

**CANADIAN PHOENIX RESOURCES CORP.**

Consolidated Financial Statements

For the three months ended March 31, 2009 and 2008

(unaudited)

**CANADIAN PHOENIX RESOURCES CORP.**  
**Consolidated Balance Sheet**  
(unaudited)

|   | March 31, 2009     | December 31, 2008  |
|---|--------------------|--------------------|
|   | \$                 | \$                 |
| <b>Assets</b>                                     |                    |                    |
| <b>Current assets</b>                             |                    |                    |
| Cash  | 6,067,511          | 10,402,670         |
| Cash held in trust (note 4)                       | 233,996            | 2,007,559          |
| Accounts receivable                               | 3,316,975          | 6,733,166          |
| Prepaid expenses/cash call advances               | 897,917            | 240,188            |
|   | <b>10,516,399</b>  | <b>19,383,583</b>  |
| Property, plant and equipment (note 5)            | 78,326,942         | 83,161,732         |
| Equity Investment (note 6)                        | 38,185,512         | 43,129,618         |
|   | <b>127,028,853</b> | <b>145,674,933</b> |
| <b>Liabilities</b>                                |                    |                    |
| <b>Current liabilities</b>                        |                    |                    |
| Accounts payable and accrued liabilities (note 7) | 23,708,343         | 25,254,427         |
|   | <b>23,708,343</b>  | <b>25,254,427</b>  |
| Asset retirement obligation (note 8)              | 5,054,875          | 4,551,669          |
| Future income tax liability (note 9)              | 5,548,370          | 4,827,942          |
|   | <b>34,311,588</b>  | <b>34,634,038</b>  |
| <b>Non-controlling interest</b> (note 10)         | <b>17,630,333</b>  | <b>26,777,183</b>  |
| <b>Shareholders' Equity</b>                       |                    |                    |
| Share capital (note 11a,11b)                      | 118,977,580        | 118,977,580        |
| Warrants (note 11c)                               | 32,087,679         | 32,087,679         |
| Contributed surplus (note 11c)                    | 3,489,177          | 3,456,588          |
| Deficit   | (79,467,504)       | (70,258,135)       |
|   | <b>75,086,932</b>  | <b>84,263,712</b>  |
|   | <b>127,028,853</b> | <b>145,674,933</b> |
| <b>Going concern</b> (note 1)                     |                    |                    |
| <b>Commitments &amp; contingencies</b> (note 12)  |                    |                    |
| <b>Subsequent events</b> (note 15)                |                    |                    |

See accompanying notes to the consolidated financial statements

**On behalf of the Board of Directors:**

“Robert J. Chenery”

Director

“D. Barry Lee”

Director

**CANADIAN PHOENIX RESOURCES CORP.**  
**Consolidated Statement of Operations, Comprehensive Loss and Deficit**  
(unaudited)

|  | Three months<br>ended<br>March 31,<br>2009<br>\$ | Three months<br>ended<br>March 31,<br>2008<br>\$ |
|--|--|--|
| <b>Revenue</b>   |  |  |
| Oil and natural gas  | 3,404,337  | 1,230,481  |
| Royalties  | (593,162)  | (131,201)  |
|  | <b>2,811,175</b>                                 | <b>1,099,280</b>                                 |
| <b>Expenses</b>  |  |  |
| Operating costs  | 1,612,238  | 281,026  |
| Depletion, depreciation and accretion (note 5)                                 | 5,752,401  | 994,029  |
| Stock based compensation (note 10, 11c)  | 650,479  | 108,568  |
| General and administrative   | 1,503,613  | 898,631  |
| Interest accretion – debentures  | -  | 1,399,231  |
| Interest expense   | 4,521  | 291,275  |
| Impairment of goodwill (note 3)  | 213,939  | -  |
| Other (income)   | (11,866)   | (54,299)   |
|  | <b>9,725,325</b>                                 | <b>3,918,461</b>                                 |
| <b>Net loss before equity investment, non-controlling<br/>interest and tax</b> | <b>(6,914,150)</b>                               | <b>(2,819,181)</b>                               |
| Net loss – equity investment (note 6)  | (4,944,105)                                      | -  |
| Net loss – non-controlling interest (note 10)                                  | 1,087,496  | -  |
| <b>Net loss for the year before taxes</b>                                      | <b>(10,770,759)</b>                              | <b>(2,819,181)</b>                               |
| Current income tax recovery/(expense)  | -  | (20,000)   |
| Future income tax recovery (note 9)  | 1,561,390  | 615,283  |
| <b>Net loss and comprehensive loss for the period</b>                          | <b>(9,209,369)</b>                               | <b>(2,223,898)</b>                               |
| <b>Deficit, beginning of period</b>  | <b>(70,258,135)</b>                              | <b>(8,795,550)</b>                               |
| <b>Deficit, end of period</b>  | <b>(79,467,504)</b>                              | <b>(11,019,448)</b>                              |
| <b>Net loss per share</b>  |  |  |
| <b>Basic and Diluted</b> (note 11d)  | <b>(0.01)</b>                                    | <b>(0.01)</b>                                    |

See accompanying notes to the consolidated financial statements

**CANADIAN PHOENIX RESOURCES CORP.**  
**Consolidated Statement of Cash Flows**  
(unaudited)

|   | Three months<br>ended<br>March 31,<br>2009<br>\$ | Three months<br>ended<br>March 31,<br>2008<br>\$ |
|---|--|--|
| <b>Cash provided by (used in)</b>                         |  |  |
| <b>Operating activities</b>                               |  |  |
| Net loss after tax for the year                           | (9,209,369)                                      | (2,223,898)                                      |
| Items not affecting cash                                  |  |  |
| Non-controlling interest                                  | (1,087,496)                                      | -  |
| Depletion, depreciation & accretion                       | 5,752,401  | 994,029  |
| Equity investment loss                                    | 4,944,105  | -  |
| Stock-based compensation                                  | 650,479  | 108,568  |
| Interest accretion on debentures                          | -  | 1,399,231  |
| Other non-cash expense                                    | 213,939  | 20,000   |
| Future tax (recovery)                                     | (1,561,390)                                      | (615,283)  |
| Funds from operations                                     | (297,331)  | (317,353)  |
| Change in non-cash working capital – operating activities | (1,796,098)                                      | (2,077,724)                                      |
|   | <b>(2,093,429)</b>                               | <b>(2,395,077)</b>                               |
| <b>Financing activities</b>                               |  |  |
| Decrease in bank loan                                     | -  | (1,980,000)                                      |
| Issuance of common shares for cash, net of costs          | -  | 25,315,194                                       |
| Change in non-cash working capital – financing activities | -  | -  |
|   | -  | <b>23,335,194</b>                                |
| <b>Investing activities</b>                               |  |  |
| Acquisition of petroleum and natural gas assets           | (6,965,683)                                      | (26,148)   |
| Movement in restricted cash/cash held in trust            | 1,773,563  | 17,775,000                                       |
| Change in non-cash working capital – investing activities | 2,950,390  | (4,898,995)                                      |
|   | <b>(2,241,730)</b>                               | <b>12,849,857</b>                                |
| <b>Increase/(decrease) in Cash</b>                        | (4,335,159)                                      | 33,789,974                                       |
| <b>Cash, beginning of period</b>                          | 10,402,670                                       | 1,285,235  |
| <b>Cash, end of period</b>                                | <b>6,067,511</b>                                 | <b>35,075,209</b>                                |
| Taxes Paid  | -  | -  |
| Interest paid   | -  | 7,234  |

See accompanying notes to the consolidated financial statements

## 1. BASIS OF PREPARATION

Canadian Phoenix Resources Corp. (the “Corporation”) is engaged in the exploration, development and production of oil and natural gas in Western Canada. The consolidated interim financial statements as at and for the three months ending March 31, 2009 are comprised of the Corporation and its controlled entities (the “Group”).

The consolidated financial statements of the Group are stated in Canadian dollars and have been prepared in accordance with Canadian generally accepted accounting principles (“GAAP”). The consolidated interim financial statements have been prepared on the same basis as the annual consolidated financial statements for the year ended December 31, 2008. These interim consolidated financial statements do not contain all the note disclosure required for annual financial statements and therefore should be read in conjunction with the December 31, 2008 annual audited consolidated financial statements. A copy of those financial statements is available on SEDAR ([www.sedar.com](http://www.sedar.com)).

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of revenues and expenses, assets and liabilities, and disclosure of contingent assets and liabilities. Key sources of judgment and estimation uncertainty relate to the amounts recorded for depletion and depreciation of property, plant and equipment, the provision for asset retirement obligations, and the amounts used for the impairment test calculations. These amounts are based on estimates of reserves, future commodity prices, royalties, operating costs, development costs, abandonment costs, and the fair value of unproven properties, all of which are inherently uncertain.

### **Going concern**

These consolidated financial statements have been prepared in accordance with GAAP on a going concern basis, which contemplates the realization of assets and the settlement of liabilities in the ordinary course of business. Should the Group be unable to continue as a going concern, it may be unable to realize the carrying value of its assets and meet its liabilities as they become due. The financial statements do not include any adjustments related to the recoverability and classification of recorded asset amounts and classification of liabilities that might be necessary should the Corporation or its subsidiary Serrano Energy Ltd. (‘Serrano’) be unable to continue in existence. Such adjustments could be material.

The Group reported an after-tax loss of \$9.2 million and a net operating cash outflow of \$2.1 million for the three months ended March 31, 2009 and at March 31, 2009 the Corporation had accumulated losses of \$79.5 million. At March 31, 2009 the Group had net assets of \$92.7 million, a working capital deficiency of \$13.2 million, no external long-term debt, and capital expenditure commitments of approximately \$2.5 million.

The Group’s ability to continue as a going concern is dependent on its ability to secure debt facilities or other external funding to meet its expected cash outflows for 2009, and more generally, on increased oil and natural gas prices to improve operating cashflows. It is also dependent on the ability of its subsidiary (Serrano) to renegotiate payment terms with its creditors. During the first quarter of 2009, Serrano reached agreements with certain trade creditors to settle \$4.1 million of payables with a combination of cash and share issuances, and has negotiated deferred payment plans with certain other creditors. Certain settlements were closed subsequent to the reporting

CANADIAN PHOENIX RESOURCES CORP.  
Notes to Consolidated Financial Statements  
For the three months ended March 31, 2009 and 2008

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period (see Note 15). The Corporation and its subsidiary are also currently negotiating revolving credit facilities with expected limits of \$0.5 million (the Corporation) and \$7.5 million (Serrano), which will assist in meeting the Group's obligations.

It is the view of the directors that the Group should be able to finalize the credit facilities referred to above, and otherwise raise further debt or equity capital when needed to fund ongoing operations and exploration and development activities. However, given the current economic recession and weak oil and natural gas prices, access to either debt or equity financing is difficult and there is no assurance that management's initiatives will be successful. Should a debt or equity financing not be obtained, the Group would be forced to delay or cancel exploration and development, and reduce general and administrative costs permanently or until such time as market conditions improve to allow a financing to proceed. In that scenario, there is significant doubt as to the ability of the Group to continue as a going concern, and the going concern basis of accounting may not be appropriate.

## 2. CHANGES IN ACCOUNTING POLICIES

On January 1, 2009, the Group adopted CICA Handbook Section 3064, "*Goodwill and Intangible Assets*". The standard replaces CICA sections 3062 and 3450 and provides guidance relating to the recognition, measurement, presentation and disclosure of goodwill and intangible assets. There was no impact on the consolidated financial statements as a result of the adoption of this standard.

### **Future Changes in Accounting Standards – IFRS adoption effective 2011**

On February 13, 2008, the Canadian Accounting Standards Board confirmed that publicly accountable profit-oriented enterprises will be required to use International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board (IASB) in interim and annual financial statements for fiscal years beginning on or after January 1, 2011. Over the next two years, Canadian GAAP will be modified to converge with International Financial Reporting Standards ("IFRS"). The initial year of reporting under IFRS will be December 31, 2011, with full comparatives.

The Corporation has commenced the process of assessing the impact of conversion to IFRS on the Group's financial statements and internal and external financial reporting processes, as well as considering possible changes to information systems, staff training requirements, potential impacts on borrowing covenants, the terms of its corporate governance agreements with controlled and significantly influenced entities, and stock-based compensation and bonus arrangements.

The IFRS assessment process is being lead by the Corporation's Financial Reporting Manager, with oversight from the Chief Financial Officer and Audit Committee. Preliminary analysis of the impact of transitioning to IFRS has identified the following areas of significance:

- **Accounting for oil and gas exploration and development costs and property, plant and equipment** ('oil and gas assets') – transition from full-cost accounting. Accounting for these assets under IFRS will require a lower level of asset grouping for depletion/depreciation and impairment testing purposes. Assets will need to be divided into 'exploration and evaluation' and 'development/production' pools, ('cash generating units') and tested for impairment at January 1, 2010 (the opening balance sheet for the first comparative reporting year under IFRS). Cash generating units are defined as the lowest asset grouping able to generate independent cash inflows, for example a group of wells in

CANADIAN PHOENIX RESOURCES CORP.  
Notes to Consolidated Financial Statements  
For the three months ended March 31, 2009 and 2008

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the same geographical area sharing common infrastructure and the same marketing function.

Ongoing impairment testing of development/production assets is required only when there is an impairment indicator. Impairment testing requires an estimate of recoverable amount, which is defined as the greater of 'value in use' and 'fair value less costs to sell'. Value in use will be based on a discounted cashflow assessment based on proved and probable reserves, and cannot include revenues and costs associated with future development.

Depreciation of development/production asset pools can be calculated utilizing proved and probable reserves – an accounting policy choice is available.

The Corporation will not be in a position to quantify the impact of re-stating oil and gas assets under IFRS until after January 1, 2010. The impact may be material.

- **Business Combinations** – revised CICA Handbook sections 1582 Business Combinations, 1601 Consolidated Financial Statements, and 1602 Non-controlling Interests have been issued and are effective January 1, 2011. Significant changes include:
  - Section 1582 - expensing of transaction costs, recognition of contingencies, up-front recognition of contingent consideration, and recognition of any non-controlling interest at fair value.
  - Section 1601/1602 – changes in parent's interest post-control are accounted for as equity transactions rather than against property, plant and equipment.

Future changes in IFRS are expected to be issued by the IASB in 2010 and 2011 which may have an impact on the Group. Until these standards are issued, and their application date to Canadian reporting issuers is established, the impact of these changes on the Group cannot be determined.

### **3. CHANGE IN INTEREST – SERRANO**

In January 2009, the Corporation's interest in Serrano was increased to 56.8% from 47.0% following the finalization of an agreement between Serrano and one of its other shareholders, Pearl Exploration & Production Ltd ('Pearl'), described as follows:

- a. Serrano transferred to Pearl E&P Canada Ltd ("Pearl E&P"), a wholly-owned subsidiary of Pearl, 3/7<sup>ths</sup> of its interest (or a net 15% working interest) in its Blackrod oil sands leases located south of Fort McMurray, Alberta. The resulting working interests in the Blackrod project are 20% Serrano and 80% Pearl (through its wholly-owned subsidiaries) and Serrano transferred operatorship of the project to Pearl;
- b. Serrano agreed to fund the next \$6.3 million of gross expenditures on the Blackrod project, which expenditures will qualify as Canadian Exploration Expense under the Income Tax Act (Canada), this expenditure commitment was fulfilled during the first quarter 2009; and
- c. Pearl transferred to Serrano all of its 4,037,344 common shares in the capital of Serrano for cancellation and the Pearl nominee resigned from the board of directors of Serrano.

Upon completion of this transaction with Pearl, Serrano had 19,457,389 common shares outstanding, resulting in an increase in the Corporation's interest from 47% to 56.8%.

The increase in the Corporation's interest is reflected in the consolidated financial statements as a decrease to the non-controlling interest (\$7.8 million), reduction in property, plant and equipment net of tax (\$7.6 million), and a \$0.2 million impairment of the goodwill arising from the transaction. The impairment charge is reflected in the consolidated statement of operations.

### **4. CASH HELD IN TRUST (RESTRICTED CASH)**

Total restricted cash at March 31, 2009 was \$0.2 million, representing amounts held on deposit to meet the future abandonment costs of certain oil and gas properties.

In March 2009, \$1.8 million of cash held in trust was released to the Corporation. As part of the Marble Point transaction that was completed in 2008, the Corporation agreed to indemnify subscribers from possible withholding taxes payable on their preferred share dispositions. The Corporation thereby deposited into trust \$1.8 million. Certificates of Compliance were received from the Canada Revenue Agency evidencing withholding taxes were not applicable to the dispositions, and the cash was then released back to the Corporation.

CANADIAN PHOENIX RESOURCES CORP.  
Notes to Consolidated Financial Statements  
For the three months ended March 31, 2009 and 2008

**5. PROPERTY, PLANT AND EQUIPMENT**

**a) Continuity Schedule**

|  | March 31, 2009     |                                       |                   | December 31, 2008  |                                       |                   |
|--|--------------------|---------------------------------------|-------------------|--------------------|---------------------------------------|-------------------|
|  | Cost               | Accumulated<br>depletion/depreciation | Net Book<br>Value | Cost               | Accumulated<br>depletion/depreciation | Net Book<br>Value |
| Petroleum and Natural Gas properties and equipment | 120,364,890        | 42,297,879                            | 78,067,011        | 119,532,638        | 36,640,574                            | 82,892,064        |
| Office Furniture/equipment/leasehold improvements  | 482,220            | 222,290                               | 259,930           | 477,470            | 207,802                               | 269,668           |
| <b>Total PP&amp;E</b>                              | <b>120,847,110</b> | <b>42,520,169</b>                     | <b>78,326,941</b> | <b>120,010,108</b> | <b>36,848,376</b>                     | <b>83,161,732</b> |

PP&E additions for the quarter of approximately \$9 million related primarily to expenditures on the Blackrod project (\$6 million), which was largely offset by the reduction in PP&E stemming from the disposal of the 15% working interest in the project described in Note 3 above.

Depletion and depreciation expense for the quarter was \$5.8 million. The depletion calculation was done on a consolidated basis, including the Corporation's 56.5% interest in Marble Point's PP&E and proved reserves. As a result, an additional \$2.5 million of depletion was recorded in the Marble Point equity investment account (refer Note 6). The depletion calculation excluded unproven properties and major development projects of \$15.8 million (December 31, 2008 - \$16.6 million), including a proportionate \$11.9 million related to Marble Point. Future development costs of proved undeveloped reserves of \$4.5 million (Marble Point \$2.3 million) were included in the calculation (December 31, 2008 - \$10.2 million). The Corporation did not capitalize any general and administrative expenses for the quarter ended March 31, 2009, consistent with prior periods.

**b) Impairment Assessment – Ceiling Test**

PP&E impairment assessments utilized estimates of reserves data effective December 31, 2008 (with the exception of Marble Point - March 31, 2009), future operating and capital expenditure based on historical data and management's forecasts, and future price estimates from the independent reserves evaluator adjusted for heat content and basis differential.

**Price Estimates Used for the Ceiling Test**

|       | Exchange<br>Rate<br>(US\$/Cdn\$) | AECO<br>(\$Cdn/Mcf) | Edmonton<br>Light<br>(\$Cdn/Bbl) | Hardisty Heavy<br>(\$Cdn/Bbl) |
|-------|----------------------------------|---------------------|----------------------------------|-------------------------------|
| 2009  | 0.825                            | 4.87                | 60.18                            | 47.46                         |
| 2010  | 0.850                            | 6.89                | 66.92                            | 47.88                         |
| 2011  | 0.875                            | 7.69                | 74.47                            | 52.39                         |
| 2012  | 0.925                            | 7.95                | 79.34                            | 55.33                         |
| 2013  | 0.950                            | 8.15                | 84.29                            | 58.44                         |
| >2013 | 0.950                            | 2%                  | 2%                               | 2%                            |

The ceiling test was conducted on a consolidated basis in accordance with Canadian GAAP, whereby the PP&E of the Corporation plus the Corporation's interest in Serrano (56.8%) and Marble Point (56.5%)'s PP&E was tested for impairment based on future cashflows accruing to the Corporation.

CANADIAN PHOENIX RESOURCES CORP.  
Notes to Consolidated Financial Statements  
For the three months ended March 31, 2009 and 2008

Total undiscounted cashflows based on proved reserves of \$113.6 million were less than the Group's carrying value of PP&E with proved reserves of \$118.4 million. This required a fair value assessment using discounted cashflows associated with proved and probable reserves. Future cashflows discounted at a rate of 5% were \$131.6 million, which exceeded the net book value and therefore no impairment charge was required.

## 6. EQUITY INVESTMENT – MARBLE POINT

The Corporation's investment in Marble Point contributed a loss of \$4.9 million for the three months ended March 31, 2009, as summarized below:

|   |                     |
|---|---------------------|
| <b>Revenue</b>  | \$                  |
| Oil and gas   | 7,153,051           |
| Royalties   | (873,310)           |
| Unrealized loss – commodity derivatives                     | (604,000)           |
|   | <b>5,675,741</b>    |
| <b>Expenses</b>   |                     |
| Operating costs   | (1,492,870)         |
| Transportation  | (354,075)           |
| Depletion, depreciation and accretion                       | (4,990,143)         |
| General and administrative                                  | (1,364,455)         |
| Stock-based compensation                                    | (1,755,529)         |
| Interest expense  | (305,650)           |
| Other – financing recovery                                  | 252,378             |
|   | <b>(10,010,344)</b> |
| <b>Net loss before taxes</b>                                | <b>4,334,603</b>    |
| Tax recovery on loss  | -                   |
| <b>Net loss after taxes</b>                                 | <b>4,334,603</b>    |
| <b>Proportional share of loss at 56.5%</b>                  | <b>2,448,380</b>    |
| Consolidation adjustment – increased depreciation/depletion | 2,495,725           |
| <b>Total loss – Marble Point investment</b>                 | <b>4,944,105</b>    |

At March 31, 2009, Marble Point had net assets of \$65.8 million (including PP&E of \$120 million) and a working capital deficit of \$47.5 million.

## 7. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

During the three months ended March 31, 2009, Serrano reached agreements with certain trade creditors to settle \$4.1 million of payables. Subsequent to March 31, 2009, Serrano paid \$2.1 million in cash and issued 412,040 common shares at \$5 per share to settle these payables. Serrano has further negotiated deferred payment plans with certain other creditors.

Included in accounts payable at December 31, 2008 was an accrual of \$1.1 million for a legal settlement which was paid in March 2009. As part of the settlement, the Corporation received a 50% working interest in the undeveloped Sarcee region of Alberta. The fair market value of the interest in the property received was assessed to be \$nil as the property has no proved and probable reserves.

## 8. ASSET RETIREMENT OBLIGATION

Asset retirement obligations were estimated by management based on the Group's working interest in its wells, estimated costs to remediate, reclaim and abandon the wells and estimated timing of the costs to be incurred in future periods. The net present value of the Group's estimated asset retirement obligation was \$5.1 million at March 31, 2009 (December 31, 2008 - \$4.5 million). These costs are expected to be incurred over the next 2 to 34 years. A credit-adjusted risk-free rate of 7.5% was used to calculate the net present value of the Group's asset retirement obligation.

The following table provides a reconciliation of the carrying amount of the obligation associated with the retirement of oil and gas properties:

|   | <b>March 31<br/>2009</b> | <b>Dec 31<br/>2008</b> |
|---|--------------------------|------------------------|
| Asset retirement obligation, beginning of period/year     | \$4,551,669              | \$565,906              |
| Liabilities acquired/(disposed of) during the period/year | (19,586)                 | 3,037,795              |
| Liabilities incurred during the period/year               | 69,194                   | 627,442                |
| Adjustments to estimates                                  | 372,990                  | 135,029                |
| Accretion expense   | 80,608                   | 185,497                |
| <b>Asset retirement obligation, end of period/year</b>    | <b>\$5,054,875</b>       | <b>\$4,551,669</b>     |

## 9. FUTURE INCOME TAX

The increase in the future tax liability over the first quarter of 2009 reflects the renunciation of the \$2.1 million tax deduction available to subscribers of the \$7 million flow-through shares issued in November 2008. This was offset by the tax recovery for the period of \$1.5 million.

CANADIAN PHOENIX RESOURCES CORP.  
Notes to Consolidated Financial Statements  
For the three months ended March 31, 2009 and 2008

**10. NON-CONTROLLING INTEREST (“NCI”)**

The following details the movement in the non-controlling interest in Serrano for the three months ended March 31, 2009:

|   | <b>March 31, 2009</b> |
|---|-----------------------|
| Non-controlling interest - beginning of the quarter   | \$ 26,777,183         |
| NCI share of Serrano loss for the quarter   | (1,087,496)           |
| NCI share of Serrano transactions impacting share capital during the quarter (recognition of future tax liability on flow-through shares) | (870,898)             |
| Increase in NCI in relation to issued and outstanding options and warrants  | 617,890               |
| Decrease in NCI due to Serrano share cancellation (refer Note 3)  | (7,806,346)           |
| <b>Balance, March 31, 2009</b>  | <b>\$17,630,333</b>   |

The movement in the non-controlling interest reflects its share of Serrano’s net loss and equity reductions during the quarter, as well as the change in interest from the share cancellation. There is a further adjustment representing the movement in Serrano’s option and warrant reserves (due to issuances or vesting).

The following is a summary of Serrano’s share capital at March 31, 2009:

|                            |                   |             |
|----------------------------|-------------------|-------------|
| The Corporation’s holdings | 11,050,000        | 56.8%       |
| Non-controlling interest   | 8,407,389         | 43.2%       |
| <b>Total</b>               | <b>19,457,389</b> | <b>100%</b> |

The following is a summary of Serrano’s options at March 31, 2009:

|                                 | Outstanding      | Weighted Average |                |
|---------------------------------|------------------|------------------|----------------|
|                                 |                  | Remaining term   | Exercise \$    |
| Balance – December 31, 2008     | 2,090,694        | 3.7              | \$ 1.97        |
| Issued/expired/cancelled        | -                |                  | -              |
| <b>Balance - March 31, 2009</b> | <b>2,090,694</b> | <b>3.4</b>       | <b>\$ 1.97</b> |

Total stock-based compensation recorded in relation to options during the three months ended March 31, 2009 was \$0.6 million, which has been recorded in the consolidated income statement, with a credit to the NCI.

CANADIAN PHOENIX RESOURCES CORP.  
Notes to Consolidated Financial Statements  
For the three months ended March 31, 2009 and 2008

The following is a summary of Serrano's warrants:

|                             | Outstanding | Weighted Average |             |
|-----------------------------|-------------|------------------|-------------|
|                             |             | Remaining term   | Exercise \$ |
| Balance - December 31, 2008 | 500,000     | 3.6              | \$ 3.60     |
| Issued/expired/cancelled    | -           |                  | -           |
| Balance - March 31, 2009    | 500,000     | 3.3              | \$ 3.60     |

## 11. SHAREHOLDERS' EQUITY

### (a) Authorized

Unlimited number of common voting shares of no par value  
Unlimited number of preferred shares of no par value

### (b) Issued and outstanding

|                                    | # Shares             | \$ Value           |
|------------------------------------|----------------------|--------------------|
| <b>Balance - December 31, 2008</b> | <b>1,131,893,771</b> | <b>118,977,580</b> |
| Change during the quarter          | -                    | -                  |
| <b>Balance- March 31, 2009</b>     | <b>1,131,893,771</b> | <b>118,977,580</b> |

### (c) Stock Options/Warrants

During the quarter there were no changes to the Corporation's stock option plan, and no options were issued or expired during the period. 1,470,000 options were forfeited unexercised during the first quarter in relation to a former director of the Corporation. At March 31, 2009, there were 4,716,000 options outstanding (December 31, 2008: 6,186,000), with a weighted-average exercise price of \$0.17, expiring in 2012. Compensation cost of \$0.03 million was recorded during the three months ended March 31, 2009, with a corresponding increase in contributed surplus as shown below:

| Contributed Surplus      | Three months ended<br>March 31, 2009 | Year ended Dec. 31,<br>2008 |
|--------------------------|--------------------------------------|-----------------------------|
| Opening balance          | \$3,456,588                          | \$2,161,086                 |
| Expiry of warrants       | -                                    | 1,023,236                   |
| Stock Based Compensation | 32,589                               | 272,266                     |
| <b>Closing balance</b>   | <b>\$3,489,177</b>                   | <b>\$3,456,588</b>          |

Consistent with December 31, 2008, there were 760,615,060 warrants outstanding, of which 56,371,696 expired in April 2009 without being exercised. Of the remaining warrants, 223 million have an exercise

CANADIAN PHOENIX RESOURCES CORP.  
Notes to Consolidated Financial Statements  
For the three months ended March 31, 2009 and 2008

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price of \$0.15 and expire in 2012, and 482 million have an exercise price of \$0.20 and also expire in 2012.

**(d) Per share amounts**

For the three months ended March 31, 2009 the weighted average number of shares outstanding was 1,131.9 million, yielding a basic net loss per share of \$0.01. Diluted earnings per share assumes the exercise of options and warrants as if issued at the later of the date of grant or the beginning of the year. This calculation takes into account only the options and warrants that are considered in-the-money at March 31, 2009. Based on the Corporation's share price at March 31, 2009 no options or warrants were considered to be dilutive and therefore the weighted average number of dilutive shares outstanding is the same as the weighted average number of shares outstanding.

**12. COMMITMENTS & CONTINGENCIES**

- a) The Group has total capital expenditure commitments of \$2.2 million at March 31, 2009 relating to a single well commitment with a joint venture partner. In addition, the Group has a \$0.3 million remaining flow-through expenditure commitment required by December 31, 2009 (fulfilled subsequent to March 31, 2009).
- b) Claim statements totaling \$1.4 million have been filed against the Corporation's subsidiary by vendors. Serrano has filed a statement of defense with respect to certain of these claims. Serrano has also been served with approximately \$4.8 million of builders' liens on certain of its properties. Negotiations are underway to remove these liens and settle certain trade payables (see Note 15).
- c) Future minimum lease payments relating to operating leases for office space are as follows:

| <b>Year</b> | <b>Payments</b> |
|-------------|-----------------|
| 2009        | \$213,492       |
| 2010        | \$115,936       |
| 2011        | \$47,556        |
| 2012        | \$47,556        |
| 2013        | \$19,815        |

**13. RELATED PARTY TRANSACTIONS**

Related party transactions for the quarter were carried out on a similar basis and on similar terms to those in the 2008 fiscal year.

The Corporation has executed Corporate Governance Agreements with Marble Point and Serrano. These agreements detail certain rights and restrictions the Corporation has in its relationships with these parties.

**14. FINANCIAL INSTRUMENTS**

The Group's financial instruments consist of cash, accounts receivable, accounts payable, and borrowings. The nature of these instruments and its operations expose the Group to market risk, credit risk and liquidity risks. The Corporation manages its exposure to these risks by operating in a manner

CANADIAN PHOENIX RESOURCES CORP.  
Notes to Consolidated Financial Statements  
For the three months ended March 31, 2009 and 2008

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that minimizes this exposure. While management monitors and administers these risks, the Board of Directors of the Corporation has the overall responsibility for the establishment and oversight of the Group's risk management framework.

*Market risk*

Market risks are those risks that are outside of the control of the Group, the key ones being unfavorable movements in commodity prices, interest rates, and foreign exchange rates. The objective of the Group is to mitigate exposure to these risks, while maximizing returns.

*(a) Commodity price risk*

Due to the volatility of commodity prices, the Group is exposed to adverse consequences such as declining revenue and asset recoverability risks in the event of declining oil and gas prices. The Group manages commodity price risk by updating and monitoring forecast cashflows and profitability and making appropriate actions as needed. To date the Group has not used hedging strategies, such as forward oil and natural gas sale contracts to lock in prices with respect to future deliveries, to counter commodity price risk. The Corporation may consider utilizing these types of derivative contracts in the future to protect its revenue cash flow.

*(b) Interest Rate risk*

At March 31, 2009 the Group had minimal exposure to movements in interest rates. Movements in interest rates are monitored. The Group had no interest rate swaps or financial contracts to manage interest rate risk in place at year end, nor were any utilized during the year.

*(c) Foreign exchange risk*

Although the Group's product revenues are denominated in Canadian dollars, the underlying market prices are affected by the exchange rate between the Canadian and the United States dollar. The Group does not make any significant foreign currency denominated payments. Foreign exchange rates movements are monitored. As at March 31, 2009 the Group had no contracts in place to manage foreign exchange risk and no such contracts were utilized during the year.

*Sensitivity Analysis – market risks*

The impact of a change in commodity prices, foreign exchanges rates, or interest rate has no impact on the Group's financial instruments at March 31, 2009.

*Credit Risk*

Credit risk is the risk of default on payment by counterparties to financial assets held by the Group. A substantial portion (approximately 95%) of the Group's accounts receivables are concentrated with a limited number of customers and joint venture partners in the oil and gas industry. These receivables are subject to normal industry credit risk. Management considers this concentration of credit risk to be acceptable, as customers are major industry participants, and receivables from partners are protected by effective industry standard legal remedies. The Group requires cash calls from its partners on major field projects in advance of commencement.

Consolidated accounts receivable at March 31, 2009 were \$3.3 million. Receivables related to the sale of production are normally collected on the 25<sup>th</sup> day of the month following delivery. During the first quarter of 2009, there were no significant bad debt losses incurred. As at March 31, 2009, consistent with December 31, 2008, an impairment allowance of \$0.3 million was carried in relation to a portion of

CANADIAN PHOENIX RESOURCES CORP.  
Notes to Consolidated Financial Statements  
For the three months ended March 31, 2009 and 2008

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an amount due from a joint venture partner. No other receivables were considered impaired. At March 31, 2009 the Group had \$1.2 million in receivables outstanding for greater than 90 days, and with the exception of the \$0.3 million balance noted above, no collection issues with the remaining balances are expected.

*Liquidity risk*

Liquidity risk is the risk that the Corporation or its controlled entities are not able to meet their financial obligations as they come due. As the oil and gas industry is very capital intensive, the majority of the Group's spending and hence liquidity risk is related to funding its capital programs. The Group's goal is to prudently make capital expenditures while maintaining a strong credit reputation amongst its suppliers.

At March 31, 2009, the Group's financial liabilities consist entirely of trade accounts payable, of which \$16 million was greater than 90 days old. Refer to Note 1 'Going Concern' for discussion of the Group's plans to manage the settlement of its financial liabilities.

From time to time the Group enters into agreements which require expenditure commitments, such as the raising of flow-through equity capital and farm-in agreements with joint venture partners in the oil and gas industry. As disclosed in Note 12, as at March 31, 2009 the Group has \$2.5 million of capital expenditure commitments.

The Group has established a standard of ensuring that it has enough available resources to meet its ongoing financial expenditure requirements. The Group also manages its available resources to ensure it can sustain a downturn in the oil and gas industry in which revenue streams contract and external financing may not be readily available.

During the first quarter of 2009, the Corporation and Serrano established a borrowing facility with an arm's length lender in the amount of \$6.5 million for each company, available to fund capital projects, acquisitions, and general working capital needs. The facility is repayable on demand and bearing interest at prime plus 1%. The loans are cross-guaranteed by each of the Corporation and Serrano with a \$25 million floating debenture and a general security agreement over the property and assets of both corporations.

This credit facility has been suspended due to a number of builders liens placed on Serrano's properties. Both the Corporation and Serrano are in discussions to establish independent facilities.

Serrano

The Corporation's subsidiary Serrano Energy Ltd. carried a working capital deficiency of \$14.7 million (including \$22 million of accounts payable) at March 31, 2009. During the first quarter 2009, the company negotiated settlement of certain trade payables via cash payments and share issuances, and has proposed payment plans to other creditors.

It is the view of management of Serrano that a line of credit will be established in the near future which will assist in the company settling its accounts payable.

It is expected that Serrano will continue to experience challenges to fund ongoing operations and its planned capital program. Serrano is pursuing additional financing, debt or equity, to continue under the current capital plan. In conjunction with the potential difficulty of obtaining additional financing, the current capital expenditure plan may need to be diminished.

Refer to Note 1 Going Concern.

CANADIAN PHOENIX RESOURCES CORP.  
Notes to Consolidated Financial Statements  
For the three months ended March 31, 2009 and 2008

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*Fair Values of Financial Assets and Liabilities*

The fair values of the Group's financial instruments that are included in the consolidated balance sheet approximate their carrying amount due to the short-term maturity of those instruments.

## 15. SUBSEQUENT EVENTS

*Sale of Bonnie-Glen Gross Overriding Royalty*

On April 17, 2009 the Corporation divested of a gross-overriding royalty that had been acquired in the Bonnie Glen Unit of central Alberta in the Blue Parrot transaction. The total proceeds of the sale were \$1 million. Consideration consisted of \$0.5 million cash at closing and a promissory note. The promissory note is secured with a debenture and general security agreement on the assets of Blue Parrot, subordinated to an arm's length lender with Blue Parrot. The promissory note will be repaid in two installments. The first installment of \$250,000 plus interest is due June 30, 2009 and the final payment of \$250,000 plus interest is due December 31, 2009. The purchaser has an option to repay the notes at any time without penalty.

*Sawdy Option Exercise*

In April 2009, the Corporation's subsidiary Serrano exercised its option available under the August 20, 2008 purchase agreement to re-acquire its 40% interest in a number of wells in the Sawdy region of Alberta, for consideration of \$1. The Corporation retained a 40% participating interest in a number of wells in the Pembina area of Alberta on which it had earned that interest under the Serrano purchase agreement.

Following the exercise of the option, the Corporation paid Serrano and the operator of the wells \$1.7 million to satisfy the gross accounts payable between Serrano and the operator, and the Corporation and Serrano.

Aside from the settlement of the accounts payable, there was no impact on the consolidated financial statements as a result of the option exercise.

*Trade payable settlements – Serrano*

As discussed in Note 7, subsequent to March 31, 2009, Serrano paid \$2.1 million in cash and issued 412,040 common shares at \$5 per share to settle \$4.1 million of trade payables. Serrano has further negotiated deferred payment plans with certain other creditors.

As a result of these share issuances, the Corporation's interest in Serrano has declined slightly to 55.7%.

*Resignation of Officers*

On April 30, 2009 Thomas Stan, the President and Chief Executive Officer of the Corporation resigned. Robert Chenery who is the Co-chairman of the Corporation has assumed the position of Interim President and Chief Executive Officer.

CANADIAN PHOENIX RESOURCES CORP.  
Notes to Consolidated Financial Statements  
For the three months ended March 31, 2009 and 2008

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On May 29, 2009 Douglas Bailey, the Chief Financial Officer of the Corporation resigned. Mr. Bailey has not been replaced as of the date of these financial statements.