

*Unaudited Interim Financial Statements of*

**Sahara Energy Ltd.**

*June 30, 2009*

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**Sahara Energy Ltd.****Balance Sheets – unaudited**

<b>As at,</b>	<b>June 30, 2009</b>	<b>December 31, 2008</b>
<b>Assets</b>		
<b>Current</b>		
Cash and cash equivalents	\$ 1,476	\$ 30,574
Accounts receivable	110,122	36,060
Prepaid expenses	(32,584)	83,527
	<b>79,013</b>	150,161
<b>Property, plant and equipment (note 5)</b>	<b>7,291,915</b>	8,158,977
	<b>7,370,928</b>	\$ 8,309,138
<b>Liabilities</b>		
<b>Current</b>		
Accounts payable and accrued liabilities	\$ 2,264,091	\$ 2,237,308
Convertible debentures (note 7)	1,337,020	1,286,945
Promissory notes payable (note 11)	520,309	520,309
	<b>4,121,420</b>	4,044,562
Asset retirement obligations (note 6)	544,680	521,224
Future income taxes	410,592	655,000
	<b>5,076,692</b>	5,220,786
<b>Shareholders' Equity</b>		
Share capital (note 8)	10,830,628	10,830,628
Contributed surplus (note 9)	1,864,724	1,822,958
Deficit	(10,401,116)	(9,565,234)
	<b>2,294,236</b>	3,088,352
	<b>\$ 7,370,928</b>	\$ 8,309,138
<b>Going concern (note 1)</b>		
<b>Commitments (note 10)</b>		
<b>Subsequent events (note 15)</b>		
<b>Approved by the Board:</b>		
(Signed) "Peter J. Boswell" _____, Director		
(Signed) "Quentin Enns" _____, Director		

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**Sahara Energy Ltd.****Statements of Operations and Comprehensive Loss and Deficit (unaudited)**

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	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
<b>Revenue</b>				
Petroleum and natural gas sales	\$ 296,281	\$ 179,570	\$ 441,556	\$ 1,052,754
Royalties	(34,679)	22,778	(43,447)	22,778
Other income	31	76,937	205	75,091
	<b>261,633</b>	<b>279,285</b>	<b>398,314</b>	<b>1,154,017</b>
<b>Expenses</b>				
Production expenses	177,144	176,203	304,357	512,876
General and administrative	86,507	319,391	193,240	467,360
Audit, legal and shareholder reporting	6,741	161,986	11,734	307,359
Engineering services	-	(15,903)	-	8,267
Stock-based compensation	16,710	-	41,766	146,500
Interest expense	47,402	24,660	93,875	93,981
Depletion, depreciation and accretion	612,019	299,300	833,631	857,821
Overhead recoveries	-	(748)	-	(6,649)
	<b>946,523</b>	<b>964,888</b>	<b>1,478,604</b>	<b>2,387,515</b>
<b>Loss before income taxes</b>	<b>(684,890)</b>	<b>(685,603)</b>	<b>(1,080,290)</b>	<b>(1,233,498)</b>
<b>Future income tax recovery</b>	<b>120,014</b>	<b>-</b>	<b>244,408</b>	<b>-</b>
<b>Net loss and comprehensive loss for the period</b>	<b>(564,876)</b>	<b>(685,603)</b>	<b>(835,882)</b>	<b>(1,233,498)</b>
<b>Deficit, beginning of period</b>	<b>(9,836,240)</b>	<b>(13,102,280)</b>	<b>(9,565,234)</b>	<b>(12,554,385)</b>
<b>Deficit, end of period</b>	<b>\$ (10,401,116)</b>	<b>\$ (13,787,883)</b>	<b>\$ (10,401,116)</b>	<b>\$ (13,787,883)</b>
<b>Loss per share – basic and diluted</b>	<b>(0.01)</b>	<b>(0.02)</b>	<b>(0.02)</b>	<b>(0.05)</b>
<b>Weighted average number of shares outstanding</b>	<b>38,036,302</b>	<b>38,036,302</b>	<b>38,036,302</b>	<b>23,714,731</b>

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**Sahara Energy Ltd.****Statements of Cash Flows (unaudited)**

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	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
<b>Operating activities</b>				
Net loss	\$ (835,882)	\$ (685,605)	\$ (564,876)	\$ (1,233,499)
Items not affecting cash:				
Future income tax expense / (recovery)	(244,408)	-	(120,014)	-
Depletion, depreciation and accretion	833,631	299,301	612,019	857,822
Stock-based compensation	41,766	-	16,710	146,500
	(204,893)	(386,304)	(56,161)	(229,177)
Changes in non-cash working capital				
Accounts receivable	18,780	93,124	188,070	162,331
Prepaid expenses	23,720	263,558	35,028	(39,529)
Accounts payable and accrued liabilities	26,783	(760,009)	(371,747)	(1,189,119)
	(136,060)	(789,631)	(204,811)	(1,295,494)
<b>Financing activities</b>				
Issue of common shares	-	(37,330)	-	(37,330)
Contributed Surplus	-	(55,074)	-	(55,074)
Long-term debt	-	(44,010)	-	(119,010)
	-	(136,414)	-	(211,414)
<b>Investing activities</b>				
Property, plant and equipment	(177,347)	-	(98,390)	-
Disposition of property, plant and equipment	45,000	1,164,112	45,000	2,687,106
Accounts payable for capital expenditures	239,309	(36,122)	235,770	
	106,962	1,127,990	182,380	2,687,106
<b>Increase (decrease) in cash</b>	<b>(29,098)</b>	<b>201,945</b>	<b>(22,429)</b>	<b>1,180,200</b>
<b>Cash, beginning of period</b>	<b>30,574</b>	<b>(336,638)</b>	<b>23,905</b>	<b>(1,314,893)</b>
<b>Cash, end of period</b>	<b>\$ 1,476</b>	<b>\$ (134,693)</b>	<b>\$ 23,905</b>	<b>\$ (134,693)</b>
<b>Interest and taxes paid and received:</b>				
Interest paid	\$ -	\$ -	\$ -	\$ -
Interest received	31	412	205	833
Income taxes paid	-	-	-	-

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**1. Incorporation, nature of business and going concern**

**Incorporation and nature of business**

Sahara Energy Ltd. (the "Company") was incorporated under the Business Corporations Act (Alberta) and is listed on the TSX Venture Exchange ("the Exchange"). The Company is a junior resource exploration company engaged in the acquisition, exploration and development of petroleum and natural gas reserves in western Canada. Effective March 31, 2008, the Company acquired Mirage Energy Ltd. ("Mirage") pursuant to a plan of arrangement and the two corporations were amalgamated. The newly-amalgamated Company is continuing operations as Sahara Energy Ltd.

**Going concern**

These financial statements have been prepared on a going concern basis which assumes that the Corporation will continue to operate for the foreseeable future and be able to realize its assets and discharge its liabilities and commitments in the normal course of business.

For the six months ended June 30, 2009, the Company incurred a loss of \$835,882. As at June 30, 2009, the Company has an accumulated deficit of \$10,401,116 and a working capital deficiency of \$4,042,407.

Although the Company's assessment of its producing petroleum and natural gas assets shows positive cash flows from operations based on its current forecast and financial models, there is significant doubt as to the appropriateness of the use of the going concern assumption due to the following factors:

- a) Continued weak petroleum and natural gas prices will affect the ability of the Company to generate cash flows.
- b) Current economic and credit conditions and resulting equity market decline may affect the Company's ability to raise or have access to funds for operational & capital spending.
- c) Financial results of the Company including working capital deficiency and accumulated net deficit.

To help remedy this situation, the Company has reduced its capital spending and future administrative costs. In addition, the Company has moved its focus towards reviewing and completing projects where the risks and costs have been greatly reduced. Management believes these measures in addition to the future cash flow of the Company arising from a possible equity financing and achieving profitable operations will address the Company's working capital deficiency for the foreseeable future. However, there can be no assurances that the initiatives undertaken by management will be successful. These financial statements do not reflect adjustments that would be necessary should the going concern assumption be inappropriate. Such adjustments could be material.

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**Sahara Energy Ltd.****Notes to the Financial Statements**

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**2. Business combination**

Effective March 31, 2008, the Company acquired all of the issued and outstanding shares of Mirage Energy Ltd. ("Mirage") pursuant to a plan of arrangement. Each Mirage common share was exchanged for one-half (1/2) of a common share of the Company. The number of common shares issued by the Company was 13,403,896 with an assigned value of \$0.08 per share. The acquisition has been accounted for using the purchase method of accounting with the results from operations included from the closing date of the transaction. The purchase equation is as follows:

<b>Consideration given:</b>	
13,403,896 Common shares	<b>\$ 1,072,312</b>

  

<b>Net assets acquired:</b>	
Property, plant and equipment	<b>\$ 2,721,060</b>
Working capital	<b>(532,313)</b>
Convertible debentures	<b>(508,530)</b>
Future income tax liability	<b>(388,610)</b>
Asset retirement obligations	<b>(219,295)</b>
	<b>\$ 1,072,312</b>

Transaction costs of \$62,150 related to the acquisition were expensed during the year and are combined with audit, legal and shareholder reporting expenses in the statement of operations, comprehensive loss and deficit.

**3. Significant accounting policies**

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles and reflect the following significant accounting policies:

**a) Estimates by management**

Estimates by management represent an integral component of these financial statements. The estimates made in these financial statements reflect management's judgements based on past experiences, present conditions and expectations of future events. Where estimates were made, the reported amounts for assets, liabilities, revenues and expenses may differ from the amounts that would otherwise be reflected if the ultimate outcome of all uncertainties and future events were known at the time these financial statements were prepared.

The Company uses estimates to calculate depletion, amortization and accretion expense, to assess impairment of long-lived assets, to estimate asset retirement obligations, to calculate the fair value of stock options, warrants and the conversion feature of debentures and to estimate income tax expense or recoveries.

**b) Measurement uncertainty**

The Company calculated depletion, amortization and accretion expense and calculates the ceiling test using management estimates of petroleum and gas reserves remaining in petroleum and gas properties, commodity prices and capital costs required to develop those reserves. Estimates of

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volumes and the related future cash flows are subject to measurement uncertainty. Such reserve estimates are subject to change as additional information becomes available.

Numerous assumptions and judgments are required in the fair value calculation of asset retirement obligations ("ARO") including the ultimate settlement amounts, inflation factors, credit adjusted discount rates, timing of settlement, and changes in the legal, regulatory, environmental and political environments. To the extent future revisions to these assumptions impact the fair value of any existing ARO liability, a corresponding adjustment is made to the related petroleum and gas properties.

The assumptions used in the determination of the fair value of stock options issued are based on the use of the Black-Scholes pricing model, which includes estimates of the future volatility of the Company's stock price, expected lives of the stock options, expected dividends and other relevant assumptions.

Significant judgement is required in determining the provision for income taxes. There are many transactions and calculations for which the ultimate tax determination is uncertain in the ordinary course of business. The Company recognizes liabilities for anticipated tax audit issues based on estimates of whether additional taxes will be due. The amounts recorded for income taxes involve tax interpretations, regulations and legislation that are continually changing. Management is required to make estimates on the probability of the Company utilizing certain tax pools which, in turn, is dependent on estimates of proved and probable reserves, production rates and future petroleum prices.

By their nature, these estimates are subject to measurement uncertainty and the impact of differences between actual and estimated amounts on the financial statements of this and future periods could be material.

**c) Joint operations**

Substantially all of the Company's petroleum and gas operations are conducted jointly with other parties and accordingly, the financial statements reflect only the Company's proportionate interest in these petroleum and gas operations and the related revenues and expenses.

**d) Cash and cash equivalents**

Cash and cash equivalents include cash and highly liquid investments that have original maturity terms of ninety days or less

**e) Revenue recognition**

Revenue from the sales of petroleum and natural gas is recorded on the gross basis when title passes to an external party and is recognized based on volumes delivered to customers at contractual delivery points and rates and when the significant risks and rewards of ownership have been transferred to the buyer and collectability is reasonably assured.

**f) Property, plant and equipment**

- (i) **Capitalized costs** - The Company follows the full cost method of accounting for its petroleum and natural gas operations. Under this method, all costs related to the exploration for and development of petroleum and natural gas reserves are capitalized in cost centers on a country-by-country basis. Costs include lease acquisition costs, geological and geophysical expenses and drilling costs of productive and non-productive wells and equipment costs.

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Proceeds from the sale of properties are applied against capitalized costs and gains or losses are not recognized unless such sale would alter the depletion rate by more than 20%.

- (ii) **Depletion and depreciation** - Depletion of capitalized costs is calculated using the unit-of-production method based upon estimated proven reserves as determined by independent engineers. Administrative assets are amortized on a declining balance basis over their estimated useful lives at rates varying from 20% to 45% annually.
- (iii) **Ceiling test** - The Company performs a two-step test at least annually to assess the carrying value of petroleum and gas assets. A cost center is defined on a country-by-country basis and is tested for recoverability using undiscounted future cash flows from proved reserves and forward indexed commodity prices, adjusted for contractual obligations and product quality differentials. A cost center is written-down to its fair value when its carrying value, less the lower of cost and market value of unproved properties, is in excess of the related undiscounted future net cash flows associated with the cost centre's proved reserves. If the carrying value is not fully recoverable, the amount of impairment is measured by comparing the carrying amounts less the lower of cost and market value of unproved properties, to the discounted future net cash flows associated with the cost centre's proved and probable reserves. This impairment in the carrying amount is charged to depletion, amortization and accretion in the period in which the impairment occurs.

**g) Asset retirement obligations**

The Company recognizes the fair value of an ARO in the period in which the well or related asset is drilled, constructed or acquired and when a reasonable estimate of the fair value of the ARO can be determined. The fair value of the estimated ARO is recorded as a long-term liability, and equals the present value of estimated future cash flows, discounted using a risk-free interest rate adjusted for the Company's credit standing. The liability accretes until the date of expected settlement of the ARO or the asset is sold and is recorded as an accretion expense. The associated asset retirement costs are capitalized as part of the carrying value of the related assets. The capitalized amount is amortized on a basis consistent with the amortization and depletion of the underlying assets. Actual restoration expenditures are charged to the accumulated obligation as incurred. Any settlements are charged to income in the period of settlement.

On a periodic basis, management will review these estimates and if changes to the estimates are required, these changes will be applied on a prospective basis and will result in an increase or decrease to the ARO. Any difference between the actual costs incurred and the recorded liability is recorded as a gain or loss in the statement of operations, comprehensive loss and deficit in the period in which the settlement occurs.

**h) Income taxes**

The Company follows the asset and liability method of income tax allocation. Under the liability method, future income tax assets and liabilities are recorded to recognize future income tax inflows and outflows arising from the settlement or recovery of assets and liabilities at their carrying values. Future income tax assets are also recognized for the benefits from income tax losses and deductions that cannot be identified with particular assets or liabilities, provided those benefits are more likely than not to be realized. Future income tax assets and liabilities are determined based on the substantively enacted tax laws and rates that are anticipated to apply in the period of realization.

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**i) Stock-based compensation**

The Company grants options to employees, directors, and non-employees to purchase common shares at a specified price. The fair value of such options is estimated at the time of grant using the Black-Scholes pricing model and is recorded as stock-based compensation expense with a corresponding amount recorded as contributed surplus, on a straight-line basis over the vesting period. The fair value of stock options granted to non-employees is re-measured at the earlier of each financial reporting or vesting date, and any adjustment is charged or credited to operations upon re-measurement. Upon the exercise of stock options, the consideration paid together with the amount previously recognized in contributed surplus is recorded as an increase in share capital. In the event that options expire, previously recognized expenses associated with such stock options are not reversed. The Company accounts for forfeitures as they occur.

**j) Warrants**

The Company issues warrants to purchase common shares when issuing common share units. The fair value of such warrants is estimated at the time of issuance using the Black-Scholes pricing model and is recorded as warrants in the equity section of the balance sheet and the corresponding value is reduced from share capital from the common share issuance. Upon the exercise of warrants, the consideration paid together with the amount previously recognized in warrants is recorded as an increase in share capital. In the event that warrants options expire, previously recognized warrant value is adjusted through contributed surplus. In addition, the Company issues broker warrants as compensation related financing activities. The fair value of such warrants is estimated at the time of issuance using the Black-Scholes pricing model and is recorded as warrants in the equity section of the balance sheet.

**k) Financial instruments and derivatives**

Cash and cash equivalents are designated as held-for-trading and are measured at fair value. Accounts receivable and due from related party are designated as loans and receivables and are measured at amortized cost using the effective interest method. Accounts payable and accrued liabilities, promissory notes payable and the current portion of convertible debentures are classified as other liabilities and are measured at amortized cost using the effective interest method. The carrying value of these financial instruments approximates fair value due to the short-term nature of these instruments.

The Company may use various types of derivative financial instruments to manage risks. Proceeds and costs realized from holding the related contracts are recognized at the time each transaction under a contract is settled. For the unrealized portion of such contracts, the Company utilizes the fair value method of accounting. The fair value is based on an estimate of the amounts that would have been paid to or received from counterparties to settle these instruments. The method requires the fair value of the derivative financial instruments to be recorded at each balance sheet date with unrealized gains or losses on those contracts recorded through net earnings. Transaction costs are expensed as incurred.

An embedded derivative is a component of a contract that affects the terms in relation to another factor. These hybrid contracts are considered to consist of a "host" contract plus an embedded derivative. The embedded derivative is separated from the host contract and accounted for as a derivative only if certain conditions are met. The Company has not identified any embedded derivatives which require separate recognition and measurement.

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**l) Flow-through shares**

Share capital includes flow-through shares issued pursuant to certain provisions of the Income Tax Act in Canada (the "Act"). The Act provides that, where the share issuance proceeds are used for exploration and development expenditures, the related income tax deduction may be renounced to subscribers. Accordingly, these expenditures are not an income tax deduction to the Company. Share capital is reduced and a future income tax liability is recorded for the estimated value of the renounced expenditures at the time of filing.

**m) Per share amounts**

Basic per share amounts are calculated using the weighted average number of shares outstanding during the year. Weighted average number of shares is determined by relating the portion of time within the reporting period that common shares have been outstanding to the total time in that period.

The Company uses the treasury stock method to determine the dilutive effect of stock options and other dilutive instruments. Diluted calculations reflect the weighted average incremental common shares that would be issued upon exercise of dilutive options assuming proceeds would be used to repurchase shares at average market prices for the period. Anti-dilutive options are not included in the calculation.

**n) Share issue costs**

Costs incurred on the issue of the Company's shares are charged directly to share capital and are net of applicable future income tax benefits.

**o) Transaction costs**

Costs incurred relating to acquisition or business combination activities are expensed in the period incurred.

**p) Changes in accounting policies and standards**

The CICA published the following new sections that will apply to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007. The Company adopted these standards effective January 1, 2008.

CICA handbook section 1400, General Standards of Financial Statement Presentation, was amended to include requirements to assess and disclose an entity's ability to continue as a going concern. Realization values may be substantially different from carrying values as shown and these financial statements do not give effect to adjustments that would be necessary to the carrying values and classification of assets and liabilities should the Company be unable to continue as a going concern. As at December 31, 2008, the Company had not yet achieved profitable operations, has accumulated a deficit since its inception, and expects to incur further losses in the development of its business. However, the Company continues to operate as a going concern based on its ability to generate working capital through capital generating activities.

Section 3862, "Financial Instruments - Disclosures". This section describes the required disclosures to evaluate the significance of financial instruments for the Company's financial position and performance as well as the nature and extent of risks arising from financial instruments to which the Company is exposed and how the Company manages those risks.

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**p) Changes in accounting policies and standards (continued)**

Section 3863, "Financial Instruments - Presentation". This section establishes standards for presentation of financial instruments and non financial derivatives. It details the presentation of standards described in Section 3861, "Financial Instruments — Disclosure and Presentation."

Section 1535, "Capital Disclosures". This section establishes standards for disclosing information about the entity's capital and how it is managed. It describes the disclosure of the entity objectives, policies and processes for managing capital as well as summary quantitative data on the elements in the management of capital. The section seeks to establish whether the entity has complied with capital requirements and if not, the consequences of such non-compliance.

**4. Future accounting standards and reporting changes**

**a) Goodwill and intangible assets**

The CICA issued the new accounting standard Section 3064, Goodwill and Intangible Assets replacing Section 3062, Goodwill and Other Intangible Assets. This new Section will be effective for the Company January 1, 2009. Section 3064 applies to goodwill subsequent to initial recognition and establishes the standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. The new standard is not expected to have a material impact on the Company's financial statements.

**b) Enhanced fair value disclosure**

The CICA issued the new accounting standard Section 3862, Enhanced Fair Value Disclosures. This new Section will be effective for the Company on January 1, 2009. The new Section is similar to U.S. standard FAS 157 and International standard IFRS 7. Items recorded or disclosed at fair value are required to be placed in one of the categories being (i) Level 1 – fair value determined from quoted prices; (ii) Level 2 – fair value determined principally from quoted prices; and (iii) Level 3 – fair value not based on observable market data.

**c) Business combinations**

The CICA issued new accounting standard Sections 1582, 1601 and 1602, replacing Sections 1581 and 1600. These new Sections will be effective for the Company on January 1, 2009 and they establish the principles and requirements for accounting for business combinations. Changes include determination of the purchase price based on the fair value of shares exchanged on the acquisition or closing date and expensing versus capitalizing transaction costs as they are incurred. In addition, negative goodwill is required to be recognized in earnings at the acquisition date.

**d) International financial reporting standards**

The Canadian Accounting Standards Board confirmed January 1, 2011 as the effective date for the requirement to report under International Financial Reporting Standards ("IFRS") with comparative 2010 periods converted as well. Canadian generally accepted accounting principles, as we currently know them, will cease to exist for all public reporting entities. Changes to accounting policies are likely and may materially impact the Company's financial statements. The Company has started the processes necessary to make the transition to IFRS; however, continued progress is required before the Company is in a position to quantify the impact of IFRS on financial results.

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**Sahara Energy Ltd.****Notes to the Financial Statements**

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**5. Property, plant and equipment**

<b>June 30, 2009</b>	<b>Cost</b>	<b>Accumulated amortization</b>	<b>Net book value</b>
Petroleum and natural gas properties	\$ 17,082,752	\$ 9,838,102	\$ 7,244,650
Furniture, equipment and leasehold improvements	139,588	92,323	47,265
	<b>\$ 17,222,340</b>	<b>\$ 9,930,425</b>	<b>\$ 7,291,915</b>

  

<b>December 31, 2008</b>	<b>Cost</b>	<b>Accumulated amortization</b>	<b>Net book value</b>
Petroleum and natural gas properties	\$ 17,189,713	\$ 9,084,620	\$ 8,105,093
Furniture, equipment and leasehold improvements	139,588	85,704	53,884
	<b>\$ 17,329,301</b>	<b>\$ 9,170,324</b>	<b>\$ 8,158,977</b>

Costs excluded from depletion for 2009 - \$358,425 (2008 - \$358,425) as these costs are for unproved reserves

Capitalized G&A costs directly are \$nil (2008 - \$30,000).

**6. Asset retirement obligations**

At the date of completion of drilling and testing, the Company identified obligations related to oil and gas properties and records a liability equal to the present value of expected future assets retirement obligations. The total future ARO was estimated by management based on the Company's net ownership interest in all wells and facilities, estimated costs to reclaim and abandon the wells and facilities and the estimated timing of the costs to be incurred in future periods. The Company has estimated the net present value of its total ARO to be \$551,227 as at June 30, 2009 based on an undiscounted future liability of \$635,685 and incorporated the Company's credit-adjusted risk-free interest rate of 9% and inflation rate of 2%. These payments are expected to be made over the next five years.

The following table reconciles the Company's asset retirement obligations:

	<b>June 30, 2009</b>	<b>December 31, 2008</b>
	<b>\$</b>	<b>\$</b>
<b>Balance, beginning of period</b>	<b>521,224</b>	497,496
Liabilities incurred on Mirage acquisition	-	220,795
Accretion expense	<b>23,456</b>	14,440
Settled on sale of properties	-	(211,507)
<b>Balance, end of period</b>	<b>544,680</b>	521,224

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**Sahara Energy Ltd.****Notes to the Financial Statements**

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**7. Convertible debentures**

	<b>June 30, 2009</b>	December 31, 2008
	<b>\$</b>	<b>\$</b>
Total debenture payable	<b>1,337,020</b>	1,337,020
Value assigned to conversion option	<b>176,373</b>	176,373
Accretion and discount	<b>(176,373)</b>	(126,298)
	<b>-</b>	50,075
<b>Balance, end of period</b>	<b>1,337,020</b>	1,286,945

The convertible debentures bear interest at 10% payable quarterly and are due June 29, 2009.

For accounting purposes, the value assigned to the conversion option uses an effective risk free interest rate of 18% and the liability component of the debenture will be accreted to the principal amount over the term of the debenture.

The debentures are convertible at the option of the holder into 1,333,020 units, each unit consisting of one common share and one common share purchase warrant at a price of \$0.50 per share. The warrants expire June 29, 2009.

The debentures are convertible in whole or in part, at any time prior to maturity at the option of the holder. The holder may also convert the debentures into cash at anytime after October 29, 2007 on the basis of repayment of the principal amount together with accrued and unpaid interest to the date of conversion.

The Company at its sole discretion may redeem the outstanding debentures together with accrued interest thereon on or after October 29, 2007 provided that, prior to redemption, the Company shall have provided written notice to the holders and which notice provides thirty days for the holders to convert their debenture into units of common shares and warrants pursuant to the convertibility provision of the debentures. If the holder does not exercise his right of conversion, the debentures are redeemable by the Company and shall be purchased at a redemption price of 105% of the principal amount of the debentures plus accrued and unpaid interest to the date of redemption.

The debentures are also automatically convertible at the option of the holder in the event that the Company fails to pay interest or failure to repay the principal amount and accrued interest on the maturity date.

The Company assessed the fair value of the repayment obligation and concluded that it was equivalent to the face value of the debentures issued. Accordingly, no value was assigned to the conversion option.

The debentures have yet to be redeemed. The Company has been in contact with the debenture holders and is in the process of working towards repayment of the debentures.

**8. Share capital****Authorized:**

- Unlimited number of:
  - Common voting shares
  - Preferred non-voting shares

Sahara Energy Ltd.

Notes to the Financial Statements

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Issued:	Six months ended June 30, 2009		Year ended December 31, 2008	
	Shares	\$	Shares	\$
<b>Common shares</b>				
Balance beginning of year	38,036,302	14,192,316	24,632,406	9,916,214
Tax effect of flow-through share renunciations	-	-	-	(157,989)
Shares issued on acquisition (note 2)	-	-	13,403,896	4,434,000
<b>Balance, end of year</b>	<b>38,036,302</b>	<b>14,192,316</b>	<b>38,036,302</b>	<b>14,192,316</b>
	Number of warrants	\$	Number of warrants	\$
<b>Warrants</b>				
<b>Balance, beginning of period</b>	<b>171,814</b>	-	441,814	23,422
Expired warrants	(171,814)	-	(270,000)	(23,422)
<b>Balance, end of period</b>	<b>-</b>	<b>-</b>	<b>171,814</b>	<b>-</b>

The values assigned to the warrants in 2007 were determined by using the Black-Scholes option pricing model with a volatility rate of 119% and a risk free interest rate of 5.0%. Warrants outstanding represent warrants issued in connection with convertible debenture. No value was assigned to these warrants in prior years.

**Options**

As at June 30, 2009, the following options were outstanding:

Options outstanding	Option price	Weighted average remaining contractual life	Number of options currently exercisable	Weighted average exercisable price of options currently exercisable
935,000	0.40	1.42	935,000	0.40
200,000	1.00	1.58	200,000	1.00
80,000	1.25	1.67	80,000	1.25
110,000	1.00	1.92	73,333	1.00
160,000	1.30	1.58	106,667	1.30
225,000	0.90	2.92	150,000	0.90
<b>1,710,000</b>	<b>0.97</b>	<b>1.69</b>	<b>1,470,000</b>	<b>0.70</b>

The Corporation has an option plan (the "Option Plan") for its directors, officers, employees and consultants. Under the Option Plan, the Corporation has reserved for issuance of a total of 2,423,200 Common Shares. In addition, the aggregate number of shares so reserved for issuance to any one person shall not exceed 5% of the issued and outstanding shares. Under the plan, options are exercisable at varying vesting provisions for a maximum term of five years.

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**Sahara Energy Ltd.****Notes to the Financial Statements**

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	<b>Six months ended June 30, 2009</b>		<b>Year ended December 31, 2008</b>	
	<b>Number of Options</b>	<b>Weighted average exercise price (\$)</b>	<b>Number of Options</b>	<b>Weighted average exercise price (\$)</b>
<b>Outstanding, beginning of year</b>	1,710,000	0.70	2,290,000	0.63
Cancelled	-	-	(540,000)	1.11
<b>Outstanding, end of period</b>	<b>1,710,000</b>	<b>0.70</b>	<b>1,710,000</b>	<b>0.70</b>

For the period ended June 30, 2009, the Company recorded stock based compensation expense of \$41,766 (2008 - \$146,500) included in contributed surplus as determined based on the fair value of the stock options at the grant date estimated using the Black-Scholes model with the following assumptions:

	<b>2007</b>
Volatility rate	49-129%
Risk-free interest rate	5.0%
Dividend yield rate	0.00%
Forfeiture rate of	0.00%
Expected life	5.00 years

**Escrow**

As at December 31, 2008, there were 1,024,126 shares held in escrow. The shares held in escrow were pursuant to agreements related to the acquisition of predecessor companies. On August 30, 2009 all escrowed shares will be released and free to trade.

**9. Contributed surplus**

A summary of the status of contributed surplus as of December 31, 2008 and the changes during the year is presented below:

	<b>Six months ended June 30, 2009</b>	<b>Year ended December 31, 2008</b>
	<b>\$</b>	<b>\$</b>
<b>Balance, beginning of period</b>	1,822,568	1,566,253
Fair value assigned to stock options	42,156	232,893
Fair value of options exercised/cancelled	-	(23,422)
<b>Balance, end of period</b>	<b>1,864,724</b>	<b>1,822,568</b>

**10. Commitments****Premises lease**

The Company is committed to lease rental payments of approximately \$120,000 per annum pursuant to the terms of an office lease agreement that expires on May 31, 2011. Subsequent to

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year end, the Company re-negotiated its office lease agreement and, accordingly; has reduced its commitment to approximately \$60,000 per annum. The new lease agreement expires September 2014.

**11. Promissory notes payable**

	<b>Six months ended June 30, 2009</b>	Year ended December 31, 2008
Related party notes payable, secured by a general security agreement (see note 13).	<b>\$ 367,500</b>	\$ 367,500
Note payable – bears interest at 10% per annum, payable in monthly blended instalments of \$25,000 per month and secured by a fixed charge over certain petroleum and natural gas properties.	<b>152,809</b>	152,809
	<b>\$ 520,309</b>	\$ 520,309

**12. Related party transactions**

The Company had the following related party transactions during the year measured at the exchange rate, which is the amount established and agreed to by the related parties and which are similar to those negotiable with third parties:

Of the \$367,500 notes payable owing on June 30, 2009, \$320,000 is owed to senior management of the Company.

**13. Financial instruments**

The Company holds various forms of financial instruments. The nature of these instruments and its operations expose the Company to market risk, credit risk and liquidity risks. The Company manages its exposure to these risks by operating in a manner that minimizes this exposure. While management monitors and administers these risks, the Board of Directors has the overall responsibility for the establishment and oversight of the Company's risk management framework.

**Market risk**

Market risks are generally those risks that are outside of the control of the Company. These are: commodity prices, foreign exchange rates and interest rates. The objective of the Company is to mitigate exposure to these risks, while maximizing returns to the Company.

**Commodity price risk**

Due to the volatility of commodity prices, the Company is potentially exposed to adverse consequences in the event of declining prices. The Company may enter into petroleum and natural gas contracts in order to protect its cash flow on future sales. The contracts reduce the fluctuation in sales revenue by locking in prices with respect to future deliveries of petroleum and natural gas. As at December 31, 2008, the Company had no contracts outstanding.

**Foreign currency exchange risk**

Even though all of the Company's petroleum and natural gas sales are denominated in Canadian dollars, the underlying market prices for these commodities are impacted by the exchange rate between Canada and the United States. In addition, the fair value of our risk management contracts will fluctuate as a result of changes in foreign exchange rates as most derivative

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contracts are denominated in US dollars. As at December 31, 2008, the Company had no forward, foreign exchange contracts in place.

**Interest rate risk**

The Company does not have any debt subject to floating rates and is therefore not exposed to fluctuations in the market rate of interest. The Company has no interest rate swaps or financial contracts in place at or during the year ended December 31, 2008.

**Credit risk**

Substantially all of the accounts receivable are with customers and joint venture partners in the petroleum and gas industry and are subject to normal industry credit risks. The Company generally extends unsecured credit to these customers and therefore, the collection of accounts receivable may be affected by changes in economic or other conditions. Management believes the risk is mitigated by entering into transactions with long-standing, reputable, counterparties and partners. Wherever possible, the Company requires cash calls from its partners on capital projects before they commence. Receivables related to the sale of the Company's petroleum and natural gas production are from major marketing companies who have excellent credit ratings. These revenues are normally collected on the 25th day of the month following delivery. The Company has recorded a bad debt provision during fiscal 2008 as a result of one of its' marketing agents going into receivership (see notes 17 and 18(d)).

**Liquidity risk**

Liquidity risk would occur if the Company is not able to meet its financial obligations as they come due. The Company has suffered substantial operating losses and has a working capital deficiency of \$4,042,407 as of June 30, 2009. As our industry is very capital intensive, the majority of our spending is related to our capital programs. The Company's goal is to prudently spend its capital while improving its credit reputation amongst its suppliers.

**14. Capital disclosures**

The Company considers its capital structure to include shareholders' equity, convertible debt and working capital. The Company will adjust its capital structure to manage its current and projected debt through the issuance of shares and/or adjusting its capital spending. The Company monitors its capital based on the current and projected ratios of net debt to cash flow. The Company's objective in managing its capital structure is to:

- a) create and maintain flexibility so that the Company can continue to meet its financial obligations; and,
- b) finance its growth either through internally generated projects, joint venture relationships or asset/corporate acquisitions.

**15. Subsequent events**

- a) During the first two quarters of 2009, four of the Company's creditors sought payment from the Company for outstanding invoices totalling \$190,474. Of this amount, \$121,248 has been paid and payment agreements have been reached, whereby the Company will continue to make instalment payments until the total owing has been paid.
- b) During the third quarter of 2009, the Company sold certain petroleum and natural gas properties for \$402,000 to settle outstanding accounts payable and accrued liabilities and other corporate debt.
- c) During October 2009, the Company settled \$323,025 of accounts payable and accrued liabilities

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through the payment of \$18,006 in cash and the issuance of 953,099 common shares at a price of \$0.15 per share

- d) The Company's marketing agent SemCanada Crude went into receivership in July 2008 at which time Sahara still had not received petroleum revenues for July and August 2008 production. The Company has now written-down the outstanding receivable of \$316,739 due from their marketing agent to \$7,000 based on the Court of Queens bench decision which was handed down on August 24, 2009. The remaining \$309,739 was recognized as a bad debt in these financial statements.
- e) On June 29, 2009, the Company failed to repay the convertible debentures and accrued interest. The Company is currently attempting to re-negotiate the terms with the respective debenture holders.
- f) On June 29, 2009, all of the Company's outstanding warrants as at June 30, 2009 expired.

**16. Comparative figures**

Certain comparative figures from the prior year have been reclassified to conform to the financial statement presentation used in the current year. The changes did not have any impact on net loss or deficit.