwill and Intangible Assets" and establishes revised standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. The new standard also provides guidance for the treatment of pre-production and

start-up costs and requires that these costs be expensed as incurred. This new standard is not expected to have a significant affect on the Company's Financial Statements.

vi) International Financial Reporting Standards: In January 2006, the CICA Accounting Standards Board ("**AcSB**") adopted a strategic plan for the direction of accounting standards in Canada and the expected convergence with International Financial Reporting Standards ("**IFRS**") by the end of 2011. On February 13, 2008, the Canadian Accounting Standards Board confirmed 2011 as the official changeover date for publicly listed Canadian companies to start using IFRS. The transition will affect interim and annual financial statements relating to years beginning on or after January 1, 2011. The impact of the transition to IFRS on the Company's consolidated financial statements has not yet been determined.

### **Stock-based Compensation**

The Company adopted Section 3870, Stock-Based Compensation and Other Stock-Based Payments using the fair value method. The fair value of stock options is determined by the Black-Scholes Option Pricing Model with assumptions for risk-free interest rates, dividend yields, volatility factors of the expected market price of the Company's common shares and an expected life of the options. The fair value of direct awards of stocks is determined by the quoted market price of the Company's stock.

### **Legal, Environmental Remediation and Other Contingent Matters**

The Company is required to both determine whether a loss is probable based on judgment and interpretation of laws and regulations and determine that the loss can reasonably be estimated. When the loss is determined it is charged to earnings. The Company's management must continually monitor known and potential contingent matters and make appropriate provisions by charges to earnings when warranted by circumstance.

### **Critical Accounting Estimates**

The preparation of financial statements in conformity with Canadian GAAP requires our management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods.

Our management routinely makes judgments and estimates about the effects of matters that are inherently uncertain. As the number of variables and assumptions affecting the probable future resolution of the uncertainties increase, these judgments become even more subjective and complex. We have identified certain accounting policies that are the most important to the portrayal of our current financial condition and results of operations.

The key elements and assumptions that we have made under these principles and their impact on the amounts reported in the annual consolidated financial statements remain substantially unchanged from those described in our 2007 audited consolidated financial statements.

Please refer to Note 3 of our 2008 audited consolidated financial statements for our Significant Accounting Policies.

### **Changes in Accounting Policies Including Initial Adoption**

On September 1, 2007, the Company adopted the Canadian Institute of Chartered Accountants ("**CICA**") Handbook Section 1530, Comprehensive Income, Section 3251, Equity, Section 3855, Financial Instruments – Recognition and Measurement, Section 3861, Financial Instruments – Disclosure and Presentation, and Section 3865, Hedges. These new accounting standards provide comprehensive requirements for the recognition and measurement of financial instruments, as well as standards on when and how hedge accounting may be applied. These

new standards were adopted on a prospective basis and, accordingly, the comparative amounts for prior periods have not been restated.

Effective March 4, 2008, the Company changed its reporting currency to the US dollar (USD). This change in reporting currency has been adopted due to the Company's primary focus on acquisition, exploration, development and production of natural gas and oil interest in the United States. The majority of the Company's oil and natural gas property assets are in the United States. Prior to March 4, 2008, the Company reported its annual and quarterly consolidated financial statements in Canadian dollars (CAD). In making this change in reporting currency, the Company followed the recommendations of the Emerging Issues Committee (EIC) of the Canadian Institute of Chartered Accountants (CICA), set out in EIC-130, *Translation Method when the Reporting Currency Differs from the Measurement Currency or there is a Change in the Reporting Currency*.

In accordance with EIC-130, the financial statements for all years presented have been translated into the new reporting currency using the current rate method. Under this method, the statements of operations and cash flow statement items for each year have been translated into the reporting currency using the average exchange rates prevailing during each reporting period. All assets and liabilities have been translated using the exchange rate prevailing at the balance sheet date. All resulting foreign exchange differences arising from the translation are included as a separate component of other comprehensive income. All comparative financial information has been restated to reflect the Company's results as if they had been historically reported in US dollars.

## **Risk Factors**

*Exploration, Development and Production Risks:* Oil and natural gas exploitation involves a high degree of risk and there is no assurance that expenditures made on future exploration by the Company will result in new discoveries of oil or natural gas in commercial quantities. It is difficult to project the costs of implementing an exploratory drilling program due to the inherent uncertainties of drilling in unknown formations, the costs associated with encountering various drilling conditions such as over pressured zones and tools lost in the hole, and changes in drilling plans and locations as a result of prior exploratory wells or additional seismic data and interpretations thereof.

The Company currently has no specific exploration or development plans for the Wainwright Property or the Columbia Basin Properties. Management will continue to evaluate prospects on an ongoing basis in a manner consistent with industry standards and corporate policies. The long-term commercial success of the Company as a junior oil and gas producer depends on its ability to find, acquire, develop and commercially produce oil and natural gas reserves. No assurance can be given that the Company will be able to locate satisfactory properties for acquisition or participation. Moreover, if such acquisitions or participations are identified, the Company may determine that current markets, terms of acquisition and participation or pricing conditions make such acquisitions or participations uneconomic. There is no assurance that the Company will be able to obtain financing for further exploration and development. In this regard, the Company has not entered into any contracts relating to the acquisition or participation in any properties other than as set forth herein nor have any letters of intent been executed. The Company has a limited history of operations and has an interest in only one producing natural gas property. See "Description of Business – Wainwright Property".

Future oil and gas exploitation may involve unprofitable efforts, not only from dry wells, but from wells that are productive but do not produce sufficient net revenues to return a profit after drilling, operating and other costs. Completion of a well does not assure a profit on the investment or recovery of drilling, completion and operating costs. In addition, drilling hazards or environmental damage could greatly increase the cost of operations, and various field operating conditions may adversely affect the production from successful wells. These conditions include delays in obtaining governmental approvals or consents, shut-ins of connected wells resulting from extreme weather conditions, insufficient storage or transportation capacity or other geological and

mechanical conditions. While close well supervision and effective maintenance operations can contribute to maximizing production rates over time, production delays and declines from normal field operating conditions cannot be eliminated and can be expected to adversely affect revenue and cash flow levels to varying degrees.

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

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

Prices, Markets and Marketing of Crude Oil and Natural Gas: Oil and natural gas are commodities whose prices are determined based on world demand, supply and other factors, all of which are beyond the control of the Company. World prices for oil and natural gas have fluctuated widely in recent years. Any material decline in prices could result in a reduction of net production revenue. Certain wells or other projects may become uneconomic as a result of a decline in world oil prices and natural gas prices, leading to a reduction in the volume of the Company's oil and gas reserves. The Company might also elect not to produce from certain wells at lower prices. All of these factors could result in a material decrease in the Company's future net production revenue, causing a reduction in its oil and gas acquisition and development activities. In addition, bank borrowings available to the Company are in part determined by the borrowing base of the Company. A sustained material decline in prices from historical average prices could limit or reduce the Company's borrowing base, therefore reducing the bank credit available to the Company, and could require that a portion of any existing bank debt of the Company be repaid.

In addition to establishing markets for its oil and natural gas, the Company must also successfully market its oil and natural gas to prospective buyers. The marketability and price of oil and natural gas which may be acquired or discovered by the Company will be affected by numerous factors beyond its control. The Company will be affected by the differential between the price paid by refiners for light quality oil and the grades of any oil produced by the Company. The ability of the Company to market its natural gas may depend upon its ability to acquire space in pipelines which deliver natural gas to commercial markets. The Company will also likely be affected by deliverability uncertainties related to the proximity of its reserves to pipelines and processing facilities and related to operational problems with such pipelines and facilities and extensive government regulation relating to price, taxes, royalties, land tenure, allowable production, the export of oil and natural gas and many other aspects of the oil and natural gas business. The Company has limited direct experience in the marketing of oil and natural gas.

Substantial Capital Requirements and Liquidity: The Company anticipates that it will make substantial capital expenditures for the acquisition, exploration, development and production of oil and natural gas reserves in the future. The Company may have limited ability to secure the capital necessary to undertake or complete future drilling programs. There can be no assurance that debt or equity financing, or cash generated by operations will be available or sufficient to meet these requirements or for other corporate purposes or, if debt or equity financing is

available, that it will be on terms acceptable to the Company. Moreover, future activities may require the Company to alter its capitalization significantly. The inability of the Company to access sufficient capital for its operations could have a material adverse effect on the Company's financial condition, results of operations or prospects.

If the Company requires additional funds in order to finance proposed operations, it may sell additional securities in its capital stock. If such additional securities are sold, existing shareholders will experience a dilution of their equity interest in the Company.

Competition: The Company will actively compete for reserve acquisitions, exploitation leases, licenses and concessions and skilled industry personnel with a substantial number of other oil and gas companies, many of which have significantly greater financial resources than the Company. The Company's competitors include major integrated oil and natural gas companies and numerous other independent oil and natural gas companies and individual producers and operators.

The oil and gas industry is highly competitive. The Company's competitors for the acquisition, exploration, production and development of oil and natural gas properties, and for capital to finance such activities, include companies that have greater financial and personnel resources available to them than the Company.

Certain of the Company's natural gas customers and potential customers may themselves be exploring for oil and natural gas, and the results of these exploration efforts could affect the Company's ability to sell or supply oil or gas to these customers in the future. The Company's ability to successfully bid on and acquire additional property rights, to discover reserves, to participate in drilling opportunities and to identify and enter into commercial arrangements with customers will be dependent upon developing and maintaining close working relationships with its future industry partners and joint operators and its ability to select and evaluate suitable properties and to consummate transactions in a highly competitive environment.

Environmental Risks: All phases of the oil and natural gas business present environmental risks and hazards and are subject to environmental regulation pursuant to a variety of international conventions, federal, provincial, state and municipal laws and regulations. Environmental legislation provides for, among other things, restrictions and prohibitions on spills, releases or emissions of various substances produced in association with oil and gas operations.

The legislation also requires that wells and facility sites be operated, maintained, abandoned and reclaimed to the satisfaction of applicable regulatory authorities. Compliance with this legislation can require significant expenditures and a breach may result in the imposition of fines and penalties, some of which may be material. Environmental legislation is evolving in a manner expected to result in stricter standards and enforcement, larger fines and liability and potentially increased capital expenditures and operating costs. The discharge of oil, natural gas or other pollutants into the air, soil or water may give rise to liabilities to various levels of government and third parties and may require the Company to incur costs to remedy such discharge. No assurance can be given that environmental laws will not result in a curtailment of production or a material increase in the costs of production, development or exploration activities or otherwise adversely affect the Company's financial condition, results of operations or prospects.

Reserve Replacement: The Company's future oil and natural gas reserves, production, and cash flows to be derived therefrom are highly dependent on the Company successfully acquiring or discovering new reserves. Without the continual addition of new reserves, any existing reserves the Company may have at any particular time and the production therefrom will decline over time as existing reserves are exploited. A future increase in the Company's reserves will depend not only on the Company's ability to develop any properties it may have from time to time, but also on its ability to select and acquire suitable producing properties or prospects. There can be no assurance that the Company's future exploration and development efforts will result in the discovery and development of additional commercial accumulations of oil and natural gas.

*Reliance on Operators and Key Employees:* The Company may not be the operator of certain oil and gas properties in which it acquires an interest. To the extent the Company is not the operator of its oil and gas properties, the Company will be dependent on these operators for the timing of activities related to such properties and will largely be unable to direct or control the activities of the operators. In addition, the success of the Company will be largely dependent upon the performance of management and key employees. The Company does not have any full time employees and is dependent on its ability to hire and retain highly skilled and qualified personnel. The Company faces competition for qualified personnel from numerous industry sources, and there can be no assurance that we will be able to attract and retain qualified personnel on acceptable terms. The Company does not have any 'key man' insurance policies, and therefore there is a risk that the death or departure of any member of management or any key employee could have a materially adverse effect on the Company.

*Corporate Matters:* To date, the Company has not paid any dividends on its outstanding common shares. Certain of the directors and officers of the Company are involved in managerial and/or director positions of other oil and gas companies, partnerships or other entities involved in natural resource exploration and development, and conflicts of interest may arise between their duties as officers, managers or directors of the Company and as officers and directors of these other companies, partnerships or other entities. Conflicts must be disclosed in accordance with, and are subject to such other procedures and remedies as apply under, the British Columbia *Business Corporations Act*.

*Permits and Licenses:* The operations of the Company may require permits and licenses from various governmental authorities. There can be no assurance that the issuer will be able to obtain all necessary permits and licenses that may be required to carry out exploration and development of its projects.

*Additional Funding Requirements:* The Company's cash flow from its reserves may not be sufficient to fund its ongoing activities at all times. From time to time, the Company may require additional financing in order to carry out its oil and gas acquisition, exploration and development activities. Failure to obtain such financing on a timely basis could cause the Company to forfeit its interest in certain properties, miss certain acquisition opportunities and reduce or terminate its operations. If the Company's revenues from its reserves decrease as a result of lower oil and natural gas prices or otherwise, it will affect the Company's ability to expend the necessary capital to replace its reserves or to maintain its production. If the Company's cash flow from operations is not sufficient to satisfy its capital expenditure requirements, there can be no assurance that additional debt or equity financing will be available to meet these requirements or available on favourable terms.

*Issuance of Debt:* From time to time, the Company may enter into transactions to acquire assets or the shares of other corporations. These transactions may be financed partially or wholly with debt, which may increase the Company's debt levels above industry standards. The Company's articles do not limit the amount of indebtedness that the Company may incur. The level of the Company's indebtedness from time to time could impair the Company's ability to obtain additional financing in the future on a timely basis to take advantage of business opportunities that may arise.

*Availability of Drilling Equipment and Access Restrictions:* Oil and natural gas exploration and development activities are dependent on the availability of drilling and related equipment in the particular areas where such activities will be conducted. Demand for such limited equipment or access restrictions may affect the availability of such equipment to the Company and may delay exploration and development activities.

*Property Defects:* Although we have obtained title reports with respect to some of our properties, we have not obtained title reports with respect to all of our current properties. Title reports are not title insurance and they do not act as a guarantee of title. Our properties may be subject to prior

unregistered agreements, native land claims or transfers which have not been recorded or detected through title research or which have been asserted since the date the research was completed. Additionally, the land upon which we hold leases may not have been surveyed; therefore, the precise area and location of such interests may be subject to challenge.

Litigation: During the second quarter of 2006, Arrowhead and other unrelated defendants were served with a lawsuit alleging that certain properties, including some of the properties owned by Arrowhead, are subject to a 5% net profits interest owned by the plaintiffs and that all of the defendants, including Arrowhead, are in default of their obligations under this 5% net profits interest to pay money to the plaintiffs. On May 25, 2007, we obtained a declaratory order from the trial court quieting title with respect to some of the property owned by Arrowhead. After we obtained this order quieting title, Arrowhead leases that remain encumbered by this lawsuit consist of five Warbonnet leases totaling 2,040 gross acres (867 net) and 13 developed wells (5.5 net). On August 6, 2007 the trial court granted partial summary judgment in favor of the Plaintiffs, holding that the net profits contract did not terminate with the Pinedale Unit, a federal exploration unit formed in 1953 and terminated in 1981, and that the obligation to pay the net profits is a "lease based" obligation which runs with the land. On August 10, 2007, the trial court granted another partial summary judgment in favor of the plaintiffs, holding that they owned the net profits contract. Trial on the issue of whether the defendants owe any compensatory damages and on our affirmative defenses was held in October 2007. At trial the Judge dismissed the plaintiffs' claim that the defendants, including Arrowhead, had breached any implied covenant of good faith and he dismissed the plaintiffs' claims against Arrowhead brought under the Wyoming Royalty Payment Act (a Wyoming statute providing for interest on unpaid royalty payments). On April 14, 2008 the Judge entered a Judgment in the amount of \$4,896,589 against the Defendants, jointly and severally. The Judge denied the Defendants' Motions to Alter or Amend the Judgment on May 21, 2008. The Company filed its Notice of Appeal with the Wyoming Supreme Court on June 16, 2008. On July 1, 2008, the Judge issued an order granting the Plaintiffs' Motion for Attorney Fees and entered a judgment in the amount of \$3,917,289 against the operator Defendants. We will continue to update our disclosure with respect to this lawsuit as events require.

Currency Fluctuations: We maintain our deposit accounts in US and Canadian currencies and our Company is therefore subject to currency fluctuations. These currency fluctuations could materially affect our financial position and results. We do not engage in currency hedging activities.

### **Risks Relating to the Industry**

The oil and gas industry is subject to extensive controls and regulations imposed by various levels of government. Outlined below are some of the more significant aspects of the legislation, regulations and agreements governing the oil and gas industry. All current legislation is a matter of public record and the Company is unable to predict what additional legislation or amendments may be enacted.

Potential Profitability of Oil and Gas Ventures Depends upon Factors beyond our Control: The potential profitability of oil and gas properties is dependent upon many factors that are beyond the Company's control. For instance, world prices and markets for oil and gas are unpredictable, highly volatile, potentially subject to governmental fixing, pegging, controls, or any combination of these and other factors, and respond to changes in domestic, international, political, social, and economic environments. Additionally, due to worldwide economic uncertainty, the availability and cost of funds for production and other expenses have become increasingly difficult, if not impossible, to project. These changes and events may materially affect our financial performance.

A productive well may become uneconomic or unmarketable in the event water or other deleterious substances are encountered which impair or prevent the production of oil and/or gas from the well. The marketability of oil and gas that we may acquire or discover could be affected

by numerous factors beyond the Company's control. These factors include the proximity and capacity of pipelines and processing equipment, market fluctuations of prices, taxes, royalties, land tenure, allowable production, adverse weather conditions and environmental protection. The extent of these factors cannot be accurately predicted and the combination of these factors may result in our Company not receiving an adequate return on invested capital.

Canadian Government Regulation: The oil and natural gas industry is subject to extensive controls and regulations imposed by various levels of government. It is not expected that any of these controls or regulations will affect the operations of the Company in a manner materially different than they would affect other oil and gas companies of similar size.

- (a) Pricing and Marketing – Oil: In Canada, producers of oil negotiate sales contracts directly with oil purchasers, with the result that the market determines the price of oil. The price depends in part on oil quality, prices of competing fuels, distance to market, the value of refined products and the supply/demand balance. Oil exports may be made pursuant to export contracts with terms not exceeding one (1) year in the case of light crude, and not exceeding two (2) years in the case of heavy crude, provided that an order approving any such export has been obtained from the National Energy Board (“NEB”). Any oil export to be made pursuant to a contract of longer duration (to a maximum of twenty-five (25) years) requires an exporter to obtain an export license from the NEB and the issue of such a license requires the approval of the Governor in Council.
- (b) Pricing and Marketing – Natural Gas: In Canada, the price of natural gas sold in interprovincial and international trade is determined by negotiation between buyers and sellers. Natural gas exported from Canada is subject to regulation by the NEB and the Government of Canada. Exporters are free to negotiate prices and other terms with purchasers, provided that the export contracts continue to meet certain criteria prescribed by the NEB and the Government of Canada. Natural gas exports for a term of less than two (2) years or for a term of two (2) to twenty (20) years (in quantities of not more than 30,000 m<sup>3</sup>/day) must be made pursuant to an NEB order. Any natural gas export to be made pursuant to a contract of longer duration (to a maximum of twenty-five (25) years) or a larger quantity requires an exporter to obtain an export license from the NEB and the issue of such a license requires the approval of the Governor in Council.

The governments of Alberta, British Columbia and Saskatchewan also regulate the volume of natural gas which may be removed from those provinces for consumption elsewhere based on such factors as reserve availability, transportation arrangements and market considerations.

- (c) The North American Free Trade Agreement (“NAFTA”): On January 1, 1994, NAFTA became effective among the governments of Canada, the United States of America and Mexico. NAFTA carries forward most of the material energy terms contained in the Canada-U.S. Free Trade Agreement. In the context of energy resources, Canada continues to remain free to determine whether exports to the United States of America or Mexico will be allowed provided that any export restrictions do not: (i) reduce the proportion of energy resource exported relative to domestic use (based upon the proportion prevailing in the most recent 36-month period); (ii) impose an export price higher than the domestic price; and (iii) disrupt normal channels of supply. All three countries are prohibited from imposing minimum export or import price requirements. NAFTA contemplates the reduction of Mexican restrictive trade practices in the energy sector and prohibits discriminatory border restrictions and export taxes. NAFTA also contemplates clearer disciplines on regulators to ensure fair implementation of any regulatory changes and to minimize disruption of contractual arrangements, which is important for Canadian natural gas exports.
- (d) Royalties and Incentives: In addition to federal regulation, each province has legislation and regulations which govern land tenure, royalties, production rates, environmental

protection and other matters. The royalty regime is a significant factor in the profitability of oil and natural gas production. Royalties payable on production from lands other than Crown lands are determined by negotiations between the mineral owner and the lessee. Crown royalties are determined by government regulation and are generally calculated as a percentage of the value of the gross production, and the rate of royalties payable generally depends in part on prescribed reference prices, well productivity, geographical location, field discovery date and the type or quality of the petroleum product produced. From time-to-time, the governments of Canada, Alberta, British Columbia and Saskatchewan have established incentive programs which have included royalty rate reductions, royalty holidays and tax credits for the purpose of encouraging oil and natural gas exploration or enhanced planning projects. The Alberta government has also introduced a Third Tier Royalty with a base rate of 10% and a rate cap of 25% for oil pools discovered after September 30, 1992. The new oil royalty reserved to the Crown has a base rate of 10% and a rate cap of 30%. The old oil royalty reserved to the Crown has a base rate of 10% and a rate cap of 35%.

In the Province of Alberta, the royalty reserved to the Crown in respect of natural gas production, subject to various incentives, is between 15% and 30%, in the case of new gas, and between 15% and 35%, in the case of old gas, depending upon a prescribed or corporate average reference price. Natural gas produced from qualifying exploratory gas wells spudded or deepened after July 31, 1985 and before June 1, 1988 is eligible for a royalty exemption for a period of 12 months, up to a prescribed maximum amount. Natural gas produced from qualifying intervals in eligible gas wells spudded or deepened to a depth below 2,500 meters is also subject to a royalty exemption, the amount of which depends on the depth of the well.

On October 25, 2007, the Alberta government issued "The New Royalty Framework" report summarizing the upcoming changes to the Alberta Royalty Program. The government has indicated that all changes to the royalty structure are to take effect January 1, 2009. The Company will be assessing the full impact of these royalty changes on its operations and will provide additional details when available.

In Alberta, a producer of oil or natural gas is entitled to a credit on qualified oil and gas production against the royalties payable to the Crown by virtue of the Alberta Royalty Tax Credit ("**ARTC**") program. The ARTC program is based on a price-sensitive formula, and the ARTC rate varies between 75%, at prices for oil below \$100 per m<sup>3</sup> and 25%, at prices above \$210 per m<sup>3</sup>. The ARTC rate is applied to a maximum of C\$2,000,000 of Alberta Crown royalties payable for each producer or associated group of producers. Crown royalties on production from producing properties acquired from corporations claiming maximum entitlement to ARTC will generally not be eligible for ARTC. The rate is established quarterly based on the average "par price", as determined by the Alberta Department of Energy for the previous quarterly period.

Producers of oil and natural gas in the province of British Columbia are also required to pay annual rental payments in respect of Crown leases and royalties and freehold production taxes in respect of oil and gas produced from Crown and freehold lands, respectively. The amount payable as a royalty in respect of oil depends on the vintage of the oil (whether it was produced from a pool discovered before or after October 31, 1975), the quantity of oil produced in a month and the value of the oil. Oil produced from newly discovered pools may be exempt from the payment of a royalty for the first 36 months of production. The royalty payable on natural gas is determined by a sliding scale based on a reference price which is the greater of the amount obtained by the producer and a prescribed minimum price. Gas produced in association with oil has a minimum royalty of 8% while the royalty in respect of other gas may not be less than 15%.

Oil and natural gas royalty holidays and reductions for specific wells reduce the amount of Crown royalties paid by the Company to the provincial governments. In Alberta, the ARTC program provides a rebate on Alberta Crown royalties paid in respect of eligible producing properties. Both of these incentives have the effect of increasing the net income of the Company.

- (e) Land Tenure: Crude oil and natural gas located in the western provinces is owned predominantly by the respective provincial governments. Provincial governments grant rights to explore for and produce oil and natural gas pursuant to leases, licenses and permits for varying terms from two years and on conditions set forth in provincial legislation including requirements to perform specific work or make payments. Oil and natural gas located in such provinces can also be privately owned and rights to explore for and produce such oil and natural gas are granted by lease on such terms and conditions as may be negotiated.

The Company obtained a title report with respect to the Wainwright Property. Title reports are not title insurance and do not act as a guarantee of title. The Wainwright Property may be subject to prior unregistered agreements, native land claims or transfers which have not been recorded or detected through title research or which have been asserted since the date the research was completed.

- (f) Canadian Environmental Regulation: The oil and natural gas industry is currently subject to environmental regulation pursuant to provincial and federal legislation. Environmental legislation provides for restrictions and prohibitions on releases or emissions of various substances produced or utilized in association with certain oil and gas industry operations. In addition, legislation requires that well and facility sites are abandoned and reclaimed to the satisfaction of provincial authorities. A breach of such legislation may result in the imposition of fines and penalties.

In Alberta, environmental compliance has been governed by the Alberta Environmental Protection and Enhancement Act ("AEPEA") since September 1, 1993. In addition to replacing a variety of older statutes which related to environmental matters, the AEPEA also imposes certain new environmental responsibilities on oil and natural gas operators in Alberta and in certain instances also imposes greater penalties for violations.

Risk of Foreign Operations: Some of the Company's oil and gas operations and assets are located in the United States. As a result, they are subject to political, economic and other uncertainties for reasons that include:

- (a) changes in energy policies or the personnel administering them;
- (b) expropriation of property without fair compensation;
- (c) cancellation or modification of contract rights;
- (d) foreign exchange restrictions;
- (e) currency fluctuations;
- (f) royalty and tax increases and other risks arising out of foreign governmental sovereignty over the areas in which the Company's operations are conducted; and
- (g) risks of loss due to civil strife and acts of war.

The Company's international operations may also be adversely affected by laws and policies of Canada affecting foreign trade, taxation and investment. In the event of a dispute arising in connection with the Company's foreign operations, the Company may be subject to the exclusive jurisdiction of foreign courts or, in the alternative, may not be successful in subjecting foreign persons to the jurisdiction of courts in Canada or enforcing Canadian judgments in such other jurisdictions. The Company may also be hindered or prevented from enforcing its rights with respect to a governmental instrumentality because of the doctrine of sovereign immunity. In addition, the Company's existing interests in the United States were acquired pursuant to, and the Company's operations are governed by, a number of legal and contractual relationships. The

effectiveness of, and enforcement of these contracts and relationships with parties in these jurisdictions cannot be assured. Consequently, the Company's future foreign exploration, development and production activities could be substantially affected by factors beyond the Company's control, any of which could have a materially adverse effect on the Company and the Company's business.

*Future Sales of Common Shares by Existing Shareholders:* Sales of a large number of common shares in the public markets, or the potential for such sales, could decrease the trading price of the common shares and could impair the Company's ability to raise capital through future sales of common shares. Accordingly, certain shareholders of the Company have an investment profit in the common shares that they may seek to liquidate.

*Management:* The success of the Company is currently largely dependent on the performance of its directors and officers. The loss of services of any of these persons could have a materially adverse effect on the Company's business and prospects. There is no assurance the Company can maintain the services of its directors, officers or other qualified personnel required to operate its business.

*Conflicts of Interest:* Some of the directors and officers are engaged and will continue to be engaged in the search for additional business opportunities on behalf of other corporations, and situations may arise where these directors and officers will be in direct competition with the Company. Conflicts, if any, will be dealt with in accordance with the relevant provisions of the British Columbia *Business Corporations Act*. Some of the directors and officers of the Company are or may become directors or officers of other companies engaged in other business ventures. In order to avoid the possible conflict of interest which may arise between the directors' duties to the Company and their duties to the other companies on whose boards they serve, the directors and officers of the Company have agreed to the following:

1. participation in other business ventures offered to the directors will be allocated between the various companies and on the basis of prudent business judgment and the relative financial abilities and needs of the companies to participate;
2. no commissions or other extraordinary consideration will be paid to such directors and officers; and
3. business opportunities formulated by or through other companies in which the directors and officers are involved will not be offered to the Company except on the same or better terms than the basis on which they are offered to third party participants.

*Financial Considerations:* The Company's decision as to whether its properties contain commercial oil and gas deposits and whether these should be brought into production will require substantial funds and depend upon the results of exploration programs, feasibility studies and the recommendations of duly qualified engineers, geologists, or both. This decision will involve consideration and evaluation of several significant factors including but not limited to: (1) costs of bringing a property into production, including exploration and development work, preparation of production feasibility studies, and construction of production facilities; (2) availability and costs of financing; (3) ongoing costs of production; (4) market prices for the oil and gas to be produced; (5) environmental compliance regulations and restraints; and (6) political climate, governmental regulation and control. Many of the factors taken into consideration are beyond the Company's control and may have a material effect on the outcome of our decision.

*Need to Manage Growth:* The Company could experience rapid growth in production, revenues, personnel, complexity of administration and in other areas. There can be no assurance that the Company will be able to manage the impact that future growth could place on its administrative infrastructure, systems, and controls. If the Company is unable to manage future growth effectively, its business, operating results and financial condition may be materially and adversely affected.

*Competitiveness of the Oil and Gas Industry:* We will actively compete for reserve acquisitions, exploration leases, licenses and concessions and skilled industry personnel with a substantial number of other oil and gas companies, many of which have significantly greater technical, financial and operational resources and personnel. Our competitors include major integrated oil and natural gas companies and numerous other independent oil and natural gas companies and individual producers and operators.

The oil and gas industry is highly competitive. Our competitors for the acquisition, exploration, production and development of oil and natural gas properties, and for capital to finance such activities, include companies that have greater financial and personnel resources available to them than our Company.

Certain of our natural gas customers and potential customers may themselves be exploring for oil and natural gas, and the results of these exploration efforts could affect our ability to sell or supply oil and gas to these customers in the future. Our ability to successfully bid on and acquire additional property rights, to discover reserves, to participate in drilling opportunities and to identify and enter into commercial arrangements with customers will be dependant upon developing and maintaining close working relationships with our industry partners and joint operators and our ability to select and evaluate suitable properties and to consummate transactions in a highly competitive environment.

*Fluctuating Price and Demand:* The marketability of natural resources that we may acquire or discover may be affected by numerous factors beyond our control. These factors include market fluctuations in oil and gas pricing and demand, the proximity and capacity of natural resource markets and processing equipment, governmental regulations, land tenure, land use, regulation concerning the importing and exporting of oil and natural gas and environmental protection regulations. The impact of these factors cannot be accurately predicted, but the combination of these factors could have an adverse impact on our business.

*Comprehensive Regulation of the Oil and Gas Industry:* Our operations are subject to federal, state, and local laws relating to the protection of the environment, including laws regulating removal of natural resources from the ground and the discharge of materials into the environment. Our operations are also subject to federal, state, and local laws and regulations that seek to maintain health and safety standards by regulating the design and use of drilling methods and equipment. Various permits from government bodies are required for drilling operations to be conducted; no assurance can be given that such permits will be received. We can give no assurance that environmental standards imposed by federal, state or local authorities will not be changed or that any such changes would not have materially adverse effects on our activities. Moreover, compliance with such laws may cause substantial delays or require capital outlays in excess of those anticipated, thus causing an adverse effect on our business and our Company. Additionally, we may be subject to liability for pollution or other environmental damages, which we may elect not to insure against due to prohibitive premium costs and other reasons.

*Environmental Regulations:* In general, our exploration and production activities are subject to certain federal, state and local laws and regulations relating to environmental quality and pollution control. These laws and regulations increase the costs of these activities and may prevent or delay the commencement or continuance of a given operation. Specifically, we are subject to legislation regarding emissions into the environment, water discharges and storage and disposition of hazardous wastes. In addition, legislation has been enacted which requires well and facility sites to be abandoned and reclaimed to the satisfaction of state authorities. However, such laws and regulations are frequently changed and we are unable to predict the ultimate cost of compliance. Our operating partners maintain insurance coverage customary to the industry; however, we are not fully insured against all environmental risks.

*Government Regulation/Administrative Practice:* There is no assurance that the laws, regulations, policies or current administrative practices of any government body, organization or

regulatory agency in the United States or any other applicable jurisdiction will not be changed, applied or interpreted in a manner which will fundamentally alter our ability to develop, operate, export or market our products. The actions, policies or regulations, or changes thereto, of any government body or regulatory agency, or other special interest groups, may have a detrimental effect on our Company. Any or all of these situations may have a negative impact on our ability to operate and make a profit.

### **Uncertainty of Estimates of Reserves**

Under applicable regulatory requirements, we will be required to identify and disclose as proved oil and gas reserves, estimated quantities of crude oil, natural gas and natural gas liquids. This geological and engineering data demonstrates with reasonable certainty the estimated quantities of crude oil, natural gas and natural gas liquids, which will be recoverable in future years from known reservoirs under existing economic and operating conditions. However, the process of estimating oil and gas reserves is complex, requiring significant decisions and assumptions in the evaluation of available geological, geophysical, engineering and economic data for each reservoir, and as a result, such estimates are inherently imprecise. Actual future production, oil and gas prices, revenues, taxes, development expenditures, operating expenses and quantities of recoverable oil and gas reserves may vary substantially from our estimations from year to year. Any significant variance in the assumptions could materially affect the estimated quantities and present values of reserves. For example, a material drop in oil and gas prices, or a material increase in applicable taxes, will require management to reassess whether known reservoirs can continue to be reasonably judged as economically productive from one year to the next. In addition, the reserves may be subject to downward or upward revisions based upon production history, results of future exploration and development, prevailing oil and gas prices and other factors, many of which are beyond our Company's control. Actual production, revenues, taxes, development expenditures and operating expenses with respect to the reserves will likely vary from the estimates presented herein, and such variances may be material.

### **Declining Reserves**

In general, production rates from oil and gas properties decline as reserves are depleted. The decline rates depend on reservoir characteristics and vary from steep declines to the relatively slow declines characteristic of long-lived fields in other regions. Should one or more of the above risks materialize or should Bucking Horse's underlying assumptions prove incorrect, Bucking Horse's actual results may materially differ from Bucking Horse's current expectations. Therefore in evaluating forward-looking statements, readers should specifically consider the various factors that could cause the Company's actual results to materially differ from such forward-looking statements.

### **Reserves Data and Other Oil and Gas Information**

Our independently prepared reserves assessment and evaluation of oil and gas properties effective August 31, 2008 have been prepared in accordance with mandated National Instrument 51-101 Standards of Disclosure for Oil and Gas Activities of Canadian Securities Administrators. A summary of our reports is available on SEDAR at [www.sedar.com](http://www.sedar.com).

### **Outstanding Share Data**

Bucking Horse is a publicly traded company and our common shares were listed for trading on the TSX under the symbol BUC.

As of August 31, 2008 and the date of this MD&A, the Company has the following securities outstanding:

Class of Shares	Par Value	Number Authorized	Number Issued
Common	Nil	Unlimited	23,061,713

Security Type	Number Outstanding	Exercise/Conversion Price	Conversion/Expiry Date
Convertible Debenture <sup>(1)</sup>	2 <sup>(1)</sup>	C\$4.875 per unit <sup>(1)</sup>	N/A
Convertible Debenture <sup>(2)</sup>	2 <sup>(2)</sup>	C\$4.000 per unit <sup>(2)</sup>	N/A
Convertible Debenture <sup>(3)</sup>	2 <sup>(3)</sup>	C\$4.875 per unit <sup>(3)</sup>	N/A

<sup>(1)</sup> On March 4, 2008, two convertible debentures (the "**First Debentures**") were issued by the Company, one to each of the Debenture Lenders. Each of the First Debentures is in the principal amount of \$8,940,335 (C\$9,500,000), has a term of ten years, earns interest at a rate of 10% during the first six years and 15% during the last four years and is convertible into units during the first five years at a conversion price of C\$4.875 per unit. Each unit consists of one common share of the Company and one share purchase warrant. Each share purchase warrant entitles the holder to purchase one additional common share of the Company for C\$4.875 until the fifth anniversary of the date of issuance, at which date these share purchase warrants will expire. Effective May 16, 2008, as a result of an interest rate acceleration provision, the interest rate applicable to the First Debentures increased from 10% to 15%.

<sup>(2)</sup> On March 4, 2008, two additional convertible debentures (the "**Second Debentures**") were issued by the Company, one to each of the Debenture Lenders. The Second Debentures have the same terms as the August Debentures held by Gemini prior to the closing of the Arrangement, except that they will be convertible into units of the Company rather than Gemini. Each of the Second Debentures is in the principal amount of \$4,705,439 (C\$5,000,000), has a term of ten years from the Gemini date of issue being August 4, 2004 and carries interest. Interest is payable monthly at a rate of 10% per annum for the first six years of the term and at a rate of 15% during the last four years. All or any portion of the amount outstanding under these Second Debentures from time-to-time is convertible into units at the option of the holder at a price of C \$4.00 per unit. Upon conversion, each unit consists of one common share in the capital of the Company and one non-transferable share purchase warrant. Each of these share purchase warrants entitles the holder to purchase one additional common share of the Company at a price of C\$4.00 until the fifth anniversary of the Gemini date of issue, at which time these share purchase warrants, if issued, will expire. Effective May 16, 2008, as a result of an interest rate acceleration provision, the interest rate applicable to the Second Debentures increased from 10% to 15%.

<sup>(3)</sup> On March 4, 2008, two more convertible debentures (the "**Third Debentures**") were issued by the Company, one to each of the Debenture Lenders. Each of the Third Debentures is in the principal amount of \$9,410,879 (C\$10,000,000), has a term of ten years, earns interest at a rate of 10% during the first six years and 15% during the last four years and is convertible into units of the Company during the first five years at a conversion price of C\$4.875 per unit. Each unit consists of one common share of the Company and one share purchase warrant. Each share purchase warrant entitles the holder to purchase one additional common share of the Company for C\$4.875 until the fifth anniversary of the closing date, at which date the share purchase warrants will expire. Effective May 16, 2008, as a result of an interest rate acceleration provision, the interest rate applicable to the Third Debentures increased from 10% to 15%.

There are no common shares held in escrow and no common shares are subject to pooling.

## **Additional Information**

### Disclosure Controls and Procedures:

The Company's Chief Executive Officer and Chief Financial Officer (the "**Responsible Officers**") are responsible for establishing and maintaining disclosure controls and procedures for the Company, designed to provide reasonable assurance that material information relating to the Company and its subsidiary is made known to the Responsible Officers by others within the organization, particularly during the period in which the Company's quarterly and year-end financial statements and MD&A are being prepared. The Responsible Officers have evaluated the effectiveness of the Company's disclosure controls and procedures as defined in Multilateral Instrument 52-109 as at August 31, 2008. Based on this evaluation, except for the control weakness described below, they have concluded that such controls and procedures are effective in conveying the required information to the Responsible Officers, particularly in light of the Company's size, structure and stage of development. Management is currently in the process of formalizing the disclosure controls and procedures. These controls and procedures, no matter how well conceived or operated, can provide only reasonable, not absolute assurance, that the objectives are met.

The Company identified a material weakness in its internal control over financial reporting as at August 31, 2008 in respect of the purchase accounting for the Gemini acquisition. The Company has limited accounting personnel with experience in complex purchase accounting under Canadian generally accepted accounting principles, including determination of the purchase consideration, fair value measurements, and future income tax amounts arising as a result of the transaction, to provide for adequate segregation of duties between the preparation of the purchase price allocation with adequate independent review and authorization. This material weakness affects the amounts allocated to the assets acquired and liabilities assumed in the Gemini acquisition and related note disclosures. The Company will remediate this material weakness in internal control in respect of future acquisitions by outsourcing certain aspects of the purchase price accounting to external accounting experts, including determination of fair values and future income tax considerations.

### Internal Controls Over Financial Reporting:

The Company's Responsible Officers are responsible for establishing and maintaining internal controls and procedures for the Company, designed to provide reasonable assurance that material information relating to the Company and its subsidiary is made known to the Responsible Officers by others within the organization, particularly during the period in which the Company's quarterly and year-end financial statements and MD&A are being prepared. The Responsible Officers have evaluated the effectiveness of the Company's internal controls and procedures as defined in Multilateral Instrument 52-109 as at August 31, 2008. Based on this evaluation, except for the control weakness described above, they have concluded that such controls and procedures are effective in conveying the required information to the Responsible Officers, particularly in light of the Company's size, structure and stage of development. Management is currently in the process of formalizing the internal controls and procedures. These internal controls and procedures, no matter how well conceived or operated, can provide only reasonable, not absolute assurance, that the objectives are met. Management is aware that in-house expertise to deal with complex taxation, accounting and reporting issues may not be sufficient. The Company utilizes outside assistance and advice on complex financial, taxation and reporting issues, which is common with companies of a similar size. We have assessed the design of our internal control over financial reporting and during this process we identified potential weaknesses in internal controls over financial reporting which are as follows:

- Due to the limited number of staff at the Company it is not feasible to achieve complete segregation of incompatible duties. The Company has mitigated this weakness in controls by adding management review procedures over the areas where segregation is an issue.
- The Company does not retain staff with specialized and current income tax, financial reporting and complex accounting expertise. The Company reports current and future

income tax expenses and liabilities and other complex accounting calculations based on management's estimates and relies on reviews by management, external consultants and audit committee for quality assurance.

There have been no significant changes to the internal controls in this quarter. As a result of our assessment of the design of our internal control over financial reporting, we conclude that there is only a remote likelihood that a material misstatement would not be prevented or detected. Management and the board of directors work to mitigate the risk of a material misstatement in financial reporting, however, there can be no assurance that this risk can be reduced to less than a remote likelihood of a material misstatement.

Additional information relating to our Company, including periodic quarterly and audited financial reports are available on SEDAR at [www.sedar.com](http://www.sedar.com). We also maintain a website at [www.buckinghorseenergy.com](http://www.buckinghorseenergy.com). Information can also be obtained by contacting the Company by mail at #1100 – 609 West Hastings Street, Vancouver, British Columbia, V6B 4W4 or by telephone at (604) 331-3398.