

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following Management's Discussion and Analysis ("MD&A") for Second Wave Petroleum Ltd. ("Second Wave" or the "Company") should be read in conjunction with the audited financial statements and notes of the Company for the year ended December 31, 2007. This MD&A incorporates information up to and including April 25, 2008. The financial statements have been prepared in accordance with Canadian Generally Accepted Accounting Principles ("GAAP"). All of the amounts reported in this MD&A are in Canadian dollars, unless otherwise indicated. Certain other information with respect to the Company is available on SEDAR, at www.sedar.com and at the Company's website at www.secondwavepetroleum.com. Information can also be obtained by contacting the Company at Second Wave Petroleum Ltd, Suite 1700, 520, 5th Ave. S.W., Calgary, Alberta, T2P 3R7.

NON-GAAP FINANCIAL MEASUREMENTS

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

OTHER MEASUREMENTS

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

ADVISORY REGARDING FORWARD LOOKING STATEMENTS

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

this report, effective April 25, 2008. The forward-looking statements contained herein are expressly qualified by this cautionary statement.

Overview

(\$000s, except share amounts)	Three months ended December 31,			Year ended December 31,		
	2007	2006	% Change	2007	2006	% Change
Petroleum and natural gas sales	2,494	1,248	100	5,862	5,715	3
Royalties	(338)	(161)	110	(896)	(710)	26
Lease operating costs	(1,047)	(372)	181	(1,719)	(1,187)	45
Transportation	(50)	(25)	100	(127)	(150)	(15)
Operating netback	1,059	690	53	3,120	3,668	(15)
Other income	14	6	133	35	33	6
General and administrative	(558)	(555)	-	(2,188)	(1,938)	13
Financing expenses	(859)	(227)	278	(1,956)	(751)	160
Asset retirement expenditures	-	-	-	(56)	-	-
Funds from operations⁽¹⁾	(344)	(86)	276	(1,045)	1,012	(203)
Depletion, depreciation and accretion	(898)	(3,358)	(73)	(2,318)	(22,477)	(90)
Write-off of goodwill	(145)	-	-	(514)	(2,842)	(82)
Future income taxes	(11)	-	-	1,342	5,641	(76)
Non-cash portion of financing expense	(4)	-	-	(401)	-	-
Accretion of convertible debenture	(60)	-	-	(101)	-	-
Asset retirement expenditures	-	-	-	56	-	-
Stock-based compensation	(178)	(197)	9	(565)	(497)	14
Net loss and comprehensive loss	(1,640)	(3,641)	(55)	(3,546)	(19,163)	(81)
Funds from operations per share ⁽¹⁾ :						
Basic (\$)	0.00	0.00	0.00	(0.01)	0.03	(133)
Diluted (\$)	0.00	0.00	0.00	(0.01)	0.03	(133)
Net loss and comprehensive loss per share:						
Basic (\$)	(0.02)	(0.12)	83	(0.04)	(0.60)	(93)
Diluted (\$)	(0.02)	(0.12)	83	(0.04)	(0.60)	(93)
Average number of shares outstanding (000s):						
Basic	129,675	32,162	303	90,791	32,162	182
Diluted	152,085	32,162	303	113,381	32,162	182

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

(\$000s)	Three months ended December 31,			Year ended December 31,		
	2007	2006	% Change	2007	2006	% Change
Cash flow from (used in) operating activities (GAAP)	(937)	(173)	442	(1,538)	1,771	187
Change in non-cash working capital (GAAP)	593	87	582	493	(759)	165
Funds from operations (non-GAAP)	(344)	(86)	276	(1,045)	1,012	(203)

Quarterly Information

Summary of Quarterly Information

(\$000s, except per share amounts)

	December 31	September 30	2007 Quarter ended	
			June 30	March 31
Total revenues, net of royalties	2,169	936	1,012	883
Net income (loss) and comprehensive income (loss)	(1,640)	(1,102)	(1,200)	395
Per basic share	(0.02)	(0.01)	(0.02)	0.01
Per diluted share	(0.02)	(0.01)	(0.02)	0.01

	December 31	September 30	2006 Quarter ended	
			June 30	March 31
Total revenues, net of royalties	1,093	1,278	1,530	1,139
Net loss and comprehensive loss	(3,641)	(14,509)	(493)	(521)
Per basic share	(0.12)	(0.45)	(0.01)	(0.02)
Per diluted share	(0.12)	(0.45)	(0.01)	(0.02)

Funds from Operations

	Three months ended			Year ended		
	December 31,			December 31,		
	%			%		
	2007	2006	Change	2007	2006	Change
Funds from operations	(344)	(86)	300	(1,045)	1,012	(203)
Per share:						
Basic (\$)	0.00	0.00	0.00	(0.01)	0.03	(133)
Diluted (\$)	0.00	0.00	0.00	(0.01)	0.03	(133)

For the year ended December 31, 2007, funds from operations were (\$1,000,000) or (\$0.01) per share, 133% lower than in 2006. The decrease was mainly due to higher general and administrative expenses and finance expenses realized in 2007.

Net Loss and Comprehensive Loss

	Three months ended			Year ended		
	December 31,			December 31,		
	%			%		
	2007	2006	Change	2007	2006	Change
Net loss and comprehensive loss	(1,640)	(3,641)	(55)	(3,547)	(19,163)	(81)
Per share:						
Basic (\$)	(0.02)	(0.12)	(83)	(0.04)	(0.60)	(93)
Diluted (\$)	(0.02)	(0.12)	(83)	(0.04)	(0.60)	(93)

Net loss and comprehensive loss for the three month period ended December 31, 2007 was 55% lower than the previous year, with higher commodity prices realized during the quarter more than offsetting production declines. Higher revenues for the fourth quarter of 2007, together with lower lease operating costs, were also tempered somewhat by higher depletion costs and higher transportation costs.

For the twelve months ended December 31, 2007, net loss and comprehensive loss was \$3,500,000, or \$0.04 per share, 81% lower than the net loss and comprehensive loss for the twelve months of 2006. The 2006 comparative includes a significant writedown of oil and gas assets. This was partially offset by higher operating and transportation costs in 2007.

Petroleum and natural gas sales

Sales volumes		Three months ended December 31, %			Year ended December 31, %		
		2007	2006	Change	2007	2006	Change
Natural gas	<i>mcf/d</i>	868	805	8	739	641	15
Oil and natural gas liquids	<i>bbl/d</i>	307	133	131	167	183	(9)
Combined (6:1)	<i>boe/d</i>	451	267	69	290	290	-

Sales volumes for the fourth quarter averaged 451 boe/d, 69% higher than the average for the comparable quarter in 2006. Increases in production are largely due to the acquisition of certain producing assets in October 2007. As the acquisition was included for only two of the three months in the quarter, current sales volumes are in excess of those averages indicated for the quarter. Sales volumes for the month of December 2007 were approximately 500 boed.

For the year, our sales volumes averaged 290 boe/d, consistent with the 287 boe achieved in 2006. As a result of the acquisition in October 2007, the 2007 versus 2006 year to date comparison is not representative of the full year impact.

Revenues (\$000s)		Three months ended December 31, %			Year ended December 31, %		
		2007	2006	Change	2007	2006	Change
Natural gas		516	540	(5)	1,827	1,498	22
Oil		1,840	590	212	3,582	3,900	(8)
Natural gas liquids		138	118	17	453	317	43
Total oil and gas		2,494	1,248	100	5,862	5,715	3

The acquisition of producing assets in October 2007 was a major factor in the 100% increase in revenues during the fourth quarter this year as compared with last year.

Revenues for the twelve month periods ended December 31, 2007, and 2006 were consistent.

Average Sales Prices		Three months ended December 31, %			Year ended December 31, %		
		2007	2006	Change	2007	2006	Change
Natural gas	<i>\$/mcf</i>	6.46	7.28	(11)	6.77	6.53	4
Oil	<i>\$/bbl</i>	70.18	58.35	20	67.54	63.46	6
Natural gas liquids	<i>\$/bbl</i>	69.04	56.83	21	57.66	60.32	(4)
Combined (6:1)	<i>\$/boe</i>	60.05	50.73	18	55.39	54.47	2

Oil prices continued to remain strong during the fourth quarter of 2007, with Second Wave's oil price averaging 20% higher than the fourth quarter last year. Market factors contribute to the rise in continuing worldwide high oil prices. In order to reduce the risk of a price decrease and its impact on the cash flows and the 2008 capital program, Second Wave hedged 100 bbls/d of oil in a costless collar between \$US 80.00 to US\$101.00 for the period of April 1, to October 31, 2008.

Natural gas prices continued to remain weak in 2007, however first quarter 2008 price increases have improved significantly.

Royalties

<i>(\$000s)</i>	Three months ended December 31, %			Year ended December 31, %		
	2007	2006	Change	2007	2006	Change
Crown royalties (net of ARTC)	174	121	44	652	503	30
Freehold and GORR	164	40	310	244	207	18
Total	338	161	110	896	710	26
As % of oil and gas revenues	14%	13%	8	15%	12%	25

Total royalties increased by 110% in the fourth quarter of 2007, and by 26% for the twelve month period ended December 31, 2007 due mainly related revenues of the properties acquired during the fourth quarter of 2007. Royalties as a percentage of working interest revenues amounted to 14% during the fourth quarter of 2007, compared to 13% during the same quarter last year, again due to the mix of newly acquired assets in the Company.

For the twelve months ended December 31, 2007 and 2006, the 26% increase in absolute amounts for royalties this year as compared with last year was a function of new production acquired during 2007. Royalties as a percentage of working interest revenues, increased from 12% in 2006 to 15% in 2007.

On October 25, 2007, the Alberta government released a report entitled "The New Royalty Framework" (the "NRF") containing the governments proposals for Alberta's new royalty regime, which is scheduled to be effective on January 1, 2009. Given that the NRF has only recently been announced, it is not possible at this time to determine the full impact of the NRF on Second Wave's financial condition and operations. Based on oil and gas properties held at year end, the increased royalties payable to the Alberta government pursuant to its NRF will not materially negatively impact our net cash flow. In addition, we cannot provide any assurance that the NRF will be implemented in the form proposed. If changes are made to the NRF before it is implemented and legislated by the Alberta government, such changes could result in the implementation of a new royalty regime that impacts us in a materially different manner, and that is more adverse to us, than the NRF as currently proposed.

Lease Operating Costs

<i>(\$000s, except per boe)</i>	Three months ended December 31, %			Year ended December 31, %		
	2007	2006	Change	2007	2006	Change
Lease operating costs	1,047	372	181	1,719	1,187	45
Per boe (\$)	25.21	14.87	70	16.24	11.31	44

Lease operating costs increased 181% from the fourth quarter last year to the fourth quarter of 2007 due mainly to the acquisition of producing properties during the fourth quarter of 2007. A significant amount of repairs and maintenance were required on the properties subsequent to their acquisition. The properties acquired have experienced high operating costs in the past, and will require capital improvements to improve efficiencies. The Company believes that its lease operating costs on a per boe basis are in excess of those of our competitors, and as a result it is taking steps to improve field operating efficiencies. Second Wave has budgeted in excess of \$1,000,000 for certain capital expenditures and facility improvements for later in 2008, which should also help in lowering future operating costs. On a boe basis, lease operating costs were 70% higher during the fourth quarter compared to the fourth quarter in 2006.

For the years ended December 31, 2007 and 2006, lease operating costs increased by 45% year-over-year, due mainly to the acquisition of properties in October 2007. On a boe basis, lease operating costs increased 44% from last year, due to the amount of repairs and maintenance required on the acquired properties.

Transportation

<i>(\$000s, except per boe)</i>	Three months ended			Year ended		
	2007	2006	Change	2007	2006	Change
			%			%
Transportation	50	25	100	127	150	(15)
Per boe (\$)	1.20	1.00	20	1.20	1.43	(16)

The increase in transportation costs for the three months ended December 31, 2007, compared to the same period in 2006, was due mainly to the impact of the acquisition in the fourth quarter of 2007. The majority of transportation costs are for trucking oil.

For the twelve months ended December 31, 2007 and 2006, transportation costs were \$127,000 and \$150,000 respectively.

Second Wave considers transportation to include all oil trucking costs commencing from the wellhead to delivery to the ultimate sales point.

Operating Netback

<i>(\$/boe)</i>	Three months ended			Year ended		
	2007	2006	Change	2007	2006	Change
			%			%
Petroleum and natural gas sales	60.05	50.73	18	55.39	54.47	2
Royalties	(8.13)	(6.55)	24	(8.46)	(6.77)	25
Net revenues	51.92	44.18	18	46.92	47.70	(2)
Lease operating costs	(25.21)	(14.87)	70	(16.24)	(11.31)	44
Transportation	(1.20)	(1.00)	20	(1.20)	(1.43)	(16)
Operating netback (1)	25.51	28.31	(10)	29.48	34.96	(16)

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

Operating netbacks were slightly higher for the three months ended December 31, 2007, when compared to the prior year periods, due mainly to the increase in commodity prices and lower royalties. Higher net revenues were offset by higher lease operating costs and transportation costs.

General and Administrative

<i>(\$000s, except per boe)</i>	Three months ended			Year ended		
	2007	2006	Change	2007	2006	Change
			%			%
General and administrative	558	555	-	2,188	1,938	13
Per boe (\$)	13.40	22.58	(41)	20.67	18.47	12

General and administrative costs were unchanged in the fourth quarter of this year when compared to the same period last year, however with the increase in production the cost per boe has dropped by 41%. Although the per boe rate is in excess of industry norms, the Company expects that with continued production increases, that the per boe amount will decrease in the future.

For the twelve months ended December 31, 2007, general and administrative costs increased 13% from those of last year.

No general and administrative expenses were capitalized during the 2007 as compared with \$58,125 in 2006.

Financing Expenses

	Three months ended			Year ended		
	December 31,			December 31,		
	%			%		
	2007	2006	Change	2007	2006	Change
<i>(\$000s, except per boe)</i>						
Interest on short term debt	106	227	(53)	635	751	(15)
Interest on convertible debenture	228	-	-	591	-	-
Finance charges on flow through share obligations	524	-	-	730	-	-
Total cash component	858	227	278	1,956	751	160
Non cash component						
Loan extension fees - warrants	5	-	-	401	-	-
Total financing expenses	863	227	280	2,357	751	214
Per boe (\$)	20.77	9.24	125	22.27	7.16	211

Financing expenses increased by 280% from \$227,000 in 2006 to \$863,000 in the fourth quarter of 2007, mainly as a result of increased fees on financing activities.

For the year ended December 31, 2007, financing expenses increased by 214% to \$2,357,000 as compared with \$751,000 in 2006. The majority of the increase related to finance charges on flow through obligations, loan extension and other lender fees on the companies debt facilities.

With the proposed acquisition of Milagro Energy Inc. and the Company's capital drilling program, the company expects to incur debt carrying costs throughout the remainder of 2008.

In 2006, the Company raised \$7,000,000 in flow through equity and was committed to expend those monies on eligible Canadian Exploration Expenditures ("CEE"). In 2006, the company expended \$2,367,000 of those expenditures and as a result was subject to finance charges from Canada Revenue Agency on the remaining \$4,633,000 on a monthly basis until eligible expenditures were incurred. The company commenced expending the flow through obligation monies during the third quarter of 2007 and expended the majority in the fourth quarter of 2007 and first quarter of 2008.

Depletion, Depreciation and Accretion

	Three months ended			Year ended		
	December 31,			December 31,		
	%			%		
	2007	2006	Change	2007	2006	Change
<i>(\$000s, except per boe)</i>						
Depletion	859	948	(9)	2,241	3,964	(43)
Depreciation	10	9	11	22	22	-
Accretion of asset retirement obligations	29	(2)	1,550	55	33	67
Writedown of oil and gas assets	-	2,404	-	-	18,458	-
Total	898	3,359	(73)	2,318	22,477	(90)
Per boe (\$)	21.63	136.62	(84)	21.90	214.23	(90)

Depletion, depreciation and accretion expense decreased 73% in the fourth quarter of 2007 from the same period of 2006, mainly due to a write-down in 2006. For the year ended December 31, 2007, depletion, depreciation and accretion dropped dramatically as compared to 2006, again as a result of a significant write-down in oil and gas assets in 2006.

Write-off of Goodwill

<i>(\$000s, except per boe)</i>	Three months ended			Year ended		
	2007	2006	December 31, %	2007	2006	December 31, %
Write-off of Goodwill	145	-	-	514	2,842	(82)
Per boe (\$)	3.49	-	-	4.86	27.09	(82)

The Company periodically assesses the carrying value of goodwill for impairment. In 2007, the Company acquired Stone Castle Exploration Ltd, and recognized goodwill as a component of the purchase price. The amount recorded as goodwill was determined to be impaired and was subsequently written off.

In 2006, concurrent with the write down of the petroleum and natural gas properties, the Company concluded that the carrying value of goodwill was impaired. Accordingly, the entire carrying value was written off by a charge against earnings during 2006.

Accretion of Convertible Debenture

Accretion of convertible debenture was \$60,000 and \$101,000 for the fourth quarter and year ended December 31, 2007. As we entered into the convertible debenture during the third quarter of 2007, the comparable balances for 2006 are nil.

In January 2008, our lender elected to convert its \$9,000,000 convertible debenture into equity, and exercised \$4,700,000 of warrants. These events in connection with management's private placement of \$1,100,000 in January 2008 extinguished the vast majority of the year end debt. As such, the Company expects finance charges are significantly reduced during the first quarter of 2008.

Stock-based Compensation

Stock-based compensation expense for the fourth quarter ended December 31, 2007 was \$178,000, compared to \$196,000 for the same period in 2006. For the years ended December 31, stock-based compensation expense increased from \$497,000 in 2006 to \$565,000 in 2007. The increase is due to the number, timing and vesting of stock options granted in the relative periods. As a result of the grant of 13,275,000, representing over two times the third quarter number of options outstanding, stock based compensation expense is expected to significantly increase commencing in the first quarter of 2008.

Income Taxes

The income tax provision for the year ended December 31 amounted to a recovery of \$1,341,650 in 2007, compared to a recovery of \$5,641,000 in the comparative period of 2006. The 2006 larger recovery was a result of significant losses in 2006 that reduced future income taxes accordingly.

Income taxes are comprised of two components: current and future income taxes. The expected 2007 income tax rate as a percentage of pre-tax income is 32.12%.

With the proposed acquisition of Milagro Energy Inc. and its significant amount of available tax pools, we expect to push out our cash tax horizon well into the future.

Liquidity and Capital Resources

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

At December 31, 2007, the Company had a working capital deficiency of \$6,324,000.

Financing activities from raising equity during 2007 resulted in cash inflows of \$10,700,000. The Company's investment activities consumed \$13,400,000 of cash resources, principally on acquisition of oil and gas assets, of \$8,000,000, drilling and completion work of \$5,400,000. As a result, the Company's cash resources were reduced to Nil at December 31, 2007.

On January 15, 2008, Brookfield Bridge Lending Fund Inc. ("Brookfield") exercised Share Purchase Warrants to acquire 37,788,636 Class A Shares of Second Wave for proceeds of approximately \$4,700,000 to Second Wave. This resulted in Brookfield holding an aggregate of 67,077,272 Class A Shares of Second Wave, or 40.1% of the issued and outstanding Class A Shares of Second Wave.

On January 17, 2008, Brookfield exercised its option to convert its \$9,000,000 variable rate secured convertible debenture into 81,818,182 Class A Shares of Second Wave. Upon conversion of the debenture, Brookfield owns approximately 58% of the issued and outstanding Class A Shares of Second Wave.

On January 17, 2008, Second Wave closed a private placement to members of management and directors of Second Wave. In aggregate, Second Wave issued 6,004,889 Units, for aggregate proceeds of \$1,080,880.

On April 23, 2008, Second Wave entered into an agreement whereby Brookfield would subscribe up to \$10,000,000, not subscribed for by others, in an equity private placement for up to 40,000,000 Units at \$0.25 per Unit. Each Unit is comprised of one Class A Share and 0.6 Class A Share purchase warrant. Each warrant is exercisable for two years from the closing date at a price of \$0.3125 per warrant.

On April 23, 2008, Second Wave entered into a \$7,500,000 secured revolving facility agreement with Brookfield. The facility bears interest at the bank's prime rate plus 2%, and has a two year term

The use of the proceeds from the private placement and secured revolving facility are contingent upon the closing of the acquisition of Milagro and is to be directed to pay down the outstanding debt of Milagro upon closing the acquisition.

On April 25, 2008, Second Wave entered into an indicative term sheet with its senior lender, to increase its borrowing base from \$6,000,000 to \$12,000,000 on its existing credit facility. Upon successful closing of the Milagro acquisition this line will increase to \$18,000,000.

As of April 25, 2008, before the line extension to \$12,000,000 that is in progress as noted immediately above, the Company has approximately \$5,000,000 of its line of credit available for ongoing operations. In addition, the Company receives free cash flow, after royalties, operating expenses, overhead, and debt servicing costs, on a monthly basis. The 2008 capital budget as approved by the Board of Directors is \$9,800,000. In May 2008, the Company is scheduled to close the acquisition of all of the issued and outstanding shares of Milagro Energy Inc. which is expected to provide the Company with approximately 300 barrels per day of additional production and the resultant cash flow. As a result of monies raised in 2008, as at April 25, 2008, the Company was committed incur additional exploration and development expenditures of \$1,100,000 and has flow through warrants outstanding which upon exercise by the warrant holders could add an additional \$1,900,000 of flow through obligation.

During the twelve months ended December 31, 2007 and 2006, the Company expended \$13,400,000 and \$11,800,000 respectively on capital additions.

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

Contractual Obligations

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

Year	(\$000's)
2008	196
2009	196
2010	196
2011	62
Total contractual obligations	650

Risks and Uncertainties

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

Competition

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

Exploration and development risks

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

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

Commodity price fluctuations

Our products, including natural gas, natural gas liquids and crude oil, and other hydrocarbon products, are commodities. Because our contracts do not fix a long-term price for the products we purchase or sell, market changes in the price of such products can have a direct and immediate effect (whether favorable or adverse) upon our revenues and profitability. Prices for products may be subject to material change in response to relatively minor changes in supply and demand, general economic conditions and other market conditions over which we have no

control. As the majority of our production is from natural gas sales, the price of crude oil does not have a large impact on our profitability. Other conditions affecting our business include the level of domestic oil and gas production, the availability and prices of competing commodities and of alternative energy sources, the availability of local, intraprovincial and interprovincial transportation systems with adequate capacity, the proximity of gas production to gas pipelines and facilities, the availability of pipeline capacity, government regulation, the seasons, the weather and the impact of energy conservation efforts.

Estimating reserves and future net cash flows risk

Estimating natural gas, natural gas liquids, crude oil reserves, and future net cash flows include numerous uncertainties, many of which may be beyond our control. Such estimates are essential in our decision-making, as to whether further investment is warranted. These estimates are derived from several factors and assumptions, some of which are:

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

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

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

Replacement of reserves

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

Risks pertaining to acquisitions and joint ventures

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

Potential variability in quarterly operating results

The exploration for and development of oil and natural gas reserves depends on access to areas where operations are to be conducted. Seasonal weather variations, including freeze-up and break-up affect access in certain circumstances. Natural gas is used principally as a heating fuel and for power generation. Accordingly, seasonal variations in weather patterns affect the demand for natural gas. Depending on prevailing conditions, the prices

received for sales of natural gas are generally higher in winter than summer months, while prices are generally higher in summer than spring and fall months. Accordingly, any increase or decrease in our net operating revenues and their effects on profitability cannot be predicted. Because of the seasonality of our business and continuous fluctuations in the prices of our products, our operating results for any past quarterly period may not necessarily be indicative of results for future periods and there can be no assurance that we will be able to maintain steady levels of profitability on a quarterly or annual basis in the future.

Operating hazards and uninsured risks

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

Drilling plans subject to change

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

Shortage of supplies and equipment

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

Restoration, safety and environmental risk

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

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

Government regulation and environmental matters

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

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

Kyoto Protocol risk

The Kyoto Protocol treaty (Protocol) was established in 1997 to reduce emissions of greenhouse gases (GHG) that are believed to be responsible for increasing the Earth's surface temperatures and affecting the global climate change. Canada ratified the Protocol in December 2002. Since the implementation of the Protocol, approximately 160 countries have committed to reduce GHG internationally. Canada has committed to meet a 6% reduction of emission over base-year 1990 during the period 2008 to 2012. Canadian government assurances of cost and volume limits suggest that incremental risks and liabilities attributable to addressing Protocol related policies are manageable. It is not possible to predict the impact of how Protocol-related policies will ultimately be resolved and to what extent their impact will affect our future unit operating costs and capital expenditures.

New Alberta Royalty Regime Risk

On October 25, 2007, the Alberta government released a report entitled "The New Royalty Framework" containing the government's proposals for Alberta's new royalty regime which is scheduled to be effective on January 1, 2009. Given that the NRF has only recently been announced, it is not possible at this time to determine the full impact of the NRF on the Corporation's financial condition and operations.

The Corporation cannot provide any assurance that the NRF will be implemented in the form proposed. If changes are made to the NRF before it is implemented by the Alberta government, such changes could result in the implementation of a new royalty regime that impacts the Corporation in a materially different manner, and that is more adverse to the Corporation, than the NRF as currently proposed. See "Industry Conditions".

Critical Accounting Estimates

Use of estimates

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

Full cost ceiling test calculations

We follow the full cost method of accounting for our oil and gas properties. The full cost method requires us to calculate, whenever there is an indication of impairment, a “ceiling test” or limitation of the amount of properties that can be capitalized on the balance sheet.

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

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

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

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

Asset retirement obligations

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

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

Stock-based compensation

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

Revenue recognition

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

Disclosure controls and procedures

The company has established disclosure controls and procedures to ensure timely and accurate preparation of financial and other reports. Disclosure controls and procedures are designed to provide reasonable assurance that material information is recorded, processed, summarized and reported within the time periods specified by securities regulations and that information required to be disclosed is communicated to the appropriate members of management and properly reflected in our filings. The Chief Executive Officer (CEO) and the Chief Financial Officer (CFO) oversee this process and have concluded that the design and operation of these disclosure controls and procedures are adequate and effective in ensuring that the information required to be disclosed in reports filed with the Canadian Securities Administrators is accurate and complete and filed on a timely basis. The CEO and CFO have individually signed certifications to this effect.

It should be noted that, while we believe that our disclosure controls and procedures provide a reasonable level of assurance that they are effective, they will not necessarily prevent all errors and fraud. A control system, no matter how well conceived or operated, can only provide reasonable, not absolute, assurance that the control system's objectives are met.

Related party transactions

During the year ended December 31, 2007, the Company incurred the following

- a. Legal services, disbursements and regulatory costs totaling \$381,011 (2006 - \$152,612) payable to a legal firm of which a director of the Company is counsel. These fees are included in general and administrative expense, share issuance costs and acquisition costs.
- b. Financing and advisory fees of \$413,281, comprised of \$339,730 cash, \$73,551 non-cash (2006 - \$25,000 prior to appointment as a director of the Company) payable to a Company of which a director of the Company is an officer.
- c. Payments of \$567,688 (2006 - \$Nil) for financing expenses were paid to a company which became a significant shareholder of the Company on September 11, 2007. The payments represent only that portion of financing expenses incurred subsequent to the date which the company became a significant shareholder.
- d. Financial and advisory fees of \$40,898 (2006 - \$Nil) for services rendered payable to a company controlled by a former director of the Company.
- e. Oil and gas services of \$Nil (2006 - \$274,469) to a service company of which a former director of the Company was the sole shareholder.
- f. Oil and gas services of \$Nil (2006 - \$16,732) to a service company of which a former director of the Company was the sole shareholder.

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

Additional information

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

Financial Statements of
Second Wave Petroleum Ltd.
Year Ended December 31, 2007

AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the balance sheets of Second Wave Petroleum Ltd. as at December 31, 2007 and 2006 and the statements of loss, comprehensive loss and deficit and cash flow for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2007 and 2006 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP

Chartered Accountants
Calgary, Canada
April 29, 2008

Second Wave Petroleum Ltd.

Balance Sheets

As at December 31, 2007 and 2006

	2007	2006
ASSETS		
Current assets:		
Cash and cash equivalents	\$ -	\$ 142,052
Accounts receivable	1,982,292	1,241,300
Prepaid expenses	134,400	87,553
	<u>2,116,692</u>	<u>1,470,905</u>
Property and equipment (note 5)	29,000,831	15,478,823
	<u>\$ 31,117,523</u>	<u>\$ 16,949,728</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 2,889,217	\$ 1,804,347
Loans payable (note 6)	5,551,042	10,000,000
	<u>8,440,259</u>	<u>11,804,347</u>
Convertible debenture (note 7)	8,585,844	-
Asset retirement obligation (note 9)	2,374,826	522,765
	<u>19,400,929</u>	<u>12,327,112</u>
Shareholders' equity		
Share capital (note 10)	40,991,342	33,379,327
Warrants (note 10)	1,957,057	-
Equity component of convertible debenture (note 7)	506,481	-
Contributed surplus (note 10)	1,265,096	699,878
Deficit	(33,003,382)	(29,456,589)
	<u>11,716,594</u>	<u>4,622,616</u>
Nature of business (note 1)		
Commitments (note 11)		
Subsequent events (note 16)		
	<u>\$ 31,117,523</u>	<u>\$ 16,949,728</u>

See accompanying notes to financial statements.

Approved by the Board:

Signed "Robert F. Goods" Director

Signed "Donald E. Foulkes" Director

Second Wave Petroleum Ltd.
Statements of Loss, Comprehensive Loss and Deficit
For the years ended December 31, 2007 and 2006

	2007	2006
REVENUE		
Crude oil, natural gas, and natural gas liquids sales	\$ 5,861,528	\$ 5,715,301
Royalties	(895,634)	(710,162)
Other income	34,616	33,170
	5,000,510	5,038,309
EXPENSES		
Operating	1,718,692	1,187,434
Transportation	127,256	149,641
General and administrative	2,187,511	1,938,227
Depletion, depreciation and accretion	2,318,191	22,476,760
Financing expense (note 12)	2,356,547	751,123
Write-off of goodwill	514,228	2,841,890
Stock based compensation	565,218	497,136
Accretion of convertible debenture	101,310	-
	9,888,953	29,842,211
Loss before income taxes	(4,888,443)	(24,803,902)
Income Taxes		
Future income taxes	(1,341,650)	(5,641,000)
Net loss and comprehensive loss	(3,546,793)	(19,162,902)
Deficit, beginning of year	(29,456,589)	(10,293,687)
Deficit, end of year	\$ (33,003,382)	\$ (29,456,589)
Net loss and comprehensive loss per share-basic and diluted (note 10)	\$ (0.04)	\$ (0.60)

See accompanying notes to financial statements.

Second Wave Petroleum Ltd.
Statements of Cash Flow
For the years ended December 31, 2007 and 2006

	2007	2006
Cash provided by (used in):		
OPERATIONS:		
Net loss and comprehensive loss	\$ (3,546,793)	\$ (19,162,902)
Add (deduct) items not involving cash:		
Depletion, depreciation and accretion	2,318,191	22,476,760
Stock based compensation	565,218	497,136
Write-off of goodwill	514,228	2,841,890
Accretion of convertible debenture	101,310	-
Warrants issued on loan extensions	401,030	-
Future income taxes	(1,341,650)	(5,641,000)
Cash expenditures on asset retirements	(55,766)	-
	<u>(1,044,232)</u>	<u>1,011,884</u>
Change in non-cash working capital (note 14)	(493,679)	759,060
	<u>(1,537,911)</u>	<u>1,770,944</u>
FINANCING:		
Issue of Class A shares and warrants	9,005,000	10,055,201
Share and warrant issuance costs	(555,560)	(784,706)
Issue of Class A shares on exercise of warrants	1,723,125	-
Repayment of notes receivable	-	477,253
Loan advances	5,551,042	18,100,000
Loan repayment	(10,000,000)	(8,100,000)
Convertible debenture	8,991,015	-
Change in non-cash working capital (note 14)	697,275	(34,347)
	<u>15,411,897</u>	<u>19,713,401</u>
INVESTING:		
Property and equipment expenditures	(13,958,363)	(9,637,810)
Disposition of property and equipment	-	7,329,457
Corporate acquisitions (note 4)	(151,110)	(19,008,089)
Change in non-cash working capital (note 14)	93,435	(4,679,399)
	<u>(14,016,038)</u>	<u>(25,995,841)</u>
Decrease in cash and cash equivalents	(142,052)	(4,511,496)
Cash and cash equivalents, beginning of year	142,052	4,653,548
Cash and cash equivalents, end of year	\$ -	\$ 142,052

See accompanying notes to financial statements.

Supplementary Cash Flow Information

Interest received	\$ 34,616	\$ 33,170
Interest paid	1,225,478	751,123

Second Wave Petroleum Ltd.

Notes to the Financial Statements

For the years ended December 31, 2007 and 2006

1. Nature of business:

Second Wave Petroleum Ltd. (the "Company") is incorporated under the laws of the province of Alberta. On October 10, 2007 the Company changed its name from "WaveForm Energy Ltd." to "Second Wave Petroleum Ltd." and its Class A and Class B shares now trade under the new symbols SCS.A and SCS.B respectively. The Company is engaged in the acquisition, development and exploration of petroleum and natural gas in Western Canada.

2. Significant accounting policies:

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

(a) Joint operations:

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

(b) Cash and cash equivalents:

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

(c) Petroleum and natural gas properties:

The Company follows the full cost method of accounting for petroleum and natural gas operations. All costs of exploring for and developing petroleum and natural gas properties and related reserves are capitalized. Such costs include lease acquisition, geological and geophysical activities, lease rentals on non-producing properties, drilling of productive and non-productive wells, tangible production equipment, and that portion of overhead costs directly attributable to exploration and development activities. Gains or losses on disposition of petroleum and natural gas properties are not recognized unless crediting the proceeds against the accumulated costs results in a change in the rate of depletion and depreciation by 20 percent or more.

Costs of acquiring unproved properties are initially excluded from the amount subject to depletion and are assessed periodically to ascertain whether impairment has occurred. When proved reserves are assigned to a property or a property is considered to be impaired, the cost of the property or the amount of impairment is added to the amount subject to depletion. Depletion of petroleum and natural gas properties and depreciation of production equipment are calculated using the unit-of production method based upon estimated proved reserves, before royalties, as determined by independent engineers. For purposes of the calculation, natural gas reserves and production are converted to equivalent volumes of petroleum based upon relative energy content, where 6 mcf of natural gas is equivalent to 1 barrel of oil.

Second Wave Petroleum Ltd.

Notes to the Financial Statements

For the year ended December 31, 2007 and 2006

2. Significant accounting policies (continued):

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

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

(d) Asset retirement obligations:

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

(e) Income taxes:

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

(f) Flow-through shares:

In accordance with tax legislation, the Company renounces deductions related to resource expenditures to the extent they have been financed through the issuance of flow-through shares. Future tax liabilities and share capital are adjusted by the estimated cost of the renounced tax deductions upon renouncement.

Second Wave Petroleum Ltd.

Notes to the Financial Statements

For the years ended December 31, 2007 and 2006

2. Significant accounting policies (continued):

(g) Stock-based compensation plans:

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

(h) Measurement uncertainty:

The amounts recorded for depletion, depreciation and amortization of petroleum and natural gas properties and equipment and the provision for future asset retirement obligations are based on estimates of proved reserves, production rates, oil and gas prices, future prices and costs and other relevant assumptions. Computation of stock-based compensation expense includes estimates of future stock price volatility and dividend policies. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future periods could be significant.

(i) Per share amounts:

In calculating per share amounts, the weighted average number of Basic shares outstanding is the addition of the weighted average number of Class A plus the weighted average number of Class B shares outstanding during the period on a one to one basis. Diluted shares outstanding add the diluted Class A and diluted Class B shares outstanding, with Class B shares converted to Class A on a ten to one basis. Diluted per share amounts are calculated using the treasury stock method, which assumes that any proceeds from the exercise of stock options, and warrants in addition to the unrecognized amount of stock-based compensation expense are used to purchase Class A shares of the Company at the average market price during the reporting period. The weighted average number of shares outstanding is then adjusted by the net change.

(j) Financial instruments:

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

Second Wave Petroleum Ltd.

Notes to the Financial Statements

For the years ended December 31, 2007 and 2006

2. Significant accounting policies (continued):

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

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

A new statement of comprehensive income is required, which is comprised of net earnings and other comprehensive income which may report the changes in fair value in, derivatives designated as cash flow hedges and available-for-sale investments and foreign exchange translation. Second Wave had no “other comprehensive income or loss” transactions during the year ended December 31, 2007 and no opening or closing balances for the accumulated other comprehensive income or loss.

(k) Revenue recognition:

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

(l) Future accounting changes:

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

The new Capital Disclosure standard requires the disclosure objectives, policies and processes for managing capital. This includes qualitative information regarding the Company’s objectives, policies and processes for managing capital and summary quantitative data about what the Company manages as capital. This requires additional disclosure and will be implemented in the first quarter of 2008.

Second Wave Petroleum Ltd.

Notes to the Financial Statements

For the years ended December 31, 2007 and 2006

2. Significant accounting policies (continued):

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

(m) Basis of presentation:

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

3. Changes in accounting policies

Effective January 1, 2007, the Company has adopted the new Canadian accounting standards for financial instruments – recognition and measurement, presentation and disclosures, hedging and comprehensive income. There is no impact as a result of the adoption of the new Canadian accounting standards.

4. Acquisitions

(a) Acquisition of Stone Castle Exploration Ltd:

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

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

Second Wave Petroleum Ltd.

Notes to the Financial Statements

For the years ended December 31, 2007 and 2006

4. Acquisitions (continued)

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

(b) Acquisition of assets

On October 26, 2007, the Company closed the acquisition of certain oil and natural gas assets and working capital for approximately \$9,100,000, subject to normal closing adjustments. Included in the acquisition was \$520,000 of current and other assets. In addition the Company posted a letter of credit in the amount of \$2,300,000 (subsequently reduced to \$1,300,000) as security for potential contingent liabilities associated with the acquisition. Settlement of potential contingent liabilities will be treated as purchase price adjustments in the period of settlement. The assets were acquired from a company which is a significant shareholder in the Company; however the transaction was completed on the basis of fair market value and general market terms and conditions. To facilitate the acquisition described above the Company established an \$8,000,000 credit facility with a Canadian chartered bank. The facility is comprised of a \$6,000,000 demand operating line to be reviewed annually, and a \$2,000,000 term loan due January 31, 2008. The operating line bears interest at the bank's prime rate plus 0.4% and is secured by the assets of the Company. The term loan, bearing interest at the bank's prime rate plus 2% was repaid in full on January 15, 2008.

(c) Acquisition of limited partnership

Effective April 1 2006, the Company acquired all of the issued and outstanding partnership units of B&G Energy 2005 Limited Partnership, a partnership operating natural gas assets in the Ferrier and Rowley areas of Alberta, for cash consideration of \$18,500,000. Results of operations of the Partnership have been included with the Company's operations from the date of close, April 20, 2006. The partnership was wound up immediately after the last partner's units were acquired in the transaction.

The purchase price consists of:

Cash	\$	18,500,000
Acquisition costs		508,089
	\$	19,008,089
Fair value of assets and liabilities assumed:		
Property and equipment	\$	22,873,699
Goodwill		2,841,890
Asset retirement obligation		(66,500)
Future income taxes		(6,641,000)
	\$	19,008,089

During 2006, the value of goodwill was assessed as impaired and was fully written off.

Second Wave Petroleum Ltd.
Notes to the Financial Statements
For the years ended December 31, 2007 and 2006

5. Property and equipment

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

	December 31, 2006		
	Cost	Accumulated Depletion, Depreciation and amortization	Net Book Value
Petroleum and natural gas properties	\$52,091,798	\$36,677,002	\$15,414,796
Office equipment	103,988	39,961	64,027
	\$52,195,786	\$36,716,963	\$15,478,823

At December 31, 2007, \$1,025,025 (December 31, 2006 - \$868,796) of undeveloped land and seismic costs have been excluded from the depletion base. Future development costs of \$2,185,375 (December 31, 2006 – \$1,080,000) were included in the calculation of depletion. In 2007, \$Nil (December 31, 2006 – \$58,125) of general and administrative costs have been capitalized.

The Company has performed the ceiling test calculation at December 31, 2007 to assess the recoverable value of the petroleum and natural gas properties. The petroleum prices used in the calculation are based on December 31, 2007 benchmark commodity price for forecasts of an independent reserve evaluator and adjusted for commodity price differentials of the Company, and are as follows:

Second Wave Petroleum Ltd.

Notes to the Financial Statements

For the year ended December 31, 2007 and 2006

5. Property and equipment (continued)

	Medium Oil		Light Oil		Natural Gas	
	Company Average (Canadian \$/bbl)	Medium Crude Cromer \$/bbl	Company Average (Canadian \$/bbl)	Edmonton Par Light Crude (Canadian \$/ bbl)	Company Average (Canadian \$/mcf)	AECO – C Hub (Canadian \$/mcf)
2008	68.99	79.26	77.82	91.10	6.44	6.75
2009	66.11	75.78	74.03	87.10	7.23	7.55
2010	63.23	72.30	70.28	83.10	7.28	7.60
2011	61.79	70.56	68.97	81.10	7.26	7.60
2012	61.79	70.56	68.87	81.10	7.26	7.60
2013	62.60	70.56	68.43	81.10	7.24	7.60
2014	63.41	70.56	68.42	81.10	7.43	7.80
2015	64.22	70.56	68.42	81.10	7.59	7.97
2016	65.05	70.57	68.55	81.12	7.73	8.14
2017	66.30	72.00	70.21	82.76	7.87	8.31
2018	67.56	73.44	72.00	84.41	8.02	8.48

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

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

In 2006, the Company recorded an impairment loss of \$18,458,100 which was recognized as increased depletion in the year. The carrying value of capitalized costs was reduced to the value of discounted future net revenues from production of proved and probable reserves plus the cost of unproved properties.

6. Loans payable

	Year ended December 31,	
	2007	2006
Revolving operating loan facility (note 6a)	3,334,150	-
Cheques issued in excess of balance in account	216,892	-
Term loan payable (note 6b)	2,000,000	-
Senior secured debt facility (note 6c)	-	10,000,000
Balance, end of year	\$ 5,551,042	\$ 10,000,000

Second Wave Petroleum Ltd.
Notes to the Financial Statements
For the year ended December 31, 2007 and 2006

6. Loans payable (continued)

(a) Revolving operating loan facility

On October 26, 2007, the Company entered into a \$6,000,000 credit facility with a Canadian chartered bank. The facility is a demand revolving operating line which is reviewed annually and includes a \$2,265,850 letter of guarantee that was posted for potential contingent liabilities in connection with an asset acquisition. The operating line bears interest at the bank's prime rate plus 0.4% and is secured by the assets of the Company. The letter of guarantee has a one year term and includes a fee of 2% per annum.

Subsequent to year end \$1,000,000 of the contingent liabilities were settled for a nominal amount and the letter of guarantee was reduced to \$1,265,850.

At December 31, 2007, the Company was not in compliance with certain financial covenants under the loan agreement. The lender has waived compliance to such covenants.

(b) Non revolving term loan

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

(c) Senior secured debt facility

In 2006, the Company entered into a senior secured debt facility (the "facility") that had a first charge on all assets of the Company. The facility was initially drawn for \$18,100,000 to finance the acquisition of the limited partnership units (note 3c), but was repaid to \$10,000,000 within 30 days of the closing of the acquisition. The facility bore interest at bank prime rate plus 3% per annum. At December 31, 2006, the Company had a loan of \$10,000,000, of which \$2,000,000 was repaid in January 2007 from proceeds of an equity offering (see note 10a). At December 31, 2006, the Company was not in compliance with certain financial covenants under the loan agreement. The lender has waived compliance to such covenants. The facility was fully repaid on July 30, 2007, with proceeds on issuance of the convertible debenture (see note 7).

7. Convertible debenture

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

Second Wave Petroleum Ltd.
Notes to the Financial Statements
For the year ended December 31, 2007 and 2006

7. Convertible debenture (continued)

Convertible debenture	Equity Component	Debt Component
Debenture issued	\$ -	\$ 9,000,000
Equity portion	515,466	(515,466)
Issue costs (net of future taxes of \$3,850)	(8,985)	-
Accretion of non-cash interest expense	-	101,310
Balance, end of period	\$ 506,481	\$ 8,585,844

On July 30, 2007, the Company issued a secured convertible debenture (“the Debenture”) in the amount of \$9,000,000. The Debenture bears interest at bank prime rate plus 2% per annum, has a fixed charge on all the assets of the Company and is due on July 30, 2009. Proceeds from the issuance of the debenture were used to repay the Company’s existing credit facility. The Company may redeem the Debenture at anytime prior to July 30, 2009 at a price equal to 108% of the aggregate principal amount outstanding and is convertible at anytime, in whole or in part, into Class A shares of the Company at a price of \$0.11 per share.

At December 31, 2007, the Company was not in compliance with certain financial covenants under the loan agreement. The lender has waived compliance to such covenants.

On January 17, 2008, the holder exercised its option to convert its \$9.0 million convertible debenture into 81,818,182 Class A Shares of Second Wave.

8. Future income taxes

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

	2007	2006
Net loss and comprehensive loss before income taxes	\$ (4,888,443)	\$ (24,803,902)
Combined federal and provincial tax rate	32.12%	34.25%
Calculated “expected” income tax expense	(1,570,100)	(8,495,000)
Increase resulting from:		
Non-deductible goodwill	165,200	973,000
Other non-deductible items	206,100	239,000
Resource allowance	-	(71,000)
Change in tax rate	239,100	434,000
Valuation allowance	(523,850)	1,227,000
Other	141,900	52,000
Future income tax reduction	\$ (1,341,650)	\$ (5,641,000)

Second Wave Petroleum Ltd.

Notes to the Financial Statements

For the year ended December 31, 2007 and 2006

8. Future income taxes (continued)

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

Property, and equipment	\$	(1,840,000)	\$	431,000
Share issuance costs		545,000		696,000
Non capital losses		2,408,000		100,000
Valuation allowance		(1,113,000)		(1,227,000)
Net future income tax asset	\$	-	\$	-

The Company has accumulated non-capital losses for income tax purposes of approximately \$9,674,000 which are available against future taxable income. Unless sufficient taxable income is earned, these losses will expire in 2015.

9. Asset retirement obligation

The Company's asset retirement obligations result from net ownership interest in petroleum and natural gas assets. A credit adjusted risk free rate of 7.5% and an inflation rate of 2% (2006 -1.5%) were used to calculate the fair value of the asset retirement obligation. Undiscounted estimated cash flow of \$3,475,000 (2006 - \$965,000) is required to settle the obligation at estimated dates in the future ranging from 2008 to 2025.

	December 31, 2007	December 31, 2006
Beginning of year	\$ 522,765	\$ 421,937
Liabilities incurred	115,948	1,784
Accretion expense	54,991	32,544
Acquired on asset acquisition (note 4b)	1,766,750	-
Acquired on business acquisitions (note 4a and 4c)	209,279	66,500
Changes in accounting estimates	(239,141)	-
Abandonments	(55,766)	-
End of year	\$ 2,374,826	\$ 522,765

Second Wave Petroleum Ltd.
Notes to the Financial Statements
For the year ended December 31, 2007 and 2006

10. Share capital

(a) Authorized:

The authorized share capital consists of an unlimited number of Class A and B voting shares. The Class B shares are convertible into Class A shares based on a formula equal to \$10 divided by the greater of \$1 and the then market price of the Class A shares. The Class B shares are convertible at the option of the Company at any time after January 21, 2008 and before January 31, 2010. The Class B shares are convertible at the option of the shareholder, at any time after February 1, 2010 and before March 1, 2010. Any Class B shares not previously converted will automatically convert to Class A shares on March 1, 2010.

(b) Issued and outstanding:

	2007		2006	
	Number of Shares	Value	Number of Shares	Value
Class A Shares				
Beginning of year	32,118,631	\$ 28,261,895	27,461,264	\$ 20,578,468
Issued for cash (note 10c)	77,500,000	7,266,393	1,630,500	3,000,120
Flow through shares issued for cash (note 10d)	-	-	2,916,700	7,000,080
Transfer of carrying value on exercise of warrants	-	290,938	-	-
Flow through shares issued on exercise of warrants (note 10g)	200,000	24,000	-	-
Stock options exercised (note 10f)	-	-	110,167	73,933
Warrants exercised (note 10g)	11,958,000	1,499,125	-	-
Broker warrants exercised (note 10g)	1,600,000	200,000	-	-
Future tax effect of flow-through shares	-	(2,282,200)	-	(1,873,000)
Issued for acquisition of Stone Castle (note 4a)	6,192,500	891,720	-	-
Share issue costs (net of future income taxes of \$128,040 (2006 - \$267,000))	-	(277,961)	-	(517,706)
End of year	129,569,131	\$ 35,873,910	32,118,631	\$ 28,261,895
Class B Shares				
Beginning of year	935,616	\$ 5,117,432	935,616	\$ 5,117,432
Future tax effect of share issue costs	-	-	-	413,600
End of year	935,616	\$ 5,117,432	935,616	\$ 5,117,432
End of year – Class A and Class B shares	130,504,707	\$ 40,991,342	33,054,247	\$ 33,379,327

Second Wave Petroleum Ltd.

Notes to the Financial Statements

For the year ended December 31, 2007 and 2006

10. Share capital (continued)

(c) Issued for cash:

On January 15, 2007, the Company issued 32,000,000 Units at \$0.125 per unit for gross proceeds of \$4,000,000 and in September 2007, the Company issued an additional 45,500,000 Units at \$0.11 per unit for gross proceeds of \$5,005,000. In both placements the Units consisted of one Class A share and one Class A share purchase warrant. The Company used the Black-Scholes option pricing model to determine the values of the Class A share purchase warrants in connection with these issuances. The Black-Scholes value of the warrants was \$1,738,607.

In March 2006, the Company issued 1,630,500 Class A shares at \$1.84 per share for gross proceeds of \$3,000,120.

(d) Flow-through shares issued:

In November 2007, 200,000 Class A shares of the Company were issued on exercise of \$0.12 flow through warrants. The Company is committed to spend 100% of the funds on qualifying exploration and development expenditures prior to December 31, 2008.

In March 2006, the Second Wave issued 2,916,700 Class A “flow through” shares at \$2.40 per share for gross proceeds of \$7,000,080. The Company is committed to spend 100% of the funds on qualifying exploration and development expenditures. Effective December 31, 2006 in accordance with the terms of the share subscription agreements, the Company renounced for income tax purposes, \$7,000,080 to holders of Class A shares and had incurred \$2,367,714 in eligible expenditures. During 2007, \$3,650,000 was expended on qualifying flow through expenditures and approximately \$580,000 was incurred during the first quarter in 2008.

(e) Net loss and comprehensive loss per share:

The basic weighted average number of Class A and Class B shares outstanding during the year was 90,790,728 (December 31, 2006 – 32,161,503). All warrants and options would have an anti-dilutive effect on the loss per share as the Company is in a loss position.

Diluted weighted average number of Class A and Class B shares outstanding as at December 31, 2007 was 113,380,693. The dilutive effect of outstanding options and warrants is calculated using the treasury stock method. For this period the effects are antidilutive.

Second Wave Petroleum Ltd.

Notes to the Financial Statements

For the year ended December 31, 2007 and 2006

10. Share capital (continued)

(f) Stock option plan:

The Company has a stock option plan for directors, officers, employees and consultants. The Company may grant up to 10% of the aggregate number of Class A and Class B shares outstanding and no one optionee is permitted to hold more than 5% of the total Class A and B shares outstanding. Options granted prior to December 21, 2007 vest one third immediately and one third on the first and second anniversary dates of the grant. Options granted subsequent to the appointment of new management vest one third on the each of the first, second and third anniversary dates. All options expire in five years from the date of grant.

	December 31, 2007		December 31, 2006	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Beginning of year	1,645,333	\$ 0.60	1,871,400	\$ 0.88
Granted	13,300,000	0.20	400,000	1.00
Forfeited	(2,270,333)	0.39	(515,900)	1.17
Exercised	-	-	(110,167)	0.50
Outstanding – end of year	12,675,000	\$ 0.23	1,645,333	\$ 0.60
Exercisable – end of year	2,441,677	\$0.31	1,203,662	\$ 0.61

Exercise Price	Options outstanding		Options exercisable	
	Number	Weighted Average Remaining Life (years)	Number	Weighted Average Remaining Life (years)
\$0.11	400,000	4.66	133,336	4.66
\$0.15	300,000	4.32	100,002	4.32
\$0.20	11,400,000	4.62	1,766,672	4.04
\$0.40	150,000	2.02	150,000	2.02
\$1.00	400,000	3.52	266,667	3.52
\$2.04	25,000	2.61	25,000	2.61
	12,675,000		2,441,677	

The weighted average grant date fair value of all options granted in 2007 was \$0.125 (2006 - \$0.40).

The fair value of options granted during the year of \$1,662,528 (2006 - \$158,483) was calculated using a risk free rate of approximately 4%, dividend yield of 0%, volatility factor of 75%, and an expected life of 5 years. The value of the options was recorded as stock based compensation expense, with an offsetting amount to contributed surplus based on the vesting terms.

Second Wave Petroleum Ltd.
Notes to the Financial Statements
For the year ended December 31, 2007 and 2006

10. Share capital (continued)

(g) Warrants:

	Year ended December 31, 2007	
	Number of warrants	Value
Balance beginning of year	-	-
Issued with shares (net of share issuance costs of \$103,490 and future taxes of \$31,054)	79,100,000	\$ 1,662,796
Issued to brokers	1,600,000	38,463
Issued on loan extensions	8,500,000	401,030
Issued on acquisition of Stone Castle Exploration	6,192,500	145,706
Warrants exercised	(11,958,000)	-
Brokers warrants exercised	(1,600,000)	-
Flow through warrants exercised	(200,000)	-
Transfer of carrying value on exercise of warrants	-	(290,938)
Balance, end of year	81,634,500	\$ 1,957,057

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

On January 15, 2007, the Company issued 32,000,000 Units at \$0.125 per unit for gross proceeds of \$4,000,000. The Units were comprised of one Class A share and one Warrant. Each warrant is exercisable into one Class A Share at a price of \$0.125 per share until March 31, 2007 (extended to April 3, 2007), thereafter at \$0.20 per share until June 30, 2007, thereafter at \$0.30 per share until December 31, 2007, and thereafter at \$0.40 per share until expiry on December 31, 2008. In connection with the financing, the Company also issued 1,600,000 broker warrants to the financing agent. Each broker warrant is exercisable into one unit comprised of one Class A Share and one warrant at a price of \$0.125 per unit, with each warrant then being exercisable under the same terms as the non-broker warrants. Upon exercise of the brokers warrants, an additional 1,600,000 warrants were issued to the brokers.

On January 15, 2007, the Company issued 3,500,000 warrants to its lender as consideration for the loan extension. Each warrant is exercisable into one Class A Share at a price of \$0.125 per share, before the Facility is fully paid, \$0.175 upon full repayment of the Facility, until expiry on January 15, 2009.

In May 7, 2007, the Company issued 12,385,000 units at \$0.084 per unit for total consideration \$1,037,426 to the shareholders of Stone Castle. The units consisted of 0.5 Class A share and 0.5 warrant. Each warrant is exercisable into one Class A share at a price of \$0.20 per share until June 30, 2007, thereafter at \$0.30 per share until December 31, 2007 and thereafter at \$0.40 per share until expiry on December 31, 2008.

Second Wave Petroleum Ltd.

Notes to the Financial Statements

For the year ended December 31, 2007 and 2006

10. Share capital (continued)

In May 7, 2007, as a result of the acquisition of Stone Castle, the Company increased its debt facility with its principal lender by \$1,000,000 and extended the repayment of the debt facility to December 31, 2007. As consideration for the increased loan and extension, the Company issued 5,000,000 warrants to purchase 5,000,000 Class A shares to its lender. The warrants have an exercise price of \$0.15 until the loan is repaid and thereafter at a price of \$0.175 until expiry on May 7, 2009.

On September 11, 2007, the Company issued 45,500,000 Units at \$0.11 per unit for gross proceeds of \$5,005,000. Each unit consisted of a Class A Share and a flow through warrant exercisable at \$0.12 until they expire on December 31, 2008.

In January 2008, the holder of 29,288,636 of these warrants exercised its warrants and elected not to take the related flow through deductions. If all remaining flow through warrants that arose from the September 2007 private placement is exercised, the Company could be committed to expend an additional \$1,900,000 of eligible expenditures during the year.

(h) Escrowed shares

Pursuant to an Escrow Agreement dated October 28, 2004 a total of 6,179,000 Class A shares of certain officers, directors, employees, and principal shareholders were being held in escrow. On January 7, 2005 when the shares of the Company were listed on the TSX Venture exchange, 10% of the escrowed shares were released. The remaining 90% were released in 15% increments during consecutive 6 month periods following the listing. As of December 31, 2007, 911,094 Class A shares were in escrow, and were released on January 11, 2008.

(i) Contributed surplus

A summary of change in the Company's contributed surplus balance for the year ended December 31, 2007 and 2006 is as follows:

	Year ended December 31,	
	2007	2006
Balance beginning of year	\$699,878	\$ 221,674
Stock based compensation related to fair value of options granted	565,218	497,674
Options exercised	-	(18,932)
Balance, end of year	\$1,265,096	\$ 699,878

Second Wave Petroleum Ltd.
Notes to the Financial Statements
For the year ended December 31, 2007 and 2006

11. Commitments

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

2008	\$	195,750
2009		195,750
2010		195,750
2011		65,250

12. Financing expense

	2007	2006
Interest on short term debt	\$ 634,600	\$ 751,123
Interest on convertible debenture	590,878	-
Finance charges on flow through share obligation	730,039	-
Loan extension fees	401,030	-
	\$ 2,356,547	\$ 751,123

13. Related party transactions

During the year ended December 31, 2007, the Company incurred the following

- a. Legal services, disbursements and regulatory costs totaling \$381,011 (2006 - \$152,612) payable to a legal firm of which a director of the Company is counsel. These fees are included in general and administrative expense, share issuance costs and acquisition costs.
- b. Financing and advisory fees of \$413,281, comprised of \$339,730 cash, \$73,551 non-cash (2006 - \$25,000 prior to appointment as a director of the Company) payable to a Company of which a director of the Company is an officer.
- c. Payments of \$567,688 (2006 - \$Nil) for financing expenses were paid to a company which became a significant shareholder of the Company on September 11, 2007. The payments represent only that portion of financing expenses incurred subsequent to the date which the company became a significant shareholder.
- d. Financial and advisory fees of \$40,898 (2006 - \$Nil) for services rendered payable to a company controlled by a former director of the Company.
- e. Oil and gas services of \$Nil (2006 - \$274,469) to a service company of which a former director of the Company was the sole shareholder.

Second Wave Petroleum Ltd.

Notes to the Financial Statements

For the year ended December 31, 2007 and 2006

13. Related party transactions (continued)

- f. Oil and gas services of \$Nil (2006 - \$16,732) to a service company of which a former director of the Company was the sole shareholder.

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

14. Changes in non-cash working capital

	2007	2006
Decrease (increase) in non-cash working capital		
Accounts receivable	\$ (740,992)	\$ 2,806,837
Prepaid expenses	(46,847)	(70,188)
Accounts payable and accrued liabilities	1,084,870	(6,691,335)
Net change in non-cash working capital	\$ 297,031	\$ (3,954,686)
Relating to:		
Operations	\$ (493,679)	\$ 759,060
Financing	697,275	(34,347)
Investments	93,435	(4,679,399)
	\$ 297,031	\$ (3,954,686)

15. Financial instruments

The Company's financial instruments recognized in the balance sheet include cash and cash equivalents, accounts receivable, accounts payable, bank loans and a convertible debenture. The fair values of these instruments approximate their carrying value due to their short term to maturity of these instruments and the market rate of interest applied to the loan. Substantially all of the Company's accounts receivable relate to crude oil and natural gas sales and are exposed to typical industry credit risks and amounts due from joint venture partners. The Company attempts to reduce its credit risk by entering into sales contracts with only credit worthy entities. Account receivable from joint venture partners on properties that the Company operates are adequately secured by provisions of various joint operating agreements. The holder of the convertible debenture elected to convert its debenture into equity on January 17, 2008 (see note 16b).

Second Wave Petroleum Ltd.

Notes to the Financial Statements

For the year ended December 31, 2007 and 2006

15. Financial instruments (continued)

During 2007, the Company did not undertake any hedging activities with respect to its crude oil, natural gas liquids, and natural gas sales. The Company was exposed to fluctuations in commodity prices. However in 2008, Second Wave entered into the following hedge:

Volume (bbl/d)	Costless Collar (WTI)	Term
100 bbl	US \$80 - \$101/bbl	April – October 2008

16. Subsequent events

- (a) On January 15, 2008, Brookfield Bridge Lending Fund Inc. (“Brookfield”), exercised Share Purchase Warrants to acquire 37,788,636 Class A Shares of Second Wave for proceeds of approximately \$4,700,000 to Second Wave. This resulted in Brookfield holding an aggregate of 67,077,272 Class A Shares of Second Wave, or 40.1% of the issued and outstanding Class A Shares of Second Wave.

On January 17, 2008, Brookfield exercised its option to convert its \$9,000,000 variable rate secured convertible debenture into 81,818,182 Class A Shares of Second Wave. Upon conversion of the debenture, Brookfield owns approximately 58% of the issued and outstanding Class A Shares of Second Wave.

- (b) On January 17, 2008, Second Wave closed a private placement to members of management and directors of Second Wave. In aggregate, Second Wave issued 6,004,889 Units, for aggregate proceeds of \$1,080,880. Each Unit was comprised of One Class A Share issued on a flow-through basis and one share purchase warrant entitling the holder to acquire one Class A Share of Second Wave at \$0.20 per share for a period of up to two years.

In connection with the private placement, Second Wave is committed to expend \$1,080,880 in eligible flow through expenditures during 2008.

- (c) On February 22, 2008, Second Wave agreed to acquire all of the issued shares of Milagro Energy Inc. (“Milagro”) through the issuance of a maximum 5,000,000 units comprised of one Class A Share of Second Wave and one share purchase warrant to acquire one Class A Share of Second Wave. Each whole warrant would entitle the holder to purchase one Class A Share of Second Wave at a price of \$0.40 for one year from the closing date of the Transaction. The acquisition is subject to approval of Milagro’s shareholders.
- (d) Subsequent to year end the Company granted 6,175,000 stock options at prices of either \$0.24 or \$0.26 per option to employees.

Second Wave Petroleum Ltd.

Notes to the Financial Statements

For the year ended December 31, 2007 and 2006

16. Subsequent events (continued)

- (e) On April 23, 2008, Second Wave entered into an agreement whereby Brookfield would subscribe for up to \$10,000,000, not subscribed for by others, in an equity private placement for up to 40,000,000 Units at \$0.25 per Unit. Each Unit is comprised of one Class A Share and 0.6 Class A Share purchase warrant. Each warrant is exercisable for two years from the closing date at a price of \$0.3125 per warrant.

On April 23, 2008, Second Wave entered into a \$7,500,000 secured revolving facility agreement with Brookfield. The facility bears interest at the bank's prime rate plus 2%, and has a two year term.

The combined commitment fees on the above financings amount to \$475,000.

The use of the proceeds from the private placement and secured revolving facility is contingent upon the closing of the acquisition of Milagro and is to be directed to pay down the outstanding debt of Milagro upon closing the acquisition.

- (f) On April 25, 2008, Second Wave entered into an indicative non binding term sheet with its senior lender, to increase its borrowing base from \$6,000,000 to \$12,000,000 on its existing credit facility. Upon successful closing of the Milagro acquisition this line will increase to \$18,000,000.