

Regal Energy Ltd.
Interim Financial Statements
December 31, 2008
(unaudited)

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Management’s Comments on the Unaudited Financial Statements

The accompanying unaudited interim financial statements of Regal Energy Ltd. for the three months ended December 31, 2008 have been prepared by management and approved by the Audit Committee and the Board of Directors of the Company. These statements have not been reviewed by the Company’s external auditors.

Regal Energy Ltd.
Interim Balance Sheets

As at	Dec. 31, 2008 (unaudited)	Sept. 30, 2008 (audited)
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 487,343	\$ -
Accounts receivable	1,643,020	2,298,600
Deposits and prepaid expenses	424,518	484,460
	<u>2,554,881</u>	<u>2,783,060</u>
Property and equipment (Note 3)	28,826,458	28,367,818
Intangible assets	<u>-</u>	<u>24,993</u>
	\$ 31,381,339	\$ 31,175,871
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current		
Bank indebtedness (Note 4)	\$ 3,350,000	\$ 2,593,819
Accounts payable and accrued liabilities	3,966,123	3,288,808
	<u>7,316,123</u>	<u>5,882,627</u>
Asset retirement obligation (Note 6)	979,849	950,799
SHAREHOLDERS' EQUITY		
Equity instruments (Note 5(b) and (c))	93,641,650	93,641,650
Contributed surplus (Note 5(e))	2,402,556	2,298,280
Deficit	(72,958,839)	(71,597,485)
	<u>23,085,367</u>	<u>24,342,445</u>
	\$ 31,381,339	\$ 31,175,871
Future operations (Note 1)		
Subsequent events (Note 10)		

See accompanying notes

Regal Energy Ltd.

Interim Statements of Operations, Comprehensive Loss and Deficit

	For the three month period ended Dec. 31, 2008 (unaudited)	For the three month period ended Dec. 31, 2007 (audited)
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REVENUE		
Production revenues	\$ 1,252,207	\$ 691,631
Royalties	(286,463)	(113,484)
Interest and other income	2,304	352
	968,048	578,499
 EXPENSES		
Operating	544,110	369,808
General and administrative	668,254	242,221
Interest	37,631	28,150
Stock-based compensation (Note 5(d))	104,276	22,895
Depletion and depreciation	933,726	379,496
Amortization of intangible asset	24,993	24,993
Accretion	16,412	9,078
	2,329,402	1,076,641
 Net loss and comprehensive loss for the period	(1,361,354)	(498,142)
 Deficit, beginning of period	(71,597,485)	(68,511,830)
 Deficit, end of period	\$ (72,958,839)	\$ (69,009,972)
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Net loss per share		
- Basic and diluted	\$ 0.01	\$ 0.01
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Weighted average shares outstanding		
- Basic	150,050,209	48,137,590
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See accompanying notes.

Regal Energy Ltd.
Interim Statements of Cash Flows

	For the three month period ended Dec. 31, 2008 (unaudited)	For the three month period ended Dec. 31, 2007 (audited)
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CASH FLOW FROM OPERATING ACTIVITIES		
Net loss for the period	\$ (1,361,354)	\$ (498,142)
Add non-cash items:		
Stock-based compensation	104,276	22,895
Amortization of intangible asset	24,993	24,993
Depletion and depreciation	933,726	379,496
Accretion	16,412	9,078
	<u>(281,947)</u>	<u>(61,680)</u>
Net change in non-cash working capital balances	<u>126,314</u>	<u>260,095</u>
	<u>(155,633)</u>	<u>198,415</u>
 CASH FLOW FROM FINANCING ACTIVITIES		
Bank indebtedness	<u>756,181</u>	<u>1,178,556</u>
 CASH FLOW USED IN INVESTING ACTIVITIES		
Net change in non-cash working capital balances	1,266,523	12,618
Capital expenditures	<u>(1,379,728)</u>	<u>(1,389,589)</u>
	<u>(113,205)</u>	<u>(1,376,971)</u>
 Increase in cash and cash equivalents	487,343	-
 Cash and cash equivalents, beginning of period	<u>-</u>	<u>-</u>
 Cash and cash equivalents, end of period	\$ 487,343	\$ -
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See accompanying notes.

See Supplemental Cash Flow Information Note 7.

REGAL ENERGY LTD.
NOTES TO THE INTERIM FINANCIAL STATEMENTS
(unaudited)

1. Description of Business and Future Operations

Regal Energy Ltd. (“Regal or the Company”) is engaged in the exploration for and the development, production and acquisition of petroleum and natural gas reserves in Western Canada. Regal’s financial year end is September 30. The Company’s wholly-owned subsidiary G2 Resources Inc. was amalgamated into Regal on October 1, 2008.

The interim financial statements of the Company have been prepared by the Company’s management, in accordance with Canadian generally accepted accounting principles and without audit or review by the Company’s auditor. The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. The interim financial statements have been prepared following the same accounting policies and methods of computation as the audited consolidated financial statements for the year ended September 30, 2008. These interim financial statements do not include all the note disclosures required for annual financial statements and therefore they should be read in conjunction with the Company’s audited consolidated financial statements for the year ended September 30, 2008.

At December 31, 2008 the Company had a working capital deficiency of \$4,761,242 including the amounts drawn on the Company’s revolving credit facility. For the quarter ended December 31, 2008 the Company incurred a net loss of \$1,361,354 and used cash of \$155,633 in operating activities. The Company’s financial statements as at and for the quarter ended December 31, 2008 have been prepared on a going concern basis, which contemplates the realization of assets and the settlement of liabilities and commitments in the normal course of business. The successful future operations of the Company are dependent on achieving and maintaining profitable operations, and the continued financial support from its lenders. Management of the Company may also seek additional equity to complement its capital structure. (See also Note 10).

Management believes that the going concern assumption is appropriate for these financial statements. If this assumption was not, appropriate adjustments to the carrying amounts of the assets and liabilities, revenues and expenses, and the balance sheet classifications used might be necessary.

2. Significant Accounting Policies

Accounting Pronouncements

Effective October 1, 2008, the Company is required to adopt the following new accounting standards:

- a) Inventories.
- b) Goodwill and Intangible Assets.

The inventory standard prescribes measurements of inventories at the lower of cost and net realizable value. The new standard for Goodwill and Intangible Assets states that upon their initial identification, intangible assets are to be recognized as assets only if they meet the definition of an intangible asset and the recognition criteria. It also provides further information on the recognition of internally generated intangible assets, including research and development costs. These new standards are not expected to have a material impact on the Company’s financial statements.

In January 2006, the CICA Accounting Standards Board (“ASCB”) adopted a strategic plan for the direction of accounting standards in Canada. As part of that plan, accounting standards in Canada for public companies are expected to converge with International Financial Reporting Standards (“IFRS”) by 2011. The Company continues to monitor and assess the impact of the convergence of Canadian GAAP and IFRS but has not at this time made any determination on the impact on the Company’s financial statements.

REGAL ENERGY LTD.
NOTES TO THE INTERIM FINANCIAL STATEMENTS
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3. Property and equipment

December 31, 2008	Cost	Accumulated depletion, depreciation and amortization	Net book value
Petroleum and natural gas properties and equipment	\$40,593,711	\$12,728,434	\$27,865,277
Seismic resources	745,084	-	745,084
Other assets	301,447	85,350	216,097
	\$41,640,242	\$12,813,784	\$28,826,458

September 30, 2008	Cost	Accumulated depletion, depreciation and amortization	Net book value
Petroleum and natural gas properties and equipment	\$39,206,425	\$11,814,759	\$27,391,666
Seismic resources	742,419	-	742,419
Other assets	299,032	65,299	233,733
	\$40,247,876	\$11,880,058	\$28,367,818

Costs of acquiring seismic resources referenced in the above tables in the amount of \$745,084 at December 31, 2008 and \$742,419 at September 30, 2008 were excluded from the depletable costs. Costs of unproved properties in the amount of \$3,627,546 at December 31, 2008 and \$3,591,441 at September 30, 2008 are also excluded from depletable costs. Future development costs of \$5,617,000 were included in the depletion calculation at September 30, 2008 and December 31, 2008.

The petroleum and natural gas properties are subject to a ceiling test, which was calculated at December 31, 2008 using the following benchmark reference prices. At December 31, 2008 there was no impairment to the value of the Company's petroleum and natural gas properties.

	Edmonton Light Crude \$Cdn/BBL	Hardisty Bow River Crude \$Cdn/BBL	AECO Natural Gas \$Cdn/MMBTU
2009	68.61	51.44	7.58
2010	78.94	59.21	7.94
2011	83.54	63.49	8.34
2012	90.92	69.10	8.70
2013	95.91	72.89	8.95
2014	97.84	74.36	9.14
2015	99.82	75.86	9.34
2016	101.83	77.39	9.54
2017	103.89	78.96	9.75
2018+	+2% per year thereafter	+2% per year thereafter	+2% per year thereafter

4. Lending Facility

The Company has a revolving operating demand facility of \$4,300,000 that bears interest at the bank prime rate plus one and one-quarter percent. Repayments of the facility are not required provided the amounts borrowed do not exceed \$4,300,000 or an amount to be determined from time to time. At December 31, 2008 there was \$3,350,000 drawn on the revolving operating demand facility. The above facility is secured

REGAL ENERGY LTD.
NOTES TO THE INTERIM FINANCIAL STATEMENTS
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4. Lending Facility (continued)

by a \$5,000,000 debenture with a floating charge over all assets of the Company with a negative pledge and undertaking to provide fixed charges on the Company's major producing petroleum properties, and by a \$15,000,000 supplemental debenture with a floating charge over all assets of the Company with a negative pledge and undertaking to provide fixed charges on the Company's major producing petroleum properties. The Company is in compliance with the covenants contained within the loan agreement at December 31, 2008. The loan facility is subject to periodic review by the bank, with the most recent review completed in January, 2009.

As the Company's lending facilities bear interest at floating rates, the Company is exposed to interest rate risk on outstanding balances.

5. Equity Instruments

a) Authorized:

Unlimited number of common shares.

Unlimited number of non-voting preferred shares, issuable in series. The Board of Directors may fix from time to time the number of shares that comprise a series and the rights, privileges, restrictions and conditions for the series. Preferred shares of any series may be convertible into or exchangeable for common shares.

b) Common shares:

	Shares	Amount
Balance, September 30, 2007	48,137,590	\$75,184,831
Private placement issued for cash	27,500,000	2,900,336
Shares issued on acquisition of G2 Resources Inc.	72,762,619	13,606,610
Shares issued as finder's fee	1,650,000	153,186
Tax impact of flow through share issue	-	(598,500)
Share issue costs	-	(569,158)
Balance, September 30, and December 31, 2008	150,050,209	\$90,677,305

c) Warrants:

	Number of Warrants	Number of Underlying Shares	Amount
Balance, September 30, 2007	6,005,810	6,005,810	496,265
December 31, 2007 expiry of warrants	(905,643)	(905,643)	(218,300)
May 30, 2008 expiry of warrants	(916,667)	(916,667)	(49,838)
August 1, 2008 expiry of warrants	(333,500)	(333,500)	(40,260)
July 10, 2008 private placement	27,500,000	27,500,000	2,599,664
July 10, 2008 warrants issued as finders fee	1,650,000	1,650,000	176,814
Warrants acquired from G2	8,360,689	8,360,689	-
Balance, September 30, and December 31, 2008	41,360,689	41,360,689	\$2,964,345
Total Common Shares and Warrants ("Equity Instruments") outstanding September 30, and December 31, 2008			\$93,641,650

The following table summarizes warrants by the exercise price:

Date of Grant	Number of warrants	Exercise Price	Date of Expiry
July 17, 2007	3,850,000	\$0.35	July 16, 2009
July 10, 2008	29,150,000	\$0.26	July 10, 2010
July 10, 2008	8,360,689	\$1.20	March 19, 2009
	41,360,689		

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NOTES TO THE INTERIM FINANCIAL STATEMENTS
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5. Equity Instruments (continued)

d) Stock options:

The following table summarizes the status of the Company's stock option plan and the activity during the current quarter and the year ended September 30, 2008.

	Three months ended December 31, 2008		Year ended September 30, 2008	
	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
Balance, beginning of period	13,375,000	\$0.28	2,951,000	\$0.58
Granted	-	-	10,510,000	0.20
Forfeited	(2,300,000)	\$0.53	(86,000)	1.00
Balance, end of period	11,075,000	\$0.23	13,375,000	\$0.28
Exercisable, end of period	4,258,333	\$0.27	6,368,322	\$0.37

Date of Grant	Number Outstanding at Dec. 31, 2008	Exercise Price	Weighted Average Remaining Contractual Life (Years)	Date of Expiry	Number Exercisable at Dec. 31, 2008
Jan. 1, 2006	350,000	0.95	2.00	Jan. 1, 2011	350,000
Feb. 12, 2007	500,000	0.30	3.12	Feb. 12, 2012	500,000
July 16, 2008	10,225,000	0.20	4.54	July 16, 2013	3,408,333
	11,075,000				4,258,333

During the quarter ended December 31, 2008, the Company recognized \$104,276 (2007 - \$22,895) of stock compensation expense for options granted under the Company's stock option plan.

e) Contributed surplus:

The following table presents changes in contributed surplus:

	2008	2007
Balance, September 30	\$2,298,280	\$1,216,220
Stock based compensation	104,276	22,895
Expiry of warrants	-	218,300
Balance, December 31	\$2,402,556	\$1,457,415

f) Per share amounts:

Basic loss per share is calculated using the weighted average number of shares of 150,050,209 (2007 - 48,137,590) outstanding for the period. Options and warrants were excluded from the dilution calculation as they were anti-dilutive for the year ended September 30, 2008 and the period ended December 31, 2008.

The numbers of options and warrants that would have been included in the computation of diluted earnings per share would have been 52,435,689 (2007 - 5,100,167).

REGAL ENERGY LTD.
NOTES TO THE INTERIM FINANCIAL STATEMENTS
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6. Asset Retirement Obligation

The following table presents the reconciliation of the beginning and ending aggregate carrying amount of the obligation associated with the retirement of oil and gas properties:

	Dec. 31, 2008	Sept. 30, 2008
Asset retirement obligation, beginning of period	\$950,799	\$397,558
Change in estimate	-	(31,191)
Liabilities incurred on drilling	12,638	7,761
Liabilities assumed on acquisitions	-	629,191
Asset disposition	-	(84,719)
Well abandonment costs incurred	-	(5,161)
Accretion expense	16,412	37,360
Asset retirement obligation, end of period	\$979,849	\$950,799

The undiscounted amount of cash flows, required over the estimated reserve life of the underlying assets, to settle the obligation, adjusted for inflation is estimated to be \$1,930,000. The obligation was calculated using a credit adjusted risk free discount rate of 9 percent and an inflation rate of 2 percent. It is expected that this obligation will be funded from general Company resources at the time the costs are incurred with the majority of costs expected to occur between 2010 and 2021.

7. Supplemental Cash Flow Information

Three months ended December 31	2008		2007	
Changes in non-cash working capital balances related to:				
Accounts receivable	\$	655,580	\$	(797,715)
Deposits and prepaid expenses		59,942		(13,386)
Accounts payable and accrued liabilities		677,315		1,083,814
	\$	1,392,837	\$	272,713
Changes in non-cash working capital balances related to:				
Operating activities	\$	1,266,523	\$	260,095
Investing activities		126,314		12,618
	\$	1,392,837	\$	272,713
		2008		2007
Interest paid	\$	37,631	\$	28,150

8. Financial Instruments

Credit Risk

The Company's substantially all of the accounts receivable are with customers and joint interest partners in the oil and gas industry and are subject to normal industry credit risks. The Company markets its oil and natural gas to several marketers so that the exposure to any one entity is minimized. In addition, when joint operations are conducted on behalf of a joint interest partner, costs of such operations are paid for in advance by the partner of the operation being conducted. Should any of the Company's customers or partners be unable to settle amounts due, the impact on the Company could be significant. The maximum exposure to loss arising from accounts receivable and cash and cash equivalents is equal to their total

REGAL ENERGY LTD.
NOTES TO THE INTERIM FINANCIAL STATEMENTS
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8. Financial Instruments (continued)

carrying amounts on the balance sheet. During the quarter ended December 31, 2008 the Company recorded an allowance for doubtful accounts in the amount of \$37,665, and recorded the corresponding amount as an expense.

The following table presents the aging of the Company's accounts receivable:

Total accounts receivable	0 to 30 days	31 to 60 days	61 to 90 days	Greater than 90 days
\$1,643,020	\$184,745	\$60,223	\$177,810	\$1,220,242

Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due. The Company's objective in managing liquidity risk is to ensure that it has sufficient resources available to meet its liabilities when due. At December 31, 2008 the Company's accounts payable and accrued liabilities were \$3,966,123 all of which are due for payment within normal terms of trade which is generally between 30 and 60 days. The Company also relies on its credit facility to manage its liquidity and the settlement of liabilities due.

The Company's financial liabilities are summarized below:

	Total	0 to 30 days	31 to 60 days	61 to 90 days	Greater than 90 days
Accounts payable and accrued liabilities	\$3,966,123	\$1,213,317	\$1,050,631	\$583,107	\$1,119,068
Bank indebtedness	3,350,000	3,350,000	-	-	-
Total	\$7,316,123	\$4,563,317	\$1,050,631	\$583,107	\$1,119,068

9. Contingencies

Canada Revenue Agency ("CRA") has conducted an audit of transfer pricing on international transactions between SiberCore Technologies Incorporated and its United States subsidiary, SiberCore America Inc. for the years 2000, 2001 and 2002. SiberCore Technologies Incorporated was the predecessor company of Azeri and ultimately Regal Energy Ltd. The Company has received a proposed settlement letter from CRA that would result in a reduction of tax pools in the amount of \$1,501,453. CRA has also proposed to charge a cash penalty of approximately \$150,000. The Company has responded to the proposed settlement letter and provided further information supporting management's view that CRA's position has no merit and intends to object to any notice of assessment that may be received. The outcome of this audit is uncertain at this time and as such no provisions have been made in these financial statements.

10. Subsequent Events

On February 10, 2009, the Company announced that it intends to offer by private placement a minimum of 83,333,334 units ("Units") at a subscription price of \$0.06 for minimum gross proceeds of \$5,000,000. Each Unit consists of one common share ("Common Shares") of the Company and one Common Share purchase warrant ("Warrant"). Each whole Warrant will have an exercise price of \$0.12 and a term of 36 months. Completion of the proposed private placement (the "Closing") is scheduled for March 10, 2009.

REGAL ENERGY LTD.
NOTES TO THE INTERIM FINANCIAL STATEMENTS
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10. Subsequent Events (continued)

Concurrent with the Closing, Hugh G. Ross and Michael H. Halvorson will be appointed to Regal's board of directors and Hugh Mogensen and Jake Pronk will resign from the Board. Mr. Ross will replace Curtis Hartzler as President and CEO of Regal. In addition, concurrent with the Closing, the following individuals will be appointed as officers of Regal: Ketan Panchmatia as VP Finance and CFO, Greg Groten as VP Exploration, Jack Lane as Manager Operations, and Connie Nischuk as Corporate Administrator (together with Mr. Ross, the "New Management"). Other officers may also be appointed at Closing as agreed by the Company.

The Company has also agreed to grant performance warrants equal to 10% of the outstanding Common Shares (including those issued in the private placement) to the New Management and other appointees to management, subject to completion of the Closing, approval of the TSXV and shareholder approval to be sought at the next annual general and special meeting of the Company. Each performance warrant will have an exercise price of \$0.06, which will be adjusted upwards on an equivalent basis for the consolidation of the common shares of the Company on an approximately 15 Common Share for one Common Share basis. The issuance of the performance warrants will also be subject to shareholder approval of this consolidation of the Common Shares, which the Company intends to seek at the next annual general and special meeting of the Company.

Closing (including appointment of the new Board appointees and New Management) is subject to a number of conditions, including the acceptance of the financing and change of management transaction by the TSXV.