

Consolidated Financial Statements  
(Expressed in United States dollars)

## **BUCKING HORSE ENERGY INC.**

For the year ended December 31, 2009, four months ended December 31,  
2008 and year ended August 31, 2008



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## AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the consolidated balance sheets of Bucking Horse Energy Inc. as at December 31, 2009 and 2008 and August 31, 2008 and the consolidated statements of operations and retained earnings (deficit), comprehensive loss, accumulated other comprehensive loss and cash flows for the year ended December 31, 2009, the four months ended December 31, 2008 and the year ended August 31, 2008. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2009 and 2008 and August 31, 2008 and the results of its operations and its cash flows for the year ended December 31, 2009, the four months ended December 31, 2008 and the year ended August 31, 2008 in accordance with Canadian generally accepted accounting principles.

Chartered Accountants

Vancouver, Canada

March 31, 2010

# BUCKING HORSE ENERGY INC.

## CONSOLIDATED BALANCE SHEETS

(Expressed in United States dollars)

	As at December 31 2009	As at December 31 2008	As at August 31 2008
<b>Assets</b>			
Current assets			
Cash and cash equivalents	\$ 6,751,735	\$ 8,867,314	\$ 5,391,123
Accounts receivable	2,631,371	2,385,081	2,388,437
Promissory note (notes 4 and 13)	79,924	3,734,738	4,090,058
Prepaid expenses	141,483	148	37,813
Derivative instruments (note 5(b))	2,130,604	4,333,497	2,927,776
Income taxes receivable	243,106	2,780,956	1,294,877
	11,978,223	22,101,734	16,130,084
Investments (note 6)	44,452	274,213	244,103
Long term prepaid note	—	—	300,000
Oil and natural gas properties (note 7)	161,555,453	148,295,535	160,578,150
	\$ 173,578,128	\$ 170,671,482	\$ 177,252,337
<b>Liabilities and Shareholders' Equity</b>			
Current liabilities			
Accounts payable and accrued liabilities	1,656,228	4,193,096	1,081,911
State resource taxes payable	902,112	978,826	647,698
Income taxes payable (note 14)	430,200	—	—
	2,988,540	5,171,922	1,729,609
Non-current liabilities			
Long-term credit facility (note 8)	18,500,000	18,500,000	13,500,000
State resource taxes payable	267,868	581,774	903,831
Convertible debentures (note 9)	25,101,563	20,588,752	23,273,493
Asset retirement obligation (note 10)	90,557	69,176	44,066
Future income taxes (note 14)	53,689,493	48,892,325	54,374,732
	100,638,021	93,803,949	93,825,731
<b>SHAREHOLDERS' EQUITY</b>			
Share capital (note 12)	61,374,762	61,648,395	61,831,100
Equity portion of debentures payable (note 9)	25,329,139	25,329,139	25,329,139
Issuer bid purchase	(22,627)	—	(122,382)
Accumulated other comprehensive income	(3,528,458)	(11,239,809)	(3,203,146)
Retained earnings (deficit)	(10,212,709)	1,129,808	(408,105)
	72,940,107	76,867,533	83,426,606
	\$ 173,578,128	\$ 170,671,482	\$ 177,252,337

Approved on behalf of the Board:

*"Gordon Nielsen"*

Director

*"Michael Schoen"*

Director

See accompanying notes to consolidated financial statements.

# BUCKING HORSE ENERGY INC.

## CONSOLIDATED STATEMENTS OF OPERATIONS AND RETAINED EARNINGS (DEFICIT)

(Expressed in United States dollars)

	Year ended December 31 2009	Four months ended December 31 2008	Year ended August 31 2008
Revenue:			
Oil and natural gas revenue	\$ 12,609,517	\$ 4,085,774	\$ 15,693,354
Direct expenses:			
Depletion, depreciation and accretion	6,438,722	1,828,947	4,248,956
State resource taxes	1,096,087	348,261	1,651,499
Royalties	10,201	33,180	106,450
Operating expenses	5,378,584	1,690,815	2,845,718
	12,923,594	3,901,203	8,852,623
Net operating (loss) income	(314,077)	184,571	6,840,731
Other expenses (income):			
Interest income and other	(22,997)	(191,471)	(388,520)
Interest expense	6,926,668	2,349,097	3,648,260
Promissory note write-down (notes 4 and 13)	3,909,729	—	—
Financing fees	25,000	—	325,000
Accretion expense on debentures (note 9)	1,142,419	295,681	929,215
General and administration	682,907	396,895	901,529
Professional fees	928,598	412,767	685,870
Foreign exchange (gain) loss	(353,592)	(196,559)	173,751
Unrealized loss (gain) on derivative instruments (note 5(b))	2,202,893	(1,405,721)	(2,927,776)
Realized (gain) loss on derivative instruments (note 5(b))	(6,969,194)	(2,315,180)	88,040
Property write-down (note 7)	1,588,951	—	—
Loss on investments (note 6)	219,410	7,520	474,265
	10,280,792	(646,971)	3,909,634
(Loss) earnings before income taxes	(10,594,869)	831,542	2,931,097
Income tax expense (recovery) (note 14):			
Current	1,303,562	(286,958)	1,150,315
Future	(568,761)	(480,974)	1,625,957
	734,801	(767,932)	2,776,272
Net (loss) earnings for the period	(11,329,670)	1,599,474	154,825
Retained earnings (deficit), beginning of year	1,129,808	(408,105)	(346,172)
Excess on cancellation of issued common shares	(12,847)	(61,561)	(216,758)
(Deficit) retained earnings, end of period	\$ (10,212,709)	\$ 1,129,808	\$ (408,105)
Net (loss) earnings per common share (note 11)			
Basic	\$ (0.49)	\$ 0.07	\$ 0.01
Diluted	\$ (0.49)	\$ 0.07	\$ 0.01
Weighted average number of shares outstanding	22,990,598	23,011,045	15,567,746

See accompanying notes to consolidated financial statements.

# BUCKING HORSE ENERGY INC.

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(Expressed in United States dollars)

	Year ended December 31 2009	Four months ended December 31 2008	Year ended August 31 2008
Net (loss) earnings for the period	\$ (11,329,670)	\$ 1,599,474	\$ 154,825
Unrealized loss on available for sale investments, net of tax of \$4,366 (December 31, 2008 - \$23,761; August 31, 2008 - \$65,277)	(30,560)	(159,014)	(355,867)
Realized loss on available for sale investments, net of tax of \$65,277	—	—	355,867
Net unrealized gains and losses on translating financial statements into reporting currency	7,741,911	(7,877,649)	(3,299,228)
<b>Comprehensive loss for the period</b>	<b>\$ (3,618,319)</b>	<b>\$ (6,437,189)</b>	<b>\$ (3,144,403)</b>

## CONSOLIDATED STATEMENTS OF ACCUMULATED OTHER COMPREHENSIVE LOSS

(Expressed in United States dollars)

	Year ended December 31 2009	Four months ended December 31 2008	Year ended August 31 2008
Accumulated other comprehensive loss, beginning of year	\$ (11,239,809)	\$ (3,203,146)	\$ -
Opening unrealized gains and losses on translating financial statements into reporting currency	—	—	96,082
Net unrealized gains and losses on translating financial statements into reporting currency	7,741,911	(7,877,649)	(3,299,228)
Unrealized loss on available for sale investments, net of tax	(30,560)	(159,014)	—
<b>Accumulated other comprehensive loss, end of period</b>	<b>\$ (3,528,458)</b>	<b>\$ (11,239,809)</b>	<b>\$ (3,203,146)</b>

See accompanying notes to consolidated financial statements.

**BUCKING HORSE ENERGY INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(Expressed in United States dollars)

	Year ended December 31 2009	Four months ended December 31 2008	Year ended August 31 2008
<b>Cash and cash equivalents provided by (used in):</b>			
<b>Operations:</b>			
Net earnings for the period	\$ (11,329,670)	\$ 1,599,474	\$ 154,825
Items not involving cash:			
Depletion, depreciation and accretion	6,438,722	1,828,947	4,248,956
Accretion expense on debentures	1,142,419	295,681	929,215
Future income taxes	(568,761)	(480,974)	1,625,957
Loss on investments (note 6)	219,410	7,520	474,265
Unrealized loss (gain) on derivative instruments (note 5(b))	2,202,893	(1,405,721)	(2,927,776)
Foreign exchange (gain) loss	(353,592)	(155,021)	(274,799)
Non-cash interest	441,078	(172,976)	(289,853)
Write down of promissory note	3,468,651	—	—
Write down of petroleum and natural gas interests	1,588,951	—	—
Changes in non-cash working capital:			
Accounts receivable	122,116	(313,071)	853,778
Prepaid expenses	(130,051)	305,996	(334,433)
Income taxes receivable	2,742,294	(1,715,367)	103,917
Income taxes payable	395,920	—	—
Accounts payable and accrued liabilities	(2,947,896)	3,375,310	(3,840,417)
State resource taxes payable	(587,707)	215,058	925,162
	<b>2,844,777</b>	<b>3,384,856</b>	<b>1,648,797</b>
<b>Investments:</b>			
Oil and natural gas property expenditures	(5,181,302)	(4,576,777)	(1,501,379)
Acquisition of Gemini Energy Corp (note 4)	—	—	(19,172,431)
Proceeds on sale of investment	—	—	397,659
Acquisition of investments	—	(254,085)	(235,272)
	<b>(5,181,302)</b>	<b>(4,830,862)</b>	<b>(20,511,423)</b>
<b>Financing:</b>			
Long-term credit facility	—	5,000,000	13,500,000
Issuance of convertible debenture (note 4)	—	—	1,707,307
Issuance of common shares (note 12(b))	—	—	8,094,709
Issuer bid purchase and shares returned to treasury	(310,610)	(121,884)	(339,140)
	<b>(310,610)</b>	<b>4,878,116</b>	<b>22,962,876</b>
Effect of foreign currency translation on cash and cash equivalents	531,556	44,081	557,608
(Decrease) / increase in cash and cash equivalents	(2,115,579)	3,476,191	4,657,858
Cash and cash equivalents, beginning of period	8,867,314	5,391,123	733,265
Cash and cash equivalents, end of period	<b>\$ 6,751,735</b>	<b>\$ 8,867,314</b>	<b>\$ 5,391,123</b>

See accompanying notes to interim consolidated financial statements.

# BUCKING HORSE ENERGY INC.

Notes to Consolidated Financial Statements  
(Expressed in United States dollars, unless otherwise noted)

For the year ended December 31, 2009, four months ended December 31, 2008 and year ended August 31, 2008

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## 1. Nature of operations:

NRG Investments Inc. was incorporated under the laws of British Columbia, Canada on April 28, 2006. Effective March 4, 2008 the Company changed its name to Bucking Horse Energy Inc. (the Company or Bucking Horse) and acquired two additional wholly-owned subsidiaries, Gemini Energy Corp. (Gemini) and its subsidiary, Arrowhead Resources (U.S.A.) Ltd. (Arrowhead), through the purchase of 100% of the issued and outstanding shares of Gemini (note 4).

The Company's principal business activity is the exploration, development and production of petroleum and natural gas reserves located in Canada and the United States of America.

An assumption underlying the preparation of financial statements in accordance with Canadian generally accepted accounting principles is that the Company will be able to realize assets and discharge liabilities in the normal course of business. Accordingly, it is management's opinion that the going concern assumption is appropriate and all assets and liabilities have been valued accordingly.

## 2. Change in reporting currency:

Effective March 4, 2008, the Company changed its reporting currency to the US dollar (US\$). 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 interests 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 (C\$). 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*.

## 3. Significant accounting policies:

### (a) Basis of consolidation:

The consolidated financial statements of the Company have been prepared in accordance with Canadian generally accepted accounting principles. The consolidated financial statements of the Company include its wholly-owned subsidiaries NRG Holdings Corp., incorporated in the State of Nevada, N Holdings Inc., incorporated in the State of Washington and Gemini, incorporated in the Province of British Columbia and its wholly-owned subsidiary, Arrowhead, incorporated in the State of South Dakota. All inter-company transactions and balances have been eliminated upon consolidation.

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Notes to Consolidated Financial Statements  
(Expressed in United States dollars, unless otherwise noted)

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### 3. Significant accounting policies (continued):

(b) Adoption of new accounting standards:

Effective January 1, 2009, the Company adopted the following new CICA accounting standards:

(i) Financial instruments:

The Company has adopted CICA Section 3862, *Financial Instruments – Disclosures*, which requires additional disclosures about fair value and liquidity risk. The amendments introduce a “fair value hierarchy” for disclosures which intends to provide information to financial statement users about the relative reliability of fair value measurements. These disclosures are included in note 5(a).

(ii) Credit risk and the fair value of financial assets and financial liabilities:

On January 20, 2009, the Emerging Issues Committee of the Canadian Accounting Standards Board (AcSB) issued EIC Abstract 173, *Credit Risk and Fair Value of Financial Assets and Financial Liabilities*, which establishes that an entity's own credit risk and the credit risk of the counterparty should be taken into account in determining the fair value of financial assets and financial liabilities, including derivative instruments. The Company takes into consideration such credit risks in determining the fair value of its financial assets and financial liabilities. This change did not have a material impact on the Company's financial statements in 2009.

(iii) Goodwill and intangible assets:

In February 2008, the CICA issued Section 3064, *Goodwill and Intangible Assets*, replacing Section 3062, *Goodwill and Other Intangible Assets*. The new section clarifies the requirements for recognizing intangible assets on costs that may only be deferred when they relate to an item that meets the definition of an asset. Section 3064 effectively converges Canadian generally accepted accounting principles (GAAP) for intangible assets with International Financial Reporting Standards (IFRS). This standard was effective for the Company for the first quarter of 2009. The adoption of this new section had no impact on the Company's financial statements.

(c) Cash and cash equivalents:

Cash and cash equivalents are classified as held-for-trading and include short-term money market instruments with terms of maturity, at the date of acquisition, not exceeding ninety days, that are readily convertible to known amounts of cash, and which are subject to an insignificant risk of change in value.

(d) Financial instruments:

(i) Financial instruments:

Financial assets and liabilities classified as held-for-trading are measured at fair value with realized and unrealized gains and losses recognized in net earnings. Financial assets classified as held-for-maturity, loans and receivables, and financial liabilities other than those classified as held-for-trading, are measured at amortized cost. Financial assets classified as available for sale are measured at fair value with unrealized gains or losses recognized in accumulated other comprehensive income until the asset is sold and the gain or loss realized. The purchase and sale of a financial asset, where the contract requires the asset to be delivered within an established time

# BUCKING HORSE ENERGY INC.

Notes to Consolidated Financial Statements  
(Expressed in United States dollars, unless otherwise noted)

For the year ended December 31, 2009, four months ended December 31, 2008 and year ended August 31, 2008

### 3. Significant accounting policies (continued):

#### (d) Financial instruments (continued):

##### (i) Financial instruments (continued):

frame, are recognized on a trade-date basis. Generally, all derivatives, including embedded derivatives that must be accounted for separately from their host contract, generally must be classified as held-for-trading and recorded at fair value in the consolidated balance sheet. Transaction costs for financial instruments classified as other than held-for-trading are expensed as incurred.

The Company classifies its financial instruments into categories as follows:

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Cash and cash equivalents	held for trading
Accounts receivable	loans and receivables
Promissory note	loans and receivables
Benefit under derivative financial instrument	held for trading
Investment in shares of a related entity	available for sale
Investment in warrants of a related entity	held for trading
Accounts payable and accrued expenses	other financial liabilities
Amounts payable to related parties	other financial liabilities
Convertible debentures	other financial liabilities
Bank indebtedness	other financial liabilities
Embedded derivatives	held for trading

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##### (ii) Embedded derivatives:

The Company has identified no embedded derivatives other than the conversion option in the convertible debentures (note 9) to be separately accounted for at December 31, 2009.

##### (iii) Derivative financial instruments:

The Company utilizes derivative financial instruments to manage interest rate and price risk. Derivative financial instruments are measured at fair value with gains and losses recorded in net earnings (loss) for the year.

#### (e) Investments:

Investments include investments in shares and warrants of companies as described in note 6. The Company's investments in shares of related entities are classified as available-for-sale and are measured at cost. The Company's investment in warrants of a related entity is classified as held-for-trading and is measured at fair value with gains and losses recorded through the statement of operations. The carrying values of the investments are regularly reviewed for possible other than temporary impairment. When there is a loss in value that is other than a temporary decline, the investment is written down to recognize the loss with the write down recorded as a charge to income.

# BUCKING HORSE ENERGY INC.

Notes to Consolidated Financial Statements

(Expressed in United States dollars, unless otherwise noted)

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### 3. Significant accounting policies (continued):

(f) Oil and natural gas properties:

The Company follows the full cost method of accounting for oil and natural gas operations whereby all costs associated with the acquisition, exploration for and development of oil and natural gas reserves are capitalized. Such costs include land acquisition costs, geological and geophysical expenses, carrying charges on non-producing properties, costs of drilling both productive and non-productive wells and overhead charges directly related to acquisition, exploration and development activities.

The capitalized costs, together with the costs of production equipment, are depleted and depreciated on the unit-of-production method based on the estimated gross proven reserves as determined by external experts. Oil and natural gas reserves and production are converted into equivalent barrels of oil based upon the estimated relative energy content.

Costs of acquiring and evaluating unproven properties are initially excluded from the costs subject to depletion and depreciation. These unproven properties are assessed periodically to ascertain whether or not proved reserves are attributable to the properties or impairment has occurred. When proved reserves are attributed to the unproven properties or the property is considered to be impaired, the cost of the property or the amount of the impairment is added to the costs subject to depletion and depreciation.

The Company evaluates the carrying amounts for impairment annually. The carrying value is not considered to be impaired when the sum of the undiscounted net cash flows expected from the production of proved reserves, less any impairment, of unproved properties and related major development projects exceeds the carrying amount of the cost centre (the ceiling test). When the carrying amount is not determined to be recoverable, an impairment loss is recognized to the extent that the carrying amount of the cost centre exceeds the sum of the discounted net cash flows expected from the production of proved and probable reserves, the cost, less any impairment of unproven properties and related major development projects. The cash flows are estimated using expected future product prices and costs based on best information available and are discounted at an interest rate of 10%.

Proceeds from the sale of oil and natural gas properties are applied against capitalized costs, with no gain or loss recognized, unless such a sale would significantly alter the rate of depletion and depreciation.

Substantially all of the Company's exploration, development and production activities are conducted jointly with others and accordingly these consolidated financial statements reflect only the Company's proportionate interest in such activities.

# BUCKING HORSE ENERGY INC.

Notes to Consolidated Financial Statements

(Expressed in United States dollars, unless otherwise noted)

For the year ended December 31, 2009, four months ended December 31, 2008 and year ended August 31, 2008

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### 3. Significant accounting policies (continued):

(g) Asset retirement obligations:

The Company uses the fair value method of recording the obligation associated with closure, reclamation and restoration of oil and natural gas properties and other asset retirement costs. The fair value of the liability for the Company's asset retirement obligation is recorded in the period in which it is incurred, discounted to its present value using the Company's credit-adjusted, risk-free interest rate and the corresponding amount is capitalized to the carrying amount of the related oil and natural gas properties. The liability amount is increased each reporting period due to the passage of time and the amount of this accretion is charged to earnings in the period. Revisions to the estimated timing of cash flows or to the original estimated undiscounted cost could also result in an increase or decrease to the obligation. Actual costs incurred upon settlement of the retirement obligation are charged against the obligation to the extent of the liability recorded.

(h) Revenue recognition:

Revenues from oil and natural gas operations are recognized when persuasive evidence of a sales agreement exists, the title and risk is transferred to the customer, collection is reasonably assured, and the price is reasonably determinable.

(i) Foreign currency translation:

The Company's functional currency is Canadian dollars and its reporting currency is U.S. dollars. Accordingly, the consolidated financial statements are translated into U.S. dollars using the current rate method.

The Company's investments in NRG Holdings Corp. and N Holdings Inc. are accounted for as integrated foreign operations and accordingly are translated into Canadian dollars using the temporal method. Under this method, monetary items denominated in foreign currencies are translated to Canadian dollars at the exchange rate in effect at the balance sheet date and non-monetary items are translated at the month end rate of exchange in effect when the assets were acquired or obligations incurred. Revenue and expense items are translated at the average exchange rate for the year. Foreign exchange gains and losses are included in net earnings (loss) for the year.

Arrowhead is accounted for as a self sustaining foreign operation and accordingly is translated into Canadian dollars in accordance with the current rate method. Assets and liabilities are translated at the exchange rates prevailing at the balance sheet dates, and revenue and expenses are translated on the basis of average exchange rates during the periods. Any recognized and unrecognized gains or losses arising from the translation of these accounts are recorded in accumulated other comprehensive income (loss). An applicable portion of gains and losses is transferred to net earnings when there is a reduction of the net investment.

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### 3. Significant accounting policies (continued):

(j) Stock-based compensation:

The Company has a stock option plan as described in note 12(b). The Company accounts for all stock-based payments using the fair value based method. Consideration paid on the exercise of stock options is recorded as share capital.

Under the fair value based method, stock-based payments to non-employees are measured at the fair value of the consideration received, or the fair value of the equity instruments issued, or liabilities incurred, whichever is more reliably measurable. The fair value of stock-based payments to non-employees is periodically re-measured until counterparty performance is complete, and any change therein is recognized over the period and in the same manner as if the Company had paid cash instead of paying with or using equity instruments. The cost of stock-based payments to non-employees that are fully vested and non-forfeitable at the grant date is measured and recognized at that date.

Under the fair value based method, compensation cost for grants to employees is measured at fair value at the grant date and recognized over the vesting period. For awards that vest at the end of the vesting period, compensation cost is recognized on a straight-line basis; for awards that vest on a graded basis, compensation cost is recognized on a pro-rata basis over the vesting period.

(k) Earnings per share:

Basic earnings per share are computed by dividing net earnings (loss) by the weighted average number of shares outstanding during the year. Diluted earnings per share are computed using the treasury stock method.

(l) Income taxes:

The Company uses the asset and liability method of accounting for income taxes. Under the asset and liability method, future tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Future tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. A valuation allowance is recorded against any future income tax asset if it is more likely than not that the asset will not be realized. The effect on future tax assets and liabilities of a change in tax rates is recognized in earnings in the same period the substantive enactment occurred.

(m) Use of estimates:

The preparation of financial statements requires 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 period. Significant areas requiring the use of estimates is the evaluation of impairment of oil and natural gas properties, valuation of financial instruments, determination of asset retirement obligation, valuation allowance applied against the future income taxes assets and rates for depreciation and depletion. Actual results could differ from those estimates.

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Notes to Consolidated Financial Statements  
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### 3. Significant accounting policies (continued):

(n) Comparative figures:

Certain of the Company's comparative figures have been reclassified to conform to the financial statement presentation adopted in the current year.

(o) Recent accounting pronouncements:

(i) Business combinations:

In January 2009, the CICA issued Section 1582, *Business Combinations*, which requires that all assets and liabilities of an acquired business be recorded at fair value at acquisition. Obligations for contingent considerations and contingencies will also be recorded at fair value at the acquisition date. The standard also states that acquisition-related costs will be expensed as incurred and that restructuring charges will be expensed in the periods after the acquisition date. The Section applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period on or after January 1, 2011. The Company has not yet adopted this standard.

(ii) Consolidations and non-controlling interest:

In January 2009, the CICA issued Section 1601, *Consolidations*, and Section 1602, *Non-Controlling Interests*. Section 1601 establishes standards for preparing consolidated financial statements and Section 1602 establishes standards for accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. These standards apply to interim and annual consolidated financial statements relating to fiscal years beginning on or after January 1, 2011. The Company has not yet adopted these standards.

(iii) International Financial Reporting Standards:

In 2006, the Canadian Accounting Standards Board (AcSB) published a new strategic plan that will significantly affect financial reporting requirements for Canadian companies. The AcSB strategic plan outlines the convergence of Canadian generally accepted accounting principles with IFRS over an expected five year transitional period. In February 2008, the AcSB announced that 2011 is the changeover date for publicly-listed companies to use IFRS, replacing Canada's own generally accepted accounting principles. The date is for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The first unaudited interim financial statements under IFRS will be for the quarter ending March 31, 2011, with comparative financial information for the quarter ending March 31, 2010. The first audited annual financial statements will be for the year ending December 31, 2011, with comparative financial information for the year ending December 31, 2010. The Company anticipates a significant increase in disclosures resulting from the adoption of IFRS and is identifying and assessing the impact of this change in valuation and additional disclosure requirements, as well as implementing systems changes that will be necessary to compile the required disclosures.

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## 4. Business combination:

On March 4, 2008, Bucking Horse closed an arrangement transaction (the Arrangement), pursuant to which it acquired 100% of the issued and outstanding shares and options of Gemini. The assets and liabilities of Gemini and its wholly-owned subsidiary Arrowhead were recorded at their fair values using the purchase method of accounting.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition.

Purchase price:	
Issue of 12,836,713 common shares of Bucking Horse	\$ 51,572,778
Cash	19,959,029
Reduction in promissory note	9,537,381
Issue of convertible debentures	47,508,293
Acquisition costs	290,007
	<hr/>
	\$ 128,867,488
<hr/>	
Net assets acquired:	
Cash and cash equivalents	\$ 1,076,605
Promissory note	15,106,980
Accounts receivable	3,290,390
Income tax receivable	1,490,340
Oil and gas properties	168,269,586
Investments (note 6)	918,552
Accounts payable and accrued liabilities	(5,832,168)
Asset retirement obligations	(41,144)
Future income taxes	(55,411,653)
	<hr/>
	\$ 128,867,488
	<hr/>

Under the terms of the Arrangement, Bucking Horse acquired all of the 24,608,642 issued and outstanding common shares of Gemini and all of the 320,000 existing stock options. The acquisition was funded through the issuance of common shares of the Company, the issuance of convertible debentures, the reduction of a promissory note receivable, the draw down of the credit facility and the remainder in cash as described further below. Gemini is now a wholly owned subsidiary of the Company and its shares have been delisted from the TSX.

Prior to closing the Arrangement, Gemini had four secured convertible debentures outstanding held by two major shareholders of the Company (the Debenture Holders or the Lenders), each in the principal amount of C\$5,000,000. Prior to the Arrangement, Gemini was a related party of the Company as the Debenture Holders were also significant shareholders of Gemini. Two of these debentures were issued in March 2004 (the March Debentures) and the other two were issued in August 2004 (the August Debentures).

The March Debentures were convertible into units of Gemini 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

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## 4. Business combination (continued):

Debentures was converted concurrent with 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 was paid by the issuance of two new convertible debentures by the Company (note 9).

The August Debentures were convertible into Gemini units at a conversion price of C\$4.00 per unit. The August Debentures were cancelled and replaced with two new convertible debentures at the closing of the Arrangement 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 (note 9).

At the closing of the Arrangement, two additional new debentures for the total sum of \$20,088,000 (C\$20,000,000) were issued to the Debenture Holders as consideration for the 2,500,000 and 2,075,043 Gemini shares acquired from the Debenture Holders at C\$4.00 per share and as consideration for the \$1,707,307 (C\$1,699,828) cash received from one of the Debenture Holders which was used to fund a portion of the cash required to complete the Arrangement (note 9).

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 C\$49,000,000 held by the Debenture Holders (note 9).

Prior to closing the Arrangement, Gemini completed the sale of 12,000,000 pre-consolidated (600,000 post consolidated) common shares of XXL Energy Corp. (XXL), an entity related to the Company by virtue of common directors, to Q Investments Ltd. (QIL), a major shareholder of the Company which is controlled by the Debenture Holders. The total consideration of \$15,106,980 (C\$15,040,800) was initially paid by QIL's issuance of a promissory note in favour of Gemini which was acquired by the Company pursuant to the Arrangement. The amount owing under the promissory note was reduced by \$9,537,381 (C\$9,495,600) as consideration for the 2,373,900 Gemini shares acquired from QIL at C\$4.00 per share pursuant to the Arrangement. The amount owing under the promissory note was further reduced through the cancellation of the Company's pre-existing loan payable to QIL of \$1,506,600 (C\$1,500,000) together with accrued interest. The resulting promissory note receivable was C\$4,045,200. During fiscal 2009, the settlement of the promissory note was negotiated whereby QIL will exchange 600,000 shares of XXL to the Company in return for the retirement of the note and the related accrued interest. Accordingly, the promissory note and accrued interest was written down to the fair value of the 600,000 shares of XXL. The write down has been included in other expenses in the consolidated statement of operations. As of December 31, 2009, the finalization of the share transfer had not been completed.

The remaining 5,000,000 pre-consolidated (250,000 post consolidated) common shares and 3,000,000 pre-consolidated (150,000 post consolidated) warrants of XXL held by Gemini were acquired by the Company.

The Company issued 12,836,713 common shares of Bucking Horse to former Gemini shareholders, including 1,645,350 shares issued to one of the Debenture Holders, in exchange for 12,836,713 of the Gemini shares acquired at a deemed value of C\$4.00 per share for total consideration of \$51,572,778 (C\$51,346,852).

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Notes to Consolidated Financial Statements  
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## 4. Business combination (continued):

The Company paid cash of \$19,376,829 (C\$19,291,944) to acquire the remaining 4,822,986 of the Gemini shares. 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 and incurred \$290,007 (C\$288,737) in transaction costs associated with the Arrangement.

## 5. Financial instruments:

### (a) Fair value:

The carrying values of cash and cash equivalents, accounts receivable, promissory note, income tax receivable and accounts payable and accrued liabilities approximate their fair values due to the short terms to maturity of these financial instruments.

The fair value of the long-term credit facility has been estimated by management by discounting the future contractual cash flows under current financing arrangements at discount rates which represent borrowing rates presently available to the Company for a loan with similar terms, risks and maturities. Management estimates that at December 31, 2009, the fair value of the long-term credit facility is equal to approximately \$17,000,000. This reflects the actual interest rates incurred by the Company as being less than the equivalent current market rates.

The fair value of the convertible debentures is not readily determinable due to their related party nature and the absence of a market for such investments.

CICA amended section 3862 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets (Level 1 measurement) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are described below:

Level 1 – Unadjusted quoted prices in active markets that are accessible at the measurement date for identical unrestricted assets or liabilities.

Level 2 – Inputs that are observable, either directly or indirectly, but do not qualify as Level 1 inputs (i.e. quoted prices for similar assets or liabilities).

Level 3 – Prices or valuation techniques that are not based on observable market data and require inputs that are both significant to the fair value measurement and unobservable.

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## 5. Financial instruments (continued):

### (a) Fair value (continued):

The fair values of the Company's financial assets and liabilities as of December 31, 2009 were calculated as follows:

	Balance at December 31, 2009	Quoted prices in active markets for identical assets (\$) (Level 1)	Significant other observable inputs (\$) (Level 2)	Significant unobservable inputs (\$) (Level 3)
Financial assets:				
Held for trading:				
Cash and cash equivalents	\$ 6,751,735	\$ 6,751,735	\$ -	\$ -
Benefit under derivative financial instrument (note 5(b))	2,130,604	-	2,130,604	
Available for sale:				
Investments in shares of a related entity	44,452	44,452	-	-

### (b) Derivative instruments:

At December 31, 2009, the Company had 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 <sup>(1)</sup>	2,500	Calendar 2009	\$9.66 / MMBTU
Swap <sup>(2)</sup>	2,500	Calendar 2010	\$6.20 / MMBTU
Swap <sup>(2)</sup>	1,000	Calendar 2010	\$6.48 / MMBTU
Swap <sup>(2)</sup>	1,000	Calendar 2010	\$6.50 / MMBTU
Swap <sup>(2)</sup>	3,000	Calendar 2011	\$7.23 / MMBTU
Swap <sup>(2)</sup>	1,000	Calendar 2011	\$7.11 / MMBTU
Swap <sup>(2)</sup>	3,500	Calendar 2012	\$7.22 / MMBTU

- <sup>(1)</sup> Panhandle Eastern basis  
<sup>(2)</sup> Dominion Appalachia basis

Derivative financial instruments are measured at fair value with gains and losses recorded in net earnings.

On February 18, 2009 the company entered into a commodity swap contract, committing 2,500 MMBTU / day at the price of \$6.20. On June 11, 2009, the Company entered into two new commodity swap contracts, committing an additional 1,000 MMBTU / day in calendar 2010 and 3,000 MMBTU / day in calendar 2011 at prices of \$6.48 and \$7.23 per MMBTU respectively. On October 19, 2009 three

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## 5. Financial instruments (continued):

### (b) Derivative instruments (continued)

additional commodity swap contracts were entered into, committing an additional 1,000 MMBTU / day each in calendar 2010 and 2011 and 3,500 MMBTU / day in calendar 2012 at prices of \$6.50, \$7.11 and \$7.22 / MMBTU respectively.

The Company has engaged in currency hedging activities and on November 25, 2008 contracted to purchase C\$6,113,000 during the calendar 2009 at an exchange rate of C\$1.2226 per US\$. On March 5, 2009, the Company contracted to purchase C\$4,584,600 during calendar 2010 at an exchange rate of C\$1.2735 per US\$. In May 2009, the company realized a \$760,731 gain through the early settlement of these two currency contracts. As at December 31, 2009, the Company has no currency contracts outstanding.

The net realized gain on derivative financial contracts for the year ended December 31, 2009 of \$6,969,194 (four months ended December 31, 2008 – gain of \$2,315,180; year ended August 31, 2008 - loss of \$88,040) has been included in other income in the statement of operations.

The unrealized loss on outstanding derivative financial contracts was \$2,202,893 for the year ended December 31, 2009 (four months ended December 31, 2008 – gain of \$1,405,721; year ended August 31, 2008 - gain of \$2,927,776), which has been included in other expenses in the statement of operations.

## 6. Investments:

	Number of shares	Year ended December 31, 2009	Four months ended December 31, 2008	Year ended August 31, 2008
Investments in:				
Investment in Giant Energy Limited	1,000,000	\$ -	\$ 205,254	\$ 235,272
Investment in warrants of XXL	150,000	-	466	8,831
Investment in shares of XXL	333,700	44,452	68,493	-
		\$ 44,452	\$ 274,213	\$ 244,103

On May 21, 2008, the Company participated in a private placement conducted by Giant Energy Limited (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 was a non-arm's length transaction by virtue of a common officer of both companies and a common shareholder. Giant was created in 2007 with the intention of raising funds and investing in oil and gas resource properties in the United States. Due to the economic contraction and decline in oil and gas prices in late 2008, the company was unable to develop and maintain economic projects and consequently ceased operations in December 2008. The value of these common shares has been written down to zero during fiscal 2009.

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## 6. Investments (continued):

As at December 31, 2009, the Company holds 150,000 warrants of XXL, each of which entitles the Company to purchase one common share of XXL at an exercise price of \$20.00 per share. The warrants expire August 18, 2010. XXL is a related party by virtue of common directors. These warrants are classified as held-for-trading and are marked to market on an ongoing basis with changes in fair value recognized in net earnings. At December 31, 2009, the warrants were valued at nil.

The warrant's fair value was determined using the Black Scholes model using the following assumptions:

Expected life	0.63 years
Volatility	139.4%
Risk free rate	1.46%
Dividend rate	0%

During the four months ended December 31, 2008, the Company acquired 333,700 common shares in XXL for a total purchase price of \$254,085 (C\$306,045). These shares are classified as available for sale and are marked to market on an ongoing basis with changes in fair value recognized in other comprehensive income, net of tax. The cumulative unrealized loss on the shares of \$189,574 has been included in other comprehensive loss, net of tax of \$28,126 (four months ended December 31, 2008 – unrealized loss on shares of \$182,775 included in comprehensive loss, net of tax of \$23,761).

## 7. Oil and natural gas properties:

	Year ended December 31, 2009	Four months ended December 31, 2008	Year ended August 31, 2008
Proven, explored and impaired properties:			
Exploration and drilling costs	\$ 68,041,720	\$ 64,074,594	\$ 60,166,711
Acquisition and lease costs	98,024,053	83,269,064	98,147,394
Well equipment	8,693,017	7,311,890	6,811,694
Asset retirement	72,676	60,649	44,066
	174,831,466	154,716,197	165,169,865
Less accumulated depletion and depreciation	(13,276,013)	(6,420,662)	(4,591,715)
	\$161,555,453	\$ 148,295,535	\$ 160,578,150

For the year ended December 31, 2009, the Company has not capitalized any general and administrative expenses.

Due to disappointing drilling results in the area, the Company wrote down its Columbia River Basin properties to \$99,000 from \$1,687,951 during the last quarter of 2009.

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## 7. Oil and natural gas properties (continued):

The Company has agreements to participate in the exploration of certain oil and natural gas leases. Failure by the Company to pay its share of a proposed capital program could result in the dilution or forfeiture of the Company's interest in these properties.

The Company performed a ceiling test calculation at December 31, 2009 for its U.S. and Canadian properties to assess the recoverable value of its oil and natural gas properties. The oil and natural gas future prices for the December 31, 2009 ceiling test are based on the December 31, 2009 commodity price forecast of the Company's independent reserve evaluators. These prices have been adjusted for commodity price differentials specific to the Company. The following table summarizes the benchmark prices used in the ceiling test calculation. Based on these assumptions, the undiscounted value of future net revenues from the Company's proved reserves exceeded the carrying value of oil and natural gas properties at December 31, 2009 and accordingly no impairment was recorded.

Year	Benchmark NYMEX WTI \$US/BBL	US properties NGL / OIL \$US/BBL	Benchmark NYMEX GAS \$US/Mcf	US properties GAS \$US/Mcf	Canadian properties GAS \$C/MMBTU
2010	\$75.00	\$65.99	\$5.75	\$5.64	\$5.33
2011	\$81.60	\$72.41	\$6.65	\$6.48	\$6.20
2012	\$85.85	\$76.47	\$7.00	\$6.84	\$6.54
2013	\$90.20	\$80.64	\$7.30	\$7.15	\$6.93
2014	\$97.40	\$87.63	\$7.60	\$7.46	\$7.02
2015	\$104.90	\$94.95	\$7.98	\$7.81	\$7.22
2016	\$112.60	\$102.45	\$8.45	\$8.33	\$7.36
2017	\$114.85	\$104.55	\$8.80	\$8.69	\$7.70
2018	\$117.15	\$106.59	\$9.15	\$9.05	\$7.99
2019	\$119.50	\$108.73	\$9.45	\$9.35	\$8.28

## 8. Long-term credit facility:

In connection with the Arrangement, Bucking Horse and Gemini (Guarantors) and Arrowhead (Borrower) entered into a credit agreement dated March 4, 2008 for 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, available pursuant to the terms set out in the Credit Agreement. The debt is secured by mortgages on the oil and gas properties of Arrowhead.

The facility has an interest rate that floats, based on both the LIBOR rate and a spread, which will increase based on the percentage of availability drawn, resulting in a current interest rate of approximately 1.99% at December 31, 2009 (December 31, 2008 – 4%; August 31, 2008 – 5.5%). The Company currently has drawn \$18,500,000 from the Credit Facility, of which \$10,500,000 was drawn on March 4, 2008 to fund a portion of the cash required to complete the Arrangement (note 4) and has \$11,500,000 left available as at December 31, 2009.

The Company is required to ensure that Arrowhead's interest coverage ratio is greater than 2.5 to 1.0, that Arrowhead's ratio of total indebtedness to earnings before interest income taxes, depletion, depreciation and accretion, and exploration expenses is greater than 3.5 to 1.0, and that the Company's current ratio is greater than 1.0 to 1.0. The Company is in compliance with all bank covenants at December 31, 2009.

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## 9. Convertible debentures:

	Year ended December 31, 2009	Four months ended December 31, 2008	Year ended August 31, 2008
First Debentures (a)	\$ 18,078,021	\$ 15,599,343	\$ 17,880,670
Second Debentures (b)	9,514,748	8,210,181	9,410,879
Third Debentures (c)	19,029,496	16,420,361	18,821,758
	46,622,265	40,229,885	46,113,307
Less cumulative accretion remaining	(21,520,702)	(19,641,133)	(22,839,814)
	\$ 25,101,563	\$ 20,588,752	\$ 23,273,493

(a) On March 4, 2008 as part of the Arrangement, two convertible debentures (the First Debentures) were issued by the Company to the Debenture Holders. Each of the First Debentures is in the principal amount of \$9,039,010 (C\$9,500,000). The First Debentures mature on March 4, 2018, bear interest at a rate of 10% during the first six years and 15% during the remaining four years and are convertible into units during the first five years at a conversion price of C\$4.875 per unit and into shares at a conversion price of C\$4.875 per share during the last five years. 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 Debenture Holders may elect to accelerate the maturity date to the sixth anniversary date at any time during the first five years. 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%.

Repayment of the First Debentures is guaranteed by the Company's subsidiary Arrowhead, which has provided a mortgage and security agreement to each of the Lenders which is subordinated to other debt under the credit facility. The First Debentures are redeemable by the Company upon thirty days written notice without penalty or bonus; however, the Debenture Holders may elect to convert all or any of the First Debentures during the thirty day notice period.

The equity portion of the First Debentures was assigned a total value of \$10,103,765 (C\$10,054,257) upon issuance of the First Debentures, which was recorded in equity portion of debentures payable. The First Debentures were initially recorded net of the Conversion Option and are being accreted to their face value over their term. For the year ended December 31, 2009, accretion of \$301,912 (four months ended December 31, 2008 - \$78,243; year ended August 31, 2008 - \$305,039) has been included in accretion expense. Accretion of the First Debentures is calculated using an effective interest rate of 39.36%.

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## 9. Convertible debentures (continued):

- (b) On March 4, 2008 as part of the Arrangement, two additional convertible debentures (the Second Debentures) were issued by the Company to the Debenture Holders. Each of the Second Debentures is in the principal amount of \$4,757,374 (C\$5,000,000). The Second Debentures mature on August 4, 2014, bear interest at a rate of 10% up to August 4, 2010 and 15% during the last four years and are convertible into units up to August 4, 2009 at a conversion price of C\$4.00 per unit and into shares at a conversion price of C\$4.00 per share during the last five years. Each unit consisted of one common share of the Company and one share purchase warrant. Each share purchase warrant entitled the holder to purchase one additional common share of the Company for C\$4.00 until August 4, 2009, at which date these share purchase warrants expired. The Debenture Holders may elect to accelerate the maturity date to August 4, 2010 at any time up to August 4, 2009. 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%.

Repayment of the Second Debentures is guaranteed by the Company's subsidiary Arrowhead, which has provided a mortgage and security agreement to each of the Lenders which is subordinated to other debt under the credit facility. The Second Debentures are redeemable by the Company upon thirty days written notice without penalty or bonus; however, the Debenture Holders may elect to convert all or any of the Second Debentures during the thirty day notice period.

The equity portion of the Second Debentures was assigned a total value of \$4,589,831 (C\$4,567,341) upon issuance of the Second Debentures, which was recorded in equity portion of debentures payable. The Second Debentures were initially recorded net of the Conversion Option and are being accreted to their face value over their term. For the year ended December 31, 2009, accretion of \$522,705 (four months ended December 31, 2008 - \$135,077; year ended August 31, 2008 - \$303,082) has been included in accretion expense. Accretion on the Second Debentures is calculated using an effective interest rate of 39.94%

- (c) On March 4, 2008 as part of the Arrangement, two more convertible debentures (the Third Debentures) were issued by the Company to the Debenture Holders. Each of the Third Debentures is in the principal amount of \$9,514,748 (C\$10,000,000). The Third Debentures mature on March 4, 2018, bear interest at a rate of 10% during the first six years and 15% during the last four years and are convertible into units during the first five years at a conversion price of C\$4.875 per unit and into shares at a conversion price of C\$4.875 per share during the last five years. 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 Debenture Holders may elect to accelerate the maturity date to the sixth anniversary date at any time during the first five years. 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%.

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## 9. Convertible debentures (continued):

(c) Continued:

Repayment of the Third Debenture is guaranteed by the Company's subsidiary Arrowhead, which has provided a mortgage and security agreement to each of the Lenders which is subordinated to other debt under the credit facility. The Third Debentures are redeemable by the Company upon thirty days written notice without penalty or bonus; however, the Debenture Holders may elect to convert all or any of the Third Debentures during the thirty day notice period.

The equity portion of the Third Debentures was assigned a total value of \$10,635,543 (C\$10,583,428) upon issuance of the Third Debentures, which was recorded in equity portion of debentures payable. The Third Debentures were initially recorded net of the Conversion Option and are being accreted to their face value over their term. For the year ended December 31, 2009, accretion of \$317,802 (four months ended December 31, 2008 - \$82,361; year ended August 31, 2008 - \$321,094) has been included in accretion expense. Accretion on the Third Debentures is calculated using an effective interest rate of 39.36%.

## 10. Asset retirement obligations:

The Company's asset retirement obligations result from net ownership interest in oil and gas properties including well sites, gathering systems and processing facilities. The Company estimates the total undiscounted amount of cash flows required to settle its asset retirement obligations is approximately \$1,410,023. The majority of the costs will be incurred after 2050. An inflation factor of 2.0% has been applied to the estimated asset retirement costs. A discount rate of 10% was used to calculate the fair value of the asset retirement obligations. A reconciliation of the asset retirement obligations is provided below:

	Year ended December 31, 2009	Four months ended December 31, 2008	Year ended August 31, 2008
Balance, beginning of period	\$ 69,176	\$ 44,066	\$ 8,280
Additions during the period	9,645	18,225	34,357
Accretion expense	11,736	6,885	1,429
Balance, end of period	\$ 90,557	\$ 69,176	\$ 44,066

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## 11. Earnings per share:

As at December 31, 2009, the conversion feature of the convertible debentures into 10,500,000 common shares would be anti-dilutive, therefore diluted net earnings (loss) per common share equals basic net earnings (loss) per common share.

## 12. Share capital:

### (a) Share transactions:

Authorized capital at December 31, 2009, December 31, 2008 and August 31, 2008 consists of unlimited common shares without par value.

Share transactions for the year ended December 31, 2009, four months ended December 31, 2008 and the year ended August 31, 2008 were as follows:

	Number of shares	Amount (net)
Balance, August 31, 2007	8,225,000	\$ 2,136,701
Shares issued for cash:		
Private placement	2,000,000	8,094,709
Plan of arrangement (note 4)	12,836,713	51,599,690
Balance, August 31, 2008	23,061,713	61,831,100
Shares cancelled and returned to Treasury	(67,200)	(182,705)
Balance, December 31, 2008	22,994,513	61,648,395
Shares cancelled and returned to Treasury	(102,060)	(273,633)
Balance, December 31, 2009	22,892,453	\$ 61,374,762

During the year ended August 31, 2008, the Company repurchased 44,700 shares through a normal course issuer bid at a cost of \$122,382. The excess cost of the shares over the assigned value totaled \$216,758 and was charged to retained earnings. The shares repurchased were cancelled and returned to Treasury on November 17, 2008.

During the four months ended December 31, 2008, the Company repurchased 22,500 shares through a normal course issuer bid at a cost of \$121,884. The excess cost of the shares over the assigned value totaled \$61,561 and was charged to retained earnings. The shares repurchased were cancelled and returned to Treasury on November 17, 2008 (14,600 shares) and December 23, 2008 (7,900 shares).

During the year ended December 31, 2009, the Company repurchased 111,060 shares through a normal course issuer bid at a cost of \$310,610. The excess cost of the shares over the assigned value totaled \$12,847 and has been charged to retained earnings. On December 15, 2009, 102,060 shares were cancelled and returned to Treasury.

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## 12. Share capital (continued):

### (b) Stock option plan:

The Company has a stock option plan for its key employees, directors and certain other persons under certain conditions. Under the plan, options may be granted to purchase up to 10% of the outstanding shares of the Company to a maximum of 822,500 options. Options granted under the plan vest at a rate of 25% per year and expire five years after the date of grant. The exercise price of options granted may not be less than the closing trading price of the Company's shares on the last trading day preceding the date on which the options are granted. As at December 31, 2009, December 31, 2008, and August 31, 2008, no stock options have been issued under the plan.

The stock option plan was amended to increase the maximum number of options available to be granted to 2,306,000 options. The Company received regulatory approval for the amendment on December 1, 2008.

## 13. Related party transactions:

Related party transactions are in the normal course of operations and measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

Related party transactions are as follows:

	Year ended December 31, 2009	Four months ended December 31, 2008	Year ended August 31, 2008
General and administrative expenses:			
Office, rent, administration and professional services to a company controlled by a Debenture Holder	\$ 470,858	\$ 112,580	\$ 226,483
Oil and gas consulting and management services provided by a company controlled by a Debenture Holder	-	247,850	228,995
Directors fees	5,254	1,706	7,947
Interest paid to significant shareholders	6,436,077	2,089,552	3,124,352
Interest paid on a loan to a company with a common director	-	-	115,436

# BUCKING HORSE ENERGY INC.

Notes to Consolidated Financial Statements  
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## 13. Related party transactions (continued):

Amounts due to or prepaid to related parties are as follows:

	Year ended December 31, 2009	Four months ended December 31, 2008	Year ended August 31, 2008
General and administrative expenses:			
Prepayment of fees for office, rent, administration and professional services charged by a company controlled by one of the Debenture Holders	\$ 141,483	\$ 148	\$ 37,813
Amount receivable from a company with a common director	275,436	275,436	300,000
Amount receivable from a company controlled by one of the Debenture Holders	235,066	-	-
Amount payable to related party providing oil and gas consulting, operational, technical and business management services	-	-	74,928

In addition, the Company has an investment in Giant shares as disclosed in note 6. The Company terminated its agreement with Giant on December 31, 2008 under which Giant provided oil and gas consulting, operations, technical and business management services to the Company. The Company is currently in negotiations with Giant with respect to recovering its receivable of \$275,436 as at December 31, 2009. The recoverability of the amount due from Giant is dependent upon the profitable operation of its business and/or the ability of Giant to raise additional financing, but is considered to be recoverable at December 31, 2009; therefore no allowance has been recorded against this amount. There is no active market for the Company's investment in Giant shares.

On November 10, 2006, the Company entered into a loan agreement with QIL pursuant to which QIL provided the Company with a loan in the principal amount of \$1,327,434 (C\$1,500,000). The loan was cancelled as part of the Arrangement. As part of the Arrangement, a promissory note was given by QIL to the Company for a principal amount of \$15,106,980 (note 4). The amount owing was further reduced by \$9,537,381 (C\$9,495,600) as consideration for the 2,373,900 Gemini shares acquired from QIL at C\$4.00 as part of the Arrangement. The resulting promissory note receivable was C\$4,045,200. During fiscal 2009, the Company entered into an agreement to settle the promissory note whereby QIL will transfer to the Company 600,000 shares of XXL (refer to note 6). The promissory note was therefore written down to the estimated fair value of the 600,000 XXL shares of \$79,924.

Other related party transactions are disclosed in notes 4, 6 and 9.

# BUCKING HORSE ENERGY INC.

Notes to Consolidated Financial Statements

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For the year ended December 31, 2009, four months ended December 31, 2008 and year ended August 31, 2008

## 14. Income tax:

The Company's provision for income taxes differs from the amounts computed by applying a combined US and Canadian income tax rate of 34% (four months ended December 31, 2008 - 41%; year ended August 31, 2008 - 34%).

	Year ended December 31, 2009	Four months ended December 31, 2008	Year ended August 31, 2008
Computed tax provision	\$ (3,602,255)	\$ 344,926	\$ 996,573
Increase in valuation allowance	1,861,223	543,534	1,474,904
State and withholding taxes	-	411,335	(34,835)
Permanent differences	2,999,198	(2,165,101)	287,650
Effects of foreign exchange on temporary differences and other	(523,365)	97,374	51,980
	\$ 734,801	\$ (767,932)	\$ 2,776,272

Significant components of the Company's future tax assets and liabilities are shown below:

	Year ended December 31, 2009	Four months ended December 31, 2008	Year ended August 31, 2008
<b>Future tax assets:</b>			
Write-down of investment	\$ 60,546	\$ 23,760	\$ -
Non-capital loss carry forwards	4,465,492	3,970,368	4,565,372
Capital loss carry forwards	641,486	13,391	-
Petroleum and natural gas interests	630,136	64,878	53,051
Share issue costs	76,792	62,560	-
Unclaimed exploration and development expenditures	296,551	266,254	316,937
	6,171,003	4,401,211	4,935,360
Less valuation allowance	(6,171,003)	(4,401,211)	(4,935,360)
Net future tax assets	-	-	-
<b>Future tax liabilities:</b>			
Oil and natural gas properties	(52,989,358)	(47,436,481)	(53,392,967)
Derivative instruments	(724,405)	(1,473,389)	(995,444)
Asset retirement obligation	24,271	17,545	13,679
Net future tax liabilities	(53,689,493)	(48,892,325)	(54,374,732)
Net future income tax liability	\$ (53,689,493)	\$ (48,892,325)	\$ (54,374,732)

# BUCKING HORSE ENERGY INC.

Notes to Consolidated Financial Statements  
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## 14. Income tax (continued):

In assessing the realizability of future tax assets, management considers whether it is more likely than not that some portion or all of the future tax assets will not be realized. The ultimate realization of future tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of future tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. The amount of the future tax assets considered realizable could change materially in the near term based on future taxable income during the carry forward period.

A valuation allowance has been provided against all future tax assets as the realization of such assets is uncertain.

The Company has losses for tax purposes of approximately \$17,861,968 (December 31, 2008 - \$15,270,772; August 31, 2008 - \$14,170,471) which are available to offset future years' taxable income in Canada, expiring between 2010 and 2029.

## 15. Supplemental cash flow information:

	Year ended December 31, 2009	Four months ended December 31, 2008	Year ended August 31, 2008
Interest paid	\$ 6,903,053	\$ 2,334,748	\$ 3,510,325
Income taxes received	946,832	344,019	302,894
Non-cash investing and financing activities:			
Offset of loan payable against promissory note	-	-	1,506,600
Issuance of common shares as consideration in Gemini acquisition (note 4)	-	-	51,572,778
Issuance of convertible note as consideration in Gemini acquisition (note 4)	-	-	47,508,293
Reduction in promissory note as consideration in Gemini acquisition (note 4)	-	-	9,537,381

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## 16. Contingency:

In 2006, the Company's wholly-owned subsidiary, Arrowhead and seven 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. Arrowhead leases that are encumbered by this lawsuit consist of five Warbonnet leases totaling 2,040 gross acres (867 net acres) and at the time, 13 developed wells (5.5 net). The claims brought by the plaintiffs related to 2006 production from the properties and totaled approximately \$20,000,000.

During 2007, the Court dismissed the plaintiffs' claim that the defendants, including Arrowhead, had breached any implied covenant of good faith and dismissed the plaintiffs' claims brought under the Wyoming Royalty Payment Act (a Wyoming statute providing for interest on unpaid royalty payments). These decisions in favour of the defendants disallowed approximated \$15,000,000 of the plaintiffs' total claims.

On April 14, 2008, the Court entered a judgment relating to 2006 production in the amount of \$4,896,589 against the defendants, jointly and severally. The Company filed its Notice of Appeal with the Wyoming Supreme Court on June 16, 2008. If unsuccessful in its appeals, the Company may be required to make a payment for its portion of the total judgement relating to the 2006 production from the properties. Further, the Company may be subject to a net profits interest on its production from its encumbered leases relating to 2007, 2008, 2009 and future years.

The outcome and potential liability to the Company cannot be determined. Therefore, no amounts have been accrued in these consolidated financial statements.

## 17. Financial risk exposure and risk management:

The Company is exposed in varying degrees to a number of risks arising from financial instruments. The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework. Management's close involvement in the operations allows for the identification of risks and variances from expectations. The Board approves and monitors the risk management process.

The types of risk exposure and the way in which such exposures are managed are as follows:

### (a) Credit risk:

Credit risk is the risk of financial loss to the Company if a counterparty to a financial instrument fails to meet its payment obligations. The Company's exposure to credit risk includes cash and cash equivalents, accounts receivable, promissory note, and derivative instruments. The risk exposure is limited to their carrying amounts at the balance sheet date.

Cash and cash equivalents and derivative instruments are maintained with one financial institution. The risk is mitigated because the financial institution is a major institution with high credit rating.

Accounts receivable primarily consist of revenues due from the sale of oil and gas. To reduce credit risk, the Company regularly reviews the collectability of the accounts receivable and there is no indication that these amounts will not be fully recoverable. Canadian currency accounts receivable account for \$57,427 (C\$60,356) of the Company's total accounts receivable.

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Notes to Consolidated Financial Statements  
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For the year ended December 31, 2009, four months ended December 31, 2008 and year ended August 31, 2008

## 17. Financial risk exposure and risk management (continued):

### (b) Liquidity risk:

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due. The Company manages its liquidity risk by actively forecasting, planning, reviewing and monitoring expenditures and commitments and anticipated financial requirements.

Cash and cash equivalents on hand at December 31, 2009 and expected cash flows for the next 12 months are sufficient to fund the Company's ongoing operational needs.

In addition, the Company maintains a \$30,000,000 line of credit with the Bank of Montreal, of which it had drawn down \$18,500,000 at December 31, 2009.

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>	\$ 46,622,265	\$ -	\$ -	\$ 9,514,748	\$ 37,107,517
Accounts payable and accrued liabilities	1,656,228	1,656,228	-	-	-
State resource taxes payable	1,169,980	902,112	267,868	-	-
Income taxes payable	430,200	430,200	-	-	-
Other long-term obligations <sup>(2)</sup>	90,557	-	-	-	90,557
Line of credit	18,500,000	-	-	18,500,000	-
<b>Total contractual obligations</b>	<b>\$ 68,469,230</b>	<b>\$ 2,988,540</b>	<b>\$ 267,868</b>	<b>\$ 28,014,748</b>	<b>\$ 37,198,074</b>

<sup>(1)</sup> First, second, and third convertible debentures (C\$49,000,000 translated at current exchange rate)

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

### (c) Market risk:

Market risk is the risk that changes in market prices, such as natural gas prices, foreign exchange rates and interest rates will affect the Company's income. The object of market risk management is to manage and control market risk exposures within acceptable parameters, while optimizing the return on risk.

The Company buys and sells derivatives in the ordinary course of business in order to manage market risks.

#### (i) Commodity risk:

The Company is exposed to fluctuations in the price of oil and natural gas. It mitigates its risk by negotiating hedging contracts for up to 50% of its production (note 5(b)).

A 10% change in the price of natural gas during the period would have changed equity and net income by \$570,000.

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Notes to Consolidated Financial Statements

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For the year ended December 31, 2009, four months ended December 31, 2008 and year ended August 31, 2008

## 17. Financial risk exposure and risk management (continued):

(c) Market risk (continued):

(ii) Currency risk:

The Company is exposed to the financial risk related to the fluctuation of foreign exchange rates. The Company operates in Canada and the United States and a portion of its expenses are incurred in Canadian dollars. A significant change in the currency exchange rates between the US dollar relative to Canadian dollar could have an effect on the Company's results of operations, financial position or cash flows.

The Company is exposed to currency risk through the following assets and liabilities denominated in Canadian dollars:

	December 31, 2009	December 31, 2008	August 31, 2008
Cash and cash equivalents	\$ 534,033	\$ 1,650,526	\$ 1,902,560
Accounts receivable	60,356	136,299	314,326
Promissory note	84,000	4,548,911	4,346,096
Prepaid expenses	148,699	180	40,180
Investments	46,718	333,992	259,384
Oil and natural gas properties	120,538,880	123,325,309	124,133,684
Accounts payable and accrued liabilities	(267,015)	(205,944)	(136,456)
Convertible debentures	(26,381,743)	(25,077,100)	(24,730,414)
Asset retirement obligations	(20,151)	(21,405)	(11,290)
	<u>\$ 94,743,777</u>	<u>\$ 104,690,768</u>	<u>\$ 106,118,070</u>
US dollar equivalent (period end)	\$ 90,146,315	\$ 85,953,011	\$ 99,886,431

A 10% increase in the Canadian dollar against the United States dollar at December 31, 2009 would result in a change of \$1,480,000 to net income and \$9,675,000 to other comprehensive income.

(iii) Interest rate risk:

The majority of the Company's debt is in fixed rate debentures; however, the Company's income and cash flow are impacted by interest rate fluctuations on its bank loan of \$18,500,000. As at December 31, 2009, the Company did not have any interest rate hedges.

A change of 100 basis points in interest rates would have increased or decreased net income by \$304,000.

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## 18. Capital management:

The Company considers its capital structure to include working capital and shareholders' equity. Management's objective is to ensure that there is sufficient capital to minimize liquidity risk and to continue as a going concern. Management reviews its capital management approach on an ongoing basis and believes that its approach, given the relative size of the Company is reasonable.

The Company's objectives when managing capital are to:

- ensure there are adequate capital resources to safeguard the Company's ability to continue as a going concern;
- maintain adequate levels of funding to support the acquisition, exploration and development of petroleum and natural gas properties; and
- provide returns for shareholders and benefits for other stakeholders.

The Board of Directors does not establish quantitative return on capital criteria for management, but rather relies on the expertise of the Company's management to sustain future development of the business. There were no changes in the Company's approach to capital management during the period. Neither the Company nor any of its subsidiaries are subject to externally imposed capital requirements other than to maintain debt covenants described in note 8.

## 19. Segmented information:

The Company's activities consist of the exploration and development of oil and natural gas properties in Canada and the United States.

Selected segmented information is as follows:

Year ended December 31, 2009	Canada	United States	Total
Oil and gas revenue	\$ 159,960	\$ 12,449,557	\$ 12,609,517
Operating earnings (loss)	(71,909)	(242,168)	(314,077)
Capital expenditures	5,359	5,175,943	5,181,302
Total assets	4,118,185	169,459,943	173,578,128

  

Four months ended December 31, 2008	Canada	United States	Total
Oil and gas revenue	\$ 127,283	\$ 3,958,491	\$ 4,085,774
Operating earnings (loss)	(31,084)	215,655	184,571
Capital expenditures	-	4,576,777	4,576,777
Total assets	6,035,131	164,636,351	170,671,482

  

Year ended August 31, 2008	Canada	United States	Total
Oil and gas revenue	\$ 631,520	\$ 15,061,834	\$ 15,693,354
Operating earnings (loss)	148,884	6,691,847	6,840,731
Capital expenditures	-	1,501,379	1,501,379
Total assets	7,620,657	169,631,680	177,252,337

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## 19. Segmented information (continued):

The Company's revenues are derived from sales to customers in the oil and gas industry. One customer buys all of the oil and gas produced by the Canadian property. The sales of the United States properties are made to three customers.

## 20. Subsequent events:

### (a) Promissory note settlements:

The Company negotiated the settlements of its promissory note receivable from QIL during the year as described in notes 4 and 13. Subsequent to year end, in March 2010, the Company received the 600,000 shares of XXL and the promissory note was forgiven.

### (b) Legal proceedings:

The Company is subject to a lawsuit as described in note 16. Subsequent to year end, on March 23, 2010, the Wyoming Supreme Court upheld the judgements against the defendants; however, the Court clarified that (1) that the non-operators, which includes Arrowhead, are not jointly and severally liable for the entire judgement; and (2) that the 5% net profits interest does not relate to natural gas production used on leases in question, therefore that aspect of the judgement was reversed and remanded for recalculation of the damages. The Company and its legal counsel are reviewing the decision and the potential impact to the Company. The revised total damages and the proportion that Arrowhead may be responsible for have not been determined, therefore no provision has been recorded.

### (c) Subsequent to the year ended December 31, 2009, the Company has purchased an additional 57,140 Common Shares on the open market in issuer bid purchases at an average purchase price of C\$3.00 per share. On March 19, 2010, 65,640 Common Shares were cancelled and returned to Treasury.