



Financial Statements  
For the years ended December 31, 2009 and 2008



## **MANAGEMENT'S REPORT**

Management is responsible for the integrity and objectivity of the information contained in the accompanying financial statements, management's discussion and analysis and message to shareholders (collectively, the "annual release") and for the consistency between the financial statements and other financial and operating data contained in the annual release. The timely preparation of financial statements requires management to make estimates and assumptions, and use judgment regarding assets, liabilities, revenues and expenses. These financial statements have been prepared using policies and procedures established by management in accordance with Canadian generally accepted accounting principles and reflect fairly Midway's financial position and results of operations.

Management has established and maintains a system of internal controls which are designed to ensure that financial information is relevant, reliable and accurate and to provide assurance that assets are safeguarded from loss or unauthorized use and transactions are executed in accordance with management's authorization.

KPMG LLP, independent auditors appointed by the shareholders, has audited the financial statements. Their examination included such tests and procedures, as they considered necessary, to provide reasonable assurance that the financial statements are presented fairly in accordance with Canadian generally accepted accounting principles. Sproule Associates Limited and GLJ Petroleum Consultants Ltd. have provided an independent evaluation of the Company's petroleum and natural gas reserves.

The Board of Directors is responsible for ensuring that Management fulfills its responsibilities for financial reporting and internal control. The Board exercises this responsibility through the Audit Committee of the Board of Directors. The Audit Committee of the Corporation's Board of Directors, consisting exclusively of independent directors, has reviewed in detail the financial statements with management and the external auditors and has recommended their approval to the Board of Directors.

The Board of Directors has approved the financial statements and information as presented in this annual release.

"signed" *M. Scott Ratushny*  
M. Scott Ratushny  
Chief Executive Officer

"signed" *Douglas Smith*  
Douglas Smith  
Chief Financial Officer

March 22, 2010



**KPMG** LLP  
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## **AUDITORS' REPORT TO THE SHAREHOLDERS**

We have audited the balance sheets of Midway Energy Ltd. as at December 31, 2009 and 2008 and the statements of operations, comprehensive income (loss) and deficit and cash flows 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, 2009 and 2008 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  
March 22, 2010

**Midway Energy Ltd. (formerly Trafalgar Energy Ltd.)****Balance Sheets***Thousands of Dollars*

	December 31, 2009	December 31, 2008
<b>Assets</b>		
Current assets		
Cash and cash equivalents	\$ 1,478	\$ -
Accounts receivable	3,193	2,587
Prepaid expenses and deposits	490	536
	<b>5,161</b>	<b>3,123</b>
Deposits (note 15)	300	-
Property, plant and equipment (notes 4 and 5)	105,750	60,379
	<b>\$ 111,211</b>	<b>\$ 63,502</b>
<b>Liabilities and Shareholders' Equity</b>		
Current liabilities		
Accounts payable and accrued liabilities	\$ 13,544	\$ 2,843
Bank debt (note 6)	4,155	-
	<b>17,699</b>	<b>2,843</b>
Bank debt (note 6)	-	13,050
Tenant inducement (note 4)	159	-
Asset retirement obligations (note 7)	4,627	2,002
	<b>22,485</b>	<b>17,895</b>
Shareholders' equity		
Share capital (note 8)	96,552	46,641
Warrants (note 8)	3	-
Contributed surplus (note 8)	2,030	1,709
Deficit	(9,859)	(2,743)
	<b>88,726</b>	<b>45,607</b>
Commitments (note 13)		
Subsequent events (note 15)		
	<b>\$ 111,211</b>	<b>\$ 63,502</b>

See accompanying notes to the financial statements

Approved by the Board of Directors

"signed" Robert M. Shaunessy  
Robert M. Shaunessy  
Director

"signed" James C. Smith  
James C. Smith  
Director

**Midway Energy Ltd. (formerly Trafalgar Energy Ltd.)**  
**Statements of Operations, Comprehensive Income (Loss) and Deficit**

*Thousands of Dollars, except per share amounts*

	Year ended December 31, 2009	Year ended December 31, 2008
<b>Revenues</b>		
Petroleum and natural gas	\$ 11,271	\$ 18,944
Royalties	(888)	(3,079)
Realized loss on financial instruments	-	(83)
Interest	75	4
	<b>10,458</b>	<b>15,786</b>
<b>Expenses</b>		
Operating	5,474	5,166
General and administrative	4,687	1,891
Stock-based compensation (note 8)	283	375
Interest	453	237
Depletion, depreciation and accretion	8,410	7,936
	<b>19,307</b>	<b>15,605</b>
<b>Earnings (loss) before income taxes</b>	<b>(8,849)</b>	<b>181</b>
Future income tax reduction (note 9)	1,733	-
<b>Net earnings (loss) and comprehensive income (loss)</b>	<b>(7,116)</b>	<b>181</b>
Deficit, beginning of year	(2,743)	(2,924)
<b>Deficit, end of year</b>	<b>\$ (9,859)</b>	<b>\$ (2,743)</b>
<b>Earnings (loss) per share (note 8)</b>		
Basic and diluted	\$ (0.27)	\$ 0.01

*See accompanying notes to the financial statements*

**Midway Energy Ltd. (formerly Trafalgar Energy Ltd.)****Statements of Cash Flows***Thousands of Dollars*

	Year ended December 31, 2009	Year ended December 31, 2008
<b>Cash provided by (used in)</b>		
<b>Operating activities</b>		
Net earnings (loss)	\$ (7,116)	\$ 181
Items not involving cash:		
Depletion, depreciation and accretion	8,410	7,936
Stock-based compensation	283	375
Future income tax reduction	(1,733)	-
Amortization of tenant inducement	(12)	-
Asset retirement expenditures	(399)	-
Change in non-cash working capital (note 11)	968	(114)
	<u>401</u>	<u>8,378</u>
<b>Financing activities</b>		
Increase (decrease) in bank debt	(10,372)	13,050
Issue of common shares	51,315	6,904
Issue of warrants	3	-
Share issue costs	(2,817)	(441)
	<u>38,129</u>	<u>19,513</u>
<b>Investing activities</b>		
Acquisition of property, plant and equipment	(11,315)	(25,926)
Deposits on acquisitions (note 15)	(300)	-
Business acquisition (note 4)	(375)	-
Property acquisitions (note 5)	(34,671)	(1,450)
Disposal of property, plant and equipment	515	-
Change in non-cash working capital (note 11)	9,094	(1,128)
	<u>(37,052)</u>	<u>(28,504)</u>
Change in cash	1,478	(613)
Cash, beginning of year	-	613
<b>Cash, end of year</b>	<u>\$ 1,478</u>	<u>\$ -</u>

Cash is defined as cash and cash equivalents

*See accompanying notes to the financial statements*

## **Midway Energy Ltd. (formerly Trafalgar Energy Ltd.)**

### **Notes to Financial Statements**

Years ended December 31, 2009 and 2008

*(tabular amounts in thousands of dollars, except share and per share amounts)*

#### **1. Nature of Operations and Basis of Presentation**

Midway Energy Ltd. ("Midway" or the "Company"), formerly Trafalgar Energy Ltd., is involved in the acquisition, exploration, development and production of petroleum and natural gas in Alberta and British Columbia.

The financial statements of the Company have been prepared by management in accordance with accounting principles generally accepted in Canada. The timely preparation of financial statements requires management to make estimates and assumptions, and use judgment regarding assets, liabilities, revenues and expenses. Accordingly, actual results may differ from estimated amounts as future confirming events occur.

Significant estimates used in the preparation of these financial statements include, but are not limited, to the following. The calculation of depletion and the ceiling test are based on estimates of reserves, which by their nature include estimates of future production rates, oil and natural gas prices and costs, as well as other assumptions. The provision for asset retirement obligations is based on estimates of the costs to complete the abandonment and reclamation as well as the timing of the costs to be incurred. The amounts for stock-based compensation are based on estimates of risk-free rates, expected lives and volatility. Future income taxes are based on estimates as to the timing of the reversal of temporary differences and tax rates currently substantively enacted. By their nature, these and other estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future periods could be material.

Certain prior period comparative figures have been reclassified to conform to the current period presentation.

#### **2. Significant Accounting Policies**

##### **Property, plant and equipment**

The Company follows the full cost method of accounting for petroleum and natural gas assets whereby all costs relating to the acquisition, exploration and development of petroleum and natural gas reserves are capitalized in a single Canadian cost centre. Such costs include land acquisition costs, geological and geophysical expenses, carrying charges on non-producing properties, costs of drilling both productive and non-productive wells, production equipment costs, asset retirement and abandonment costs and overhead charges directly related to acquisition, exploration and development activities. Proceeds from the disposition of petroleum and natural gas properties are accounted for as a reduction of capitalized costs, with no gain or loss recognized, unless such a disposition would result in a greater than 20 percent change in the depletion and depreciation rate.

Capitalized costs, excluding costs related to unproven properties, are depleted using the unit-of-production method based on estimated proven petroleum and natural gas reserves before the deduction of royalties as determined by independent petroleum engineers. Petroleum and natural gas reserves and production are converted to equivalent barrels of oil using a ratio of six thousand cubic feet of natural gas to one barrel of oil. Costs of acquiring and evaluating unproved properties are initially excluded from depletion calculations. These unevaluated properties are assessed periodically to ascertain whether impairment has occurred. When proved reserves are assigned or the property is considered impaired, the costs of the property or the amount of the impairment are added to costs subject to depletion.

## **Midway Energy Ltd. (formerly Trafalgar Energy Ltd.)**

### **Notes to Financial Statements**

Years ended December 31, 2009 and 2008

*(tabular amounts in thousands of dollars, except share and per share amounts)*

Petroleum and natural gas assets are evaluated in each reporting period to determine that the carrying amount is recoverable and does not exceed the fair value of the properties (the "ceiling test"). The carrying amounts are assessed to be recoverable when the sum of the undiscounted cash flows expected from the production of proved reserves and the lower of cost and market value of unproved properties exceeds the carrying amount of the cost centre. When the carrying amount is not assessed to be recoverable, an impairment loss is recognized to the extent that the carrying amount of the cost centre exceeds the sum of the discounted cash flows expected from the production of proved and probable reserves and the lower of cost and market value of unproved properties of the cost centre. The cash flows are estimated using expected future product prices and costs and are discounted using a risk-free interest rate.

Other assets are recorded at cost and depreciated over the estimated useful lives of the assets on the following basis:

Computer hardware and software	30% per annum declining balance basis
Furniture and equipment	20% per annum declining balance basis
Leasehold improvements	straight-line over the term of the lease

#### **Asset retirement obligations**

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

#### **Joint operations**

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

#### **Revenue recognition**

Petroleum and natural gas revenues are recognized when the title and risks pass to the purchaser.

#### **Income taxes**

The Company uses the asset and liability method for calculating future income taxes. Under this method, future tax assets and liabilities are determined based on the differences between the carrying value and the tax basis of assets and liabilities, and measured using the substantively enacted tax rates and laws expected to be in effect when the differences are expected to reverse. The effect on future tax assets and liabilities of a change in tax rates is recognized in net income in the period in which the change occurs. A valuation allowance is recorded against any future tax assets if it is more likely than not that the asset will not be realized.

## **Midway Energy Ltd. (formerly Trafalgar Energy Ltd.)**

### **Notes to Financial Statements**

Years ended December 31, 2009 and 2008

*(tabular amounts in thousands of dollars, except share and per share amounts)*

#### **Flow-through shares**

The resource expenditure deductions related to exploratory activities funded by flow-through share arrangements are renounced to investors in accordance with tax legislation. The future tax liability and share capital are adjusted by the estimated cost of the renounced tax deductions when the expenditures are renounced.

#### **Stock-based compensation**

The Company follows the fair-value method for valuing stock options and other dilutive instruments granted to employees, directors and consultants. Under this method, compensation cost is measured at the grant date using the Black-Scholes option-pricing model and expensed over the vesting period of the instrument granted as stock-based compensation expense with a corresponding increase to contributed surplus. The contributed surplus balance is reduced as stock options and other dilutive instruments are exercised with the amount previously recognized plus any consideration received credited to share capital. The Company has not incorporated an estimated forfeiture rate, rather, the Company accounts for actual forfeitures as they occur.

#### **Stock appreciation rights**

The Company values stock appreciation rights ("SAR's") that are settled in cash as a liability based on the trading value of the Company's stock. The SAR's are revalued at the end of each reporting period until they vest. The SAR's are expensed over the vesting period as general and administrative expense with a corresponding increase to accounts payable and accrued liabilities.

#### **Per share amounts**

Basic per share information is computed by dividing earnings by the weighted average number of common shares outstanding for the period. The Company utilizes the treasury stock method in the determination of diluted per share amounts. Under this method, the diluted weighted average number of shares is calculated assuming the proceeds that arise from the exercise of outstanding, in-the-money options and compensation warrants are used to purchase common shares of the Company at their average market price for the period. The weighted average number of shares outstanding is then adjusted by the net change.

#### **Cash and cash equivalents**

Cash and cash equivalents are comprised of cash and all investments that are highly liquid in nature and have a maturity date of three months or less.

#### **Financial instruments**

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity. Upon initial recognition all financial instruments, including derivatives, are recognized on the balance sheet at fair value. Subsequent measurement is then based on the classification of financial instruments into one of five categories: held for trading, held to maturity, loans and receivables, available for sale and other liabilities. The Company has designated its cash and cash equivalents as held for trading, which are measured at fair value. Accounts receivable are classified as loans and receivables, which are measured at amortized cost. Accounts payable and accrued liabilities and bank debt are classified as other liabilities, which are measured at amortized cost. Amortized cost is determined using the effective interest method.

The Company will assess at each reporting period whether a financial asset is impaired with any impairment recognized in net earnings.

## **Midway Energy Ltd. (formerly Trafalgar Energy Ltd.)**

### **Notes to Financial Statements**

Years ended December 31, 2009 and 2008

*(tabular amounts in thousands of dollars, except share and per share amounts)*

The Company periodically enters into certain financial derivative and physical delivery sales contracts in order to reduce its exposure to market risks from fluctuations in commodity prices. These instruments are not used for trading or speculative purposes. The Company has elected not to designate any of its financial derivative contracts as accounting hedges and accordingly, accounts for all derivatives using the fair value method. Under this method, gains and losses resulting from changes in the fair value are recognized in net earnings when the changes occur. Proceeds and costs realized from holding the contracts are recognized in earnings at the time each transaction under a contract is settled.

The Company has elected to account for its physical delivery sales contracts, which are entered into and continue to be held for the purpose of receipt or delivery of non-financial items in accordance with its expected purchase, sale or usage requirements as executory contracts in accordance with the normal purchase and normal sale exemption. As such, these contracts are not recorded at fair value on the balance sheet. Settlements of these physical sales contracts are recognized in net earnings.

The Company measures and recognizes embedded derivatives separately from the host contracts when the economic characteristics and risks of the embedded derivatives are not closely related to those of the host contract, when it meets the definition of a derivative and when the entire contract is not measured at fair value. Embedded derivatives are recorded at fair value.

The Company records all transaction costs incurred, in relation to the acquisition of a financial asset or liability, against the related financial asset or liability.

### **3. Changes in Accounting Policies**

In February 2008, the CICA issued Section 3064, Goodwill and Intangible Assets. Effective for fiscal years beginning on or after October 1, 2008, this section provides guidance on the recognition, measurement, presentation and disclosure for goodwill and intangible assets subsequent to their initial recognition. This new standard became effective January 1, 2009 and the adoption of this standard had no impact on the Company's financial statements.

In January 2009, the CICA issued Section 1582 - "Business Combinations". This standard outlines new guidance which states that the purchase price is to be based on trading data at the closing date of the acquisition, not the announcement date of the acquisition, and that most acquisition costs are to be expensed as incurred. The new standard becomes effective on January 1, 2011 and early adoption is permitted.

In January 2009, the CICA issued Section 1601 – "Consolidated Financial Statements" and Section 1602 – "Non-Controlling Interest". These sections outline standards for preparing consolidated financial statements and the treatment of non-controlling interests in a business combination. These new standards are effective on January 1, 2011 and early adoption is permitted.

In June 2009, the CICA amended Section 3862, "Financial Instruments – Disclosures." These amendments include a hierarchy of methods used to determine the fair value of financial instruments at the balance sheet date. Level 1 inputs are based on quoted prices in active markets that Midway has the ability to access at the measurement date. Level 2 inputs are based on quoted prices in markets that are not active or based on prices that are observable for the asset or liability. Level 3 inputs are based on unobservable inputs for the asset or liability. These additional disclosures, effective December 31, 2009, are included in note 12 and did not have a significant impact on the Company's financial statements.

## Midway Energy Ltd. (formerly Trafalgar Energy Ltd.)

### Notes to Financial Statements

Years ended December 31, 2009 and 2008

(tabular amounts in thousands of dollars, except share and per share amounts)

#### 4. Business Acquisition

On July 31, 2009, the Company acquired all of the issued and outstanding common shares of EET Management Corp. ("EET"), a private oil and gas company with producing properties in Alberta. The acquisition was accounted for using the purchase method with results of operations included with the Company commencing August 1, 2009. The allocation of the purchase price to assets acquired and liabilities assumed based on their fair value is set out in the following table:

##### Consideration:

Shares issued (3,317,003 shares)	\$	2,321
Transaction costs		375
	\$	2,696

##### Allocation to net assets at fair value:

Property, plant and equipment	\$	4,706
Working capital deficiency		(79)
Bank debt		(1,477)
Asset retirement obligations		(283)
Tenant inducement		(171)
	\$	2,696

#### 5. Property, Plant and Equipment

	Cost	Accumulated Depletion & Depreciation	Net Book Value
December 31, 2009			
Petroleum and natural gas properties	\$ 130,901	\$ 25,421	\$ 105,480
Leaseholds and office furniture	373	103	270
	\$ 131,274	\$ 25,524	\$ 105,750
December 31, 2008			
Petroleum and natural gas properties	\$ 77,590	\$ 17,271	\$ 60,319
Leaseholds and office furniture	122	62	60
	\$ 77,712	\$ 17,333	\$ 60,379

For the year ended December 31, 2009, the Company capitalized general and administrative expenses and related stock-based compensation that were directly attributable to exploration activities of \$267,000 (2008 - \$486,000) and \$38,000 (2008 - \$110,000), respectively. During the year ended December 31, 2009, the Company closed several acquisitions of certain interests in petroleum and natural gas properties for cash consideration, after adjustments, of \$34,671,000 and share consideration of \$825,000 with associated asset retirement obligations of \$1,271,000. During the year ended December 31, 2008, the Company acquired certain interests in petroleum and natural gas properties for cash consideration of \$1.45 million, with associated asset retirement obligations of \$14,000.

## Midway Energy Ltd. (formerly Trafalgar Energy Ltd.)

### Notes to Financial Statements

Years ended December 31, 2009 and 2008

(tabular amounts in thousands of dollars, except share and per share amounts)

As at December 31, 2009, \$3.4 million (2008 - \$8.6 million) of costs related to unproved property costs were excluded from costs subject to depletion. Future development costs of \$48.0 million (2008 - \$1.7 million) were included in the costs subject to depletion and depreciation.

At December 31, 2009, the Company performed a ceiling test calculation and determined that there was no impairment in its petroleum and natural gas properties. The ceiling test used expected future commodity prices as follows (prices subsequent to 2015 are escalated at a rate of 2 percent):

	2010	2011	2012	2013	2014	2015
WTI Cushing (\$US/bbl)	79.17	84.46	86.89	90.20	92.01	93.85
Edmonton Par (\$Cdn/bbl)	84.25	89.99	92.61	96.19	98.13	100.11
AECO (\$Cdn/mmbtu)	5.36	6.21	6.44	7.23	7.98	8.16
Inflation rate (%/year)	2.0	2.0	2.0	2.0	2.0	2.0
Exchange rate (\$US/\$Cdn)	0.920	0.920	0.920	0.920	0.920	0.920

## 6. Bank Debt

As at December 31, 2009, Midway had a \$27.0 million revolving demand loan facility (the "Credit Facility") with an Alberta based financial institution (the "Lender"). As the Credit Facility is a demand loan facility the entire amount of bank debt outstanding is included in current liabilities.

Bank debt bears interest at the Lender's prime lending rate plus 150 basis points and the Credit Facility is secured by a general security agreement. The borrowing base is subject to re-determination annually, with the next scheduled review to be completed on or before May 31, 2010. As the available lending limits of the Credit Facility are based on the Lender's interpretation of the Company's reserves and future commodity prices there can be no assurance that the amount of the Credit Facility will not decrease at the next scheduled review. Under the Credit Facility, the Company must maintain a working capital ratio of not less than 1 to 1 at all times. The working capital ratio is defined as current assets (including the undrawn availability under the Credit Facility) to current liabilities (excluding any current portion of bank debt). The Company is in compliance with all debt covenants.

At December 31, 2009, \$4.2 million was drawn against the Credit Facility, and letters of credit in the amount of \$238,000 were issued under the Credit Facility. For the year ended December 31, 2009 the effective interest rate on the Company's bank debt was 4.25% (2008 - 4.25%).

## 7. Asset Retirement Obligations

At December 31, 2009, the total estimated amount to settle Midway's asset retirement obligations on an uninflated and undiscounted basis was \$9.1 million (2008 - \$3.7 million) and on an inflated and undiscounted basis was \$11.9 million (2008 - \$5.2 million). The asset retirement obligations were determined by applying an inflation factor of 2% (2008 - 2%) and discounting the inflated amount using credit-adjusted rates of 8% and 10% (2008 - 8% and 10%) over the expected average life of the underlying assets of 12 years. Future cash flows from operating activities are expected to fund these obligations. The following schedule reconciles the changes in Midway's asset retirement obligations:

## Midway Energy Ltd. (formerly Trafalgar Energy Ltd.)

### Notes to Financial Statements

Years ended December 31, 2009 and 2008

(tabular amounts in thousands of dollars, except share and per share amounts)

	2009	2008
Balance, beginning of year	\$ 2,002	\$ 1,650
Changes in estimates	1,211	-
Liabilities incurred on acquisitions	1,554	14
Liabilities incurred	40	222
Asset retirement expenditures	(399)	-
Accretion	219	116
Balance, end of year	\$ 4,627	\$ 2,002

## 8. Share Capital

### Authorized

An unlimited number of Class A voting common shares

An unlimited number of voting common shares

An unlimited number of non-voting common shares

An unlimited number of first preferred shares, issuable in series

### Issued and outstanding

Class A voting Common Shares	Number	Amount
Balance, December 31, 2007 and 2008	-	\$ -
Issued to voting common shareholders on reorganization (i)	11,163,590	41,043
Issued to non-voting common shareholders on reorganization (i)	2,241,291	3,865
Issued to EET shareholders on acquisition (i)	3,317,003	2,321
Issued to EILP unit holders on acquisition (i)	10,683,000	7,478
Issued pursuant to the exercise of Series A Arrangement warrants (ii)	4,468,287	3,128
Issued pursuant to property acquisition (iii)	620,301	825
Issued pursuant to short-form prospectus (iv)	22,000,000	27,500
Issued pursuant to a private placement (v)	6,952,000	13,209
Share issue costs	-	(2,817)
Balance, December 31, 2009	61,445,472	\$ 96,552

### Common Shares, voting

Balance, December 31, 2007	9,594,590	\$ 36,313
Issuance of flow-through common shares (vi)	1,569,000	6,904
Share issue costs	-	(441)
Balance, December 31, 2008	11,163,590	\$ 42,776
Future taxes on flow-through common shares (vi)	-	(1,733)
Shares exchanged for class A voting shares (i)	(11,163,590)	(41,043)
Balance, December 31, 2009	-	\$ -

### Common Shares, non-voting

Balance, December 31, 2007 and 2008	2,241,291	\$ 3,865
Shares exchanged for class A voting shares (i)	(2,241,291)	(3,865)
Balance, December 31, 2009	-	\$ -

<b>Total Share Capital</b>	<b>61,445,472</b>	<b>\$ 96,552</b>
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## Midway Energy Ltd. (formerly Trafalgar Energy Ltd.)

### Notes to Financial Statements

Years ended December 31, 2009 and 2008

*(tabular amounts in thousands of dollars, except share and per share amounts)*

- (i) On July 31, 2009, the Company closed the acquisition of EET pursuant to a Plan of Arrangement (the "Arrangement") and in connection with the acquisition reorganized the capital of the Company. Pursuant to the Arrangement, Midway issued 13,404,881 Class A voting common shares in exchange for 11,163,590 voting common shares and 2,241,291 non-voting common shares. For every three voting or non-voting common shares held, shareholders of the Company were issued a Series A Arrangement Warrant (the "Arrangement Warrants") that could be exercised for Class A voting common shares at an ascribed value of \$0.70 per common share.

In addition, the Company issued 3,317,003 Class A voting common shares at an ascribed value of \$0.70 to shareholders of EET for their issued and outstanding shares (see note 4). The ascribed value of \$0.70 per common share was determined based on the Company's five-day weighted average trading price before and after the announcement of the EET acquisition on June 4, 2009. One-third of the new common shares issued to EET shareholders who were directors, officers, employees or consultants of EET or 1,011,001 Class A voting common shares are subject to a twelve-month hold period and an additional one-third of the new common shares are subject to a twenty-four month hold period with the balance having no restrictions.

Energy Investment Limited Partnership ("EILP"), which was acquired by the Company pursuant to the Arrangement, had completed aggregate private placement financings of 10,683,000 partnership units at \$0.70 per unit for gross proceeds of \$7,478,100 with insiders of Midway subscribing for 2,874,571 of the units issued for gross proceeds of \$2,012,200. Midway issued 10,683,000 Class A voting common shares at an ascribed value of \$0.70 for all of the issued and outstanding partnership units of EILP. EET was amalgamated with the Company immediately following closing and EILP was dissolved.

- (ii) On August 31, 2009, Midway issued 4,468,287 Class A voting common shares to shareholders that exercised their Arrangement Warrants (see note 8(ii)) for gross proceeds of \$3,127,801.
- (iii) On September 15, 2009, Midway issued 620,301 Class A voting common shares with a total value of \$825,000 as partial consideration for producing oil and natural gas properties acquired pursuant to a purchase and sale agreement.
- (iv) On October 6, 2009, Midway issued 22,000,000 Class A voting common shares pursuant to a short-form prospectus for gross proceeds of \$27.5 million before issue costs of \$1,927,000. Insiders of Midway subscribed for 217,000 of the common shares issued for gross proceeds of \$271,250.
- (v) On November 24, 2009, Midway issued 6,952,000 Class A voting common shares pursuant to a private placement for gross proceeds of \$13.2 million before issue costs of \$890,000. Insiders of Midway subscribed for 75,000 of the common shares issued for gross proceeds of \$142,500.
- (vi) On May 15, 2008, the Company issued 1,569,000 flow-through common shares for gross proceeds of \$6.9 million pursuant to a private placement. During the first quarter of 2009, the Company recognized the \$1.7 million tax effect related to the flow-through shares when the expenditures were renounced.

## Midway Energy Ltd. (formerly Trafalgar Energy Ltd.)

### Notes to Financial Statements

Years ended December 31, 2009 and 2008

(tabular amounts in thousands of dollars, except share and per share amounts)

#### Compensation warrants

On July 31, 2009, in accordance with the Arrangement, the new directors, officers, employees and other nominees of Midway participated in a private placement of 3,000,000 incentive warrants at a price of \$0.001 per warrant for total gross proceeds of \$3,000, which entitle the holder to acquire one Class A voting common share at an exercise price of \$1.05 per common share for a period of five years from closing, subject to the warrants vesting in equal amounts over three years. The compensation warrants were assigned a fair value of \$0.50 per compensation warrant using a Black-Scholes option pricing model as described in contributed surplus below.

#### Per share amounts

The weighted average number of basic and diluted common shares outstanding for the years ended December 31, 2009 and 2008 were 26,837,012 and 12,821,867, respectively. The 3,000,000 compensation warrants were not included in the calculation of the weighted average diluted common shares outstanding as they were considered anti-dilutive.

#### Stock options

The Company has a stock option plan authorizing the grant of options to purchase shares to designated participants, being directors, officers, employees or consultants. Options are priced at the closing price of the shares one day prior to the grant date of the options. Options vest over a three year period, with one third of the number granted vesting on each of the first, second and third anniversary dates from the date of grant. Options have a five year term to maturity.

The following table sets forth a reconciliation of the plan activity through December 31, 2009:

	Number	Weighted Average Exercise Price
Balance, December 31, 2007	1,121,250	\$ 4.09
Granted	148,000	3.80
Balance, December 31, 2008	1,269,250	\$ 4.05
Forfeited	(974,750)	4.05
Cancelled	(294,500)	4.08
Balance, December 31, 2009	-	\$ -

Pursuant to the Arrangement with EET (see note 8(i)) stock options issued to the previous directors, officers, employees or consultants of the Company that were not continued with Midway following the Arrangement were forfeited and those issued to the directors and officers that continued with Midway were cancelled.

During the year ended December 31, 2009, the Board of Directors granted 2,074,500 stock options at an exercise price of \$0.87 per common share, 700,000 stock options at an exercise price of \$1.74 per common share and 750,000 stock options at an exercise price of \$1.60 per common share. The stock options are not exercisable pending approval by shareholders and the Toronto Stock Exchange. Concurrent with the granting of the stock options, the Board of Directors adopted a contingent stock appreciation rights ("SAR") plan and granted an equivalent number of SAR's at the aforementioned prices on the condition that the stock options are not approved. Accordingly, the options and the SAR's have not been included in the calculation of stock-based compensation.

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In the event that shareholders and the Toronto Stock Exchange approve the stock options, all conditional SAR's granted will immediately terminate without payment. Had the stock options been approved and fair valued as at December 31, 2009, the stock options would have been assigned an average fair value of \$0.90 per stock option. Midway will fair value these stock options or, if required, the contingent SAR's, on the date of the next shareholder's annual and special meeting when approval of the stock options is requested.

#### Contributed surplus

The Company uses the fair value method to determine its stock-based compensation costs for all dilutive equity instruments. Under this method, compensation cost is recorded over the vesting period for all dilutive equity instruments granted to directors, officers, employees or consultants, with a corresponding increase to contributed surplus. During the year ended December 31, 2009, the Company recorded a recovery of stock-based compensation related to forfeited stock options in the amount of \$252,000.

	2009	2008
Balance, beginning of year	\$ 1,709	\$ 1,224
Stock-based compensation	573	485
Stock-based compensation recovery	(252)	-
Balance, end of year	\$ 2,030	\$ 1,709

The fair value of dilutive equity instruments issued was estimated on the date of grant using the Black-Scholes option pricing model with weighted average assumptions and resulting values as follows:

	2009	2008
Weighted average fair value of instruments issued	\$0.50	\$1.40
Risk-free interest rate (%)	3.2	3.2
Volatility (%)	68	40
Expected life in years	5	5
Expected future dividends	Nil	Nil

## 9. Income Taxes

The provision for income taxes differs from the result that would have been obtained by applying the combined federal and provincial tax rate to the Company's earnings (loss) before income taxes. The differences result from the following:

	2009	2008
Earnings (loss) before income taxes	\$ (8,849)	\$ 181
Combined federal and provincial tax rate	29.02%	29.60%
Expected income tax expense (recovery)	\$ (2,568)	\$ 54
Add (deduct):		
Stock-based compensation	82	111
Effect of change in income tax rate and other	354	1,064
Change in valuation allowance	399	(1,229)
Future income tax reduction	\$ (1,733)	\$ -

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The components of the Company's future income tax assets and liabilities at December 31, 2009 and 2008 are as follows:

	2009	2008
Future income tax assets:		
Non-capital losses	\$ 5,277	\$ 724
Asset retirement obligations	1,158	502
Share issue costs and other	801	225
SR&ED expenses	1,326	1,330
Property, plant and equipment	-	1,925
Valuation allowance	(5,403)	(4,706)
	3,159	-
Future income tax liability:		
Property, plant and equipment	(3,159)	-
Future income tax asset, net	\$ -	\$ -

The Company has accumulated non-capital losses for income tax purposes of approximately \$21.1 million (2008 - \$2.9 million), which can be used to offset income in future periods. These losses expire as follows:

Year to Expiry		
2014	\$	4,753
2015		1,699
2016		456
2029		14,201
Total non-capital losses	\$	21,109

The Company has approximately \$5.3 million of Scientific Research and Experimental Development ("SR&ED") expenses available to reduce future years' income tax payable. These deductions can be carried forward for an indefinite period.

## 10. Capital Management

The Company's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain the future development of its business.

The Company manages its capital structure and adjusts it as a result of changes in economic conditions and the risk characteristics of the underlying petroleum and natural gas assets. The Company considers its capital structure to include shareholders' equity, bank debt and working capital as in the table below. In order to maintain or adjust the capital structure, the Company may from time to time issue shares and adjust its capital spending to manage current and projected debt levels.

	2009	2008
Shareholders' equity	\$ 88,726	\$ 45,607
Bank debt	\$ 4,155	\$ 13,050
Working capital surplus (deficiency):	\$ (8,383)	\$ 280

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The Company expects that for the next several quarters it will significantly increase its capital expenditure program and funds from operations compared to prior activity in 2009. As such, Midway will monitor capital based on the ratio of net debt to annualized forecasted funds from operations. This ratio is calculated as net debt, defined as outstanding bank debt plus or minus working capital, divided by forecasted funds from operations before changes in non-cash working capital and asset retirement expenditures, annualized. The Company's strategy is to maintain a ratio that is considered reasonable and prudent in the circumstances. This ratio may increase and/or decrease at certain times.

In order to facilitate the management of this ratio, the Company prepares an annual capital expenditure budget, which is monitored quarterly and updated as necessary depending on varying factors including current and forecast prices, successful capital deployment and general industry conditions. Budget updates are approved by the Board of Directors on a quarterly basis.

The Company's share capital is not subject to external restrictions; however, the bank credit facility is based on petroleum and natural gas reserves and is subject to certain financial covenants (note 6). The Company has not paid or declared any dividends since the date of incorporation, nor are any contemplated in the foreseeable future. Management will reconsider the use of a historical measure to monitor capital in the future.

There were no changes in the Company's approach to capital management during the year ended December 31, 2009 with the exception that capital is now monitored using expected future cash flows rather than historical cash flows which was the method used in prior periods.

#### 11. Supplemental Cash Flow Information

Changes in non-cash working capital (before amounts attributable to EET):

	2009	2008
Accounts receivable	\$ (439)	\$ 360
Prepaid expenses and deposits	107	(324)
Accounts payable and accrued liabilities	10,394	(1,278)
Change in non-cash working capital	\$ 10,062	\$ (1,242)

The change in non-cash working capital has been allocated to the following activities:

	2009	2008
Operating	\$ 968	\$ (114)
Investing	9,094	(1,128)
Change in non-cash working capital	\$ 10,062	\$ (1,242)

Interest paid and received

	2009	2008
Interest received	\$ 75	\$ 4
Interest paid	\$ 395	\$ 237

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## **12. Financial Risk Management**

### **Overview**

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

- a) credit risk
- b) liquidity risk
- c) market risk

This note presents information about the Company's exposure to each of the above risks and the Company's objectives, policies and processes for measuring and managing these risks. A detailed discussion of the key business risks faced by Midway, which includes development and production risk, commodity price risk, foreign currency rate risk, credit risk, interest rate risk, liquidity risk and environmental risk is included in the accompanying Management's Discussion and Analysis under the heading "Business Risks".

The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework. The Company's risk management policies are established to identify and analyze the risks faced by the Company, to set appropriate risk limits and controls, and to monitor risks and adherence to market conditions and the Company's activities.

### **Credit risk**

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Company's receivables from petroleum and natural gas marketers and joint venture partners. For oil and natural gas sales, Midway follows a risk procedure whereby counterparties are reviewed on a regular basis and the Company attempts to transact only with counterparties who have investment grade ratings. As at December 31, 2009, the Company's accounts receivable balance was \$3,193,000 (2008 - \$2,587,000). At December 31, 2009, \$254,000 of the Company's accounts receivable balance was outstanding for greater than 90 days (2008 - \$1,131,000). Receivables from petroleum and natural gas marketers are normally collected on the 25th day of the month following production, Midway has not experienced any collection issues with its petroleum and natural gas marketers. The Company does not have an allowance for doubtful accounts.

Cash and cash equivalents, when outstanding, consist of cash bank balances and short-term deposits maturing in less than 90 days. The carrying amount of cash and cash equivalents and accounts receivable represent the maximum credit exposure. Midway manages the credit risk exposure related to cash and cash equivalents by selecting counterparties based on credit ratings and by avoiding complex investment vehicles with higher risk such as asset-backed commercial paper.

### **Liquidity risk**

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they come due. The Company's approach to managing liquidity is to ensure, as far as possible, that it will have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions without incurring unacceptable losses or risking harm to the Company's reputation.

The Company prepares annual and quarterly capital expenditure budgets, which are regularly monitored and updated as considered necessary. Further, the Company utilizes authorizations for expenditures on both operated and non-operated projects to further manage capital expenditures. The contractual maturities of accounts payable and accrued liabilities are due within one year.

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The Company's bank debt totaling \$4.2 million is shown as a current liability since the Credit Facility is a demand loan facility. The Company manages the risk associated with the Credit Facility by regularly updating its capital expenditure budgets using forward strip commodity prices published by the Lender and other sources to ensure that budgets allow for a sufficient amount of un-drawn capacity under the Credit Facility should commodity prices weaken.

In addition, Midway maintains flexibility in its capital expenditure program to ensure bank debt under the Credit Facility is prudently managed.

#### ***Market risk***

Market risk is the risk that changes in market prices, such as foreign exchange rates, commodity prices and interest rates will affect the Company's net earnings or the fair value or future cash flows of a financial instrument. The objective of market risk management is to manage and control market risk exposures within acceptable limits, while maximizing returns. From time to time, the Company may utilize financial derivative contracts to manage market risks in accordance with the risk management policy that has been approved by the Board of Directors.

Commodity price risk is the risk that the fair value of future cash flows will fluctuate as a result of changes in commodity prices. Commodity prices for petroleum and natural gas are impacted by not only the relationship between the Canadian and United States dollar, but also by world economic events that dictate the levels of supply and demand. There were no financial derivative contracts or embedded derivatives outstanding at December 31, 2009 or 2008.

In September 2009, the Company entered into a physical delivery fixed price contract for 500 GJ of natural gas per day at \$4.425 per GJ for the period October 1, 2009 to October 31, 2010. In December 2009, the Company entered into a physical delivery fixed price contract for 500 GJ of natural gas per day at \$5.75 per GJ for the period January 1, 2010 to December 31, 2011. These contracts are accounted for as executory contracts in accordance with the normal purchase and normal sale exemption.

During 2008, the Company entered into a series of natural gas financial instruments for 2,100 GJ per day for the May to October 2008 period. The Company paid a premium of \$97,000 at the time of entering in the contract and recognized gains on settlement of \$14,000.

#### ***Fair value of financial instruments***

The Company's financial instruments as at December 31, 2009 and 2008 include cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities and bank debt. The fair value of accounts receivable and accounts payable and accrued liabilities approximate their carrying amounts due to their short terms to maturity.

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

The Company's financial instruments recorded at fair value require disclosure about how the fair value was determined based on significant levels of inputs described in accordance with the following hierarchy. Level 1 inputs are based on quoted prices in active markets that Midway has the ability to access at the measurement date. Level 2 inputs are based on quoted prices in markets that are not active or based on prices that are observable for the asset or liability. Level 3 inputs are based on unobservable inputs for the asset or liability. As at December 31, 2009, the only financial instrument recorded at fair value according to the new three-level hierarchy was cash and cash equivalents and is considered level 1.

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*(tabular amounts in thousands of dollars, except share and per share amounts)*

#### **13. Commitments**

On May 15, 2008, the Company issued 1,569,000 flow-through common shares and renounced the \$6.9 million of qualifying oil and natural gas expenditures effective December 31, 2008. The Company had until December 31, 2009 to incur the qualifying expenditures. In connection with the business acquisition of EET, the Company was committed to incur \$1 million of qualifying expenditures prior to December 31, 2009 to satisfy EET's flow-through commitment that was incurred prior to its acquisition by the Company. As at December 31, 2009, Midway has satisfied both of these commitments.

The Company has operating lease commitments for two office premises expiring December 31, 2010 and December 31, 2015, respectively that total \$380,000 in 2010 and approximately \$340,000 annually for the remaining term. In addition, the Company has an operating lease commitment for field compression equipment that totals \$286,000 annually until October 2013.

Pursuant to a consulting agreement, the Company is committed to a stock appreciation rights ("SAR") payment based on 200,000 SAR's that vest over a three year period from the commencement date of the contract and to the extent earned are not payable until the third anniversary of the commencement date. The amount payable is equal to the number of SAR's that have vested multiplied by the then current market price. The SAR's were valued at December 31, 2009 based on the Company's closing stock price and \$87,000 was recorded as general and administrative expense for the year with a corresponding increase to accounts payable and accrued liabilities.

#### **14. Related Party Transactions**

Legal services are provided by a firm in which two Directors of the Company are partners (the "Firm"). During the year ended December 31, 2009, the Firm provided legal services totaling \$425,000 (2008 - \$76,000). An accrual of \$5,000 for legal services provided by the Firm but not billed at December 31, 2009, (2008 - \$3,000) is included in Midway's total accounts payable and accrued liabilities balance.

The related party transactions were incurred during the normal course of operations on similar terms and conditions to those entered into with unrelated parties. These transactions are measured at the exchange amount, which is the amount of consideration established and agreed to between the related parties.

#### **15. Subsequent events**

In January 2010, Midway closed a purchase and sale agreement with a private oil and gas company to acquire an oil battery and truck terminal with a total purchase price of \$2.5 million. The consideration provided was \$1 million in cash (net of acquired working capital) and the issuance of 769,231 common shares of the Company. As at December 31, 2009, Midway had paid a deposit of \$250,000 related to this acquisition.

In February 2010, Midway closed a purchase and sale agreement with a private oil and gas company to acquire certain interests in producing oil and natural gas properties with a total purchase price of \$6.1 million, subject to closing adjustments. The consideration provided was \$5.65 million in cash and the issuance of 155,279 common shares of the Company. As at December 31, 2009, Midway had paid a deposit of \$50,000 related to this acquisition.