

Q1



*For the three months ended March 31, 2008*

## TO OUR SHAREHOLDERS

Painted Pony Petroleum Ltd. (“Painted Pony” or the “Company”) is pleased to report the progress made during the first three months of 2008. The accomplishments in the first quarter of 2008 of our aggressive exploration and development program include:

- Drilled 11 gross (3.74 net) horizontal operated wells targeting the Bakken formation in Saskatchewan at a 100% success rate and one (1.0 net) step-out stratigraphic exploration well in a new area. To date, Painted Pony has drilled a total of 19 (7.35 net) horizontal operated wells targeting the Bakken formation,
- Acquired access to additional potential Bakken-bearing lands with two farm-in agreements,
- Enjoyed field netbacks of \$69.60 per bbl,
- Completed a strategic production and land acquisition in our core NE BC area, and
- Established credit facilities totalling \$12.5 million.

During the first quarter of 2008, Painted Pony continued to earn lands and delineate the Bakken zone potential on our lands in south east Saskatchewan. With the completion of spring break-up, second quarter drilling has re-commenced with the drilling of a water disposal well and 3 (1.7 net) horizontal wells, including an exploratory well on a potential new Bakken trend. We are currently drilling three (1.1 net) additional wells.

Painted Pony is actively accumulating land in Saskatchewan through earning by drilling wells, participating in crown land sales and leasing freehold lands. The Company currently owns approximately 22,600 net acres, of which 3% is developed. In total, Painted Pony has, through various farm-in agreements plus owned lands, access to approximately 82,500 net acres of land prospective for light oil in the Bakken and other formations. The Company believes these lands contain approximately 200 Company-mapped horizontal drilling locations targeting the Bakken formation for light sweet oil, plus a number of locations for other light oil reservoirs within S.E. Saskatchewan.

In March 2008, Painted Pony announced and closed a strategic acquisition of natural gas-weighted production and lands in the Company's core N.E. British Columbia area, where the Company has access to 1,200 km<sup>2</sup> of three dimensional seismic through an area of mutual interest agreement. Currently, the Company owns 86,000 net acres of developed and undeveloped lands in this area.

Preliminary evaluation of these lands has identified prospects targeting the Bluesky, Gething, Cadomin, Halfway, and Montney zones, plus shale gas potential. The application of multi-stage fracture stimulation technology to these zones is expected to unlock their tight gas potential. Painted Pony is currently planning an exploration and development program for this high impact gas-prone area.

In March 2008, the Company established bank lines totalling \$12.5 million. At the end of March 2008, the Company had a positive net working capital position of \$4.7 million and no bank indebtedness. On April 30, 2008, Painted Pony issued 8,800,000 Class A shares at \$4.35 per share in a bought deal private placement equity financing, raising gross proceeds of \$38.28 million. These funds will be used for general corporate purposes and the capital program.

## **Outlook**

Since the completion of the initial public financing on May 17, 2007, followed by the commencement of trading on the TSX Venture Exchange on May 23, 2007, Painted Pony has passed many milestones. In one year, the Company has built a significant land position in both SE Saskatchewan and NE BC and generated a multi-year drilling inventory of potential Bakken zone locations. Production in the month of April 2008 averaged approximately 775 boe/d, of which 315 bbls/d is light oil from Saskatchewan, and 460 boe/d (weighted 95% gas and 5% NGL's) is from British Columbia.

I would like to thank each of the management, staff, directors and their families for their role in building the Company. Recognition is also due to Painted Pony's partners, suppliers, and government agencies; their cooperation and assistance continues to help us achieve our goals. Finally, Painted Pony wishes to acknowledge our shareholders for their continued support.

Readers are invited to review the Company's updated presentation on our website at [www.paintedpony.ca](http://www.paintedpony.ca).

On behalf of the Board of Directors,  
Sincerely,

Patrick R. Ward  
President & CEO  
May 28, 2008

# Financial and Operational Summary

(unaudited)

Three months ended  
March 31, 2008

## FINANCIAL

Revenue (before transportation, interest and other)	\$	1,354,759
Funds flow from operations <sup>(1)</sup>	\$	1,073,860
Per share – basic and diluted	\$	0.06
Net earnings	\$	3,345,551
Per share – basic and diluted	\$	0.19
Capital expenditures, net	\$	30,586,484
Net working capital	\$	4,686,036
Total assets	\$	58,660,444
Shares outstanding		
Basic – Class A		19,392,700
Basic – Class B		1,173,600
Weighted average shares		
Basic – Class A		15,327,865
Basic – Class B		1,173,600
Basic Class A after deemed conversion of Class B		17,989,761

## OPERATIONAL

Volumes		
Oil sales – daily	(bbls/d)	148
Oil sales prices (before transportation)	(\$/bbl)	100.50
Field operating netback	(\$/bbl)	69.60
Horizontal Saskatchewan wells drilled		
Gross		11
Net		3.74
Net success rate (%)		100

<sup>1</sup> This table contains the term funds flow from operations, which should not be considered an alternative to, or more meaningful than cash flow from operating activities as determined in accordance with Canadian generally accepted accounting principles (“GAAP”) as an indicator of the Company’s performance. Therefore reference to funds flow from operations or funds flow from operations per share (basic and diluted) may not be comparable with the calculation of similar measures for other entities. Management uses funds flow from operations to analyze operating performance and leverage and considers funds flow from operations to be a key measure as it demonstrates the Company’s ability to generate the cash necessary to fund future capital investment. The reconciliation between, funds flow from operations and funds flow from operating activities can be found in Management’s Discussion and Analysis. Funds flow from operations per share is calculated using the basic and diluted weighted average number of shares for the period after the deemed conversion of the Class B shares to Class A shares.

<sup>2</sup> The deemed conversion of Class B shares to Class A was calculated utilizing a deemed Current Trading Price of \$4.41, the weighted average trading price per share of Class A shares for the last 30 consecutive trading days. Class B shares are convertible into Class A shares by the formula whereby the weighted number of Class B shares are multiplied by the factor determined by dividing the last 30-day weighted average trading price of Class A shares.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

The following Management's Discussion and Analysis ("MD&A") of financial results as provided by the management of Painted Pony Petroleum Ltd. ("Painted Pony" or the "Company") should be read in conjunction with the unaudited interim consolidated financial statements for the three months ended March 31, 2008 and the audited consolidated financial statements as at and for the period ended December 31, 2007. This commentary is dated May 28, 2008. The financial data presented is in accordance with Canadian generally accepted accounting principles in Canadian dollars, except where indicated otherwise. These documents and additional information about Painted Pony are available on SEDAR at [www.sedar.com](http://www.sedar.com).

Management's Discussion and Analysis contains the term funds flow from operations, which should not be considered an alternative to, or more meaningful than cash flow from operating activities as determined in accordance with Canadian generally accepted accounting principles ("GAAP") as an indicator of the Company's performance. Therefore, reference to funds flow from operations or funds flow from operations per share (basic and diluted) may not be comparable with the calculation of similar measures for other entities. Management uses funds flow from operations to analyze operating performance and considers funds flow from operations to be a key measure as it demonstrates the Company's ability to generate the cash necessary to fund future capital investment. Funds flow from operations per share is calculated using the basic and diluted weighted average number of shares for the period, and after deemed conversion of Class B shares into Class A. The Company calculates funds flow from operations as follows:

	Three months ended March 31, 2008
Cash provided by operating activities	\$ 1,314,606
Changes in non-cash working capital	(240,746)
Funds flow from operations	\$ 1,073,860

Management's Discussion and Analysis also contains other terms, such as net working capital position and operating netbacks, which are not recognized measures under GAAP. Management believes these measures are useful supplemental measures of, firstly, the total net position of current assets and liabilities the Company has and, secondly, the amount of revenues received after royalties, transportation and operating costs. Readers are cautioned, however, that these measures should not be construed as alternatives to other terms such as current and long-term debt or net income determined in accordance with GAAP as measures of performance. Painted Pony's method of calculating these measures may differ from other companies, and accordingly, may not be comparable to measures used by other companies.

## Forward-looking Statements

This MD&A contains forward-looking statements relating to future events. Forward-looking information is information that does not relate strictly to historical or current facts, and can be identified by words such as “anticipate”, “continue”, “estimate”, “expect”, “forecast”, “may”, “will”, “project”, “should”, “believe”, or similar expressions. These statements represent management’s best projections, expectations, and estimates as of the date of this document, but undue reliance should not be placed upon them as they are derived from numerous assumptions. These assumptions are subject to known and unknown risks and uncertainties, including the business risks discussed in the MD&A, which may cause actual performance and financial results to differ materially from any projections of future performance or results expressed or implied by such forward-looking statements.

Examples of forward looking information in this document include, but are not limited to the following, each of which is subject to significant risks and uncertainties and is based on a number of assumptions which may prove to be incorrect:

- The anticipated reduction of operating costs as a result of completing construction of a multi-well battery and central treating facility and drilling a salt water disposal well in the Kisbey area; this is subject to the risk and uncertainty that the actual operating costs of the new facility and disposal well may differ materially from what is currently anticipated or that actual start-up of the facilities will be delayed for some unforeseen circumstance.
- The anticipated reduction of transportation and operating costs as a result of the construction of a gathering system in the Kisbey area during the second quarter of 2008; this is subject to the risk that the project is not completed as and when anticipated and the uncertainty that the actual operating costs of the gathering system will substantially differ from expected operating costs.
- The expectation that the Company will experience future royalty rates similar to the rate of the first quarter 2008; this is subject to the risk and uncertainty of the percentage of wells that will be drilled on Saskatchewan crown lands where a lower royalty rate is experienced, in comparison to the number of wells drilled on Saskatchewan freehold lands and British Columbia lands.
- The anticipated reduction of capital recoveries from general and administrative costs and potential increase of operating costs during the second quarter of 2008; this is subject to the risk and uncertainty of the duration of Spring breakup and the impact that weather will have on the second quarter 2008 capital expenditures and operating costs.
- The expectation that production will be adversely impacted by Spring break-up; this is subject to the risk and uncertainty of the duration and actual impact of Spring break-up.
- The expectation that interest income will remain at a substantial level in the second quarter of 2008 and gradually diminish as available funds are expended on the capital program; this is subject to the risk and uncertainty in regard to interest rates earned and unanticipated employment of funds currently expected to be invested over the second quarter of 2008.

- The expectation that depletion expense on a per barrel basis will decline as promotion phases of farm-outs end and capital and revenue interests more closely align; this is subject to the risk and uncertainty in regard to additional future farm-out arrangements that could be negotiated and the possibility that future drilling operations could be unsuccessful.
- The anticipation that the Company has sufficient financial resources with which to conduct the budgeted capital program, by drilling up to 40 Bakken horizontal wells during the last three quarters of 2008; this is subject to the risk and uncertainty that the drilling rigs, field service providers, completion and tie in equipment will be available when required and that the costs of securing such services and equipment will not materially exceed expectations.

While we anticipate that subsequent events and developments may cause our views to change, we do not have an intention to update this forward-looking information, except as required by applicable securities laws. This forward-looking information represents our views as of the date of this document and such information should not be relied upon as representing our views as of any date subsequent to the date of this document. We have attempted to identify important factors that could cause actual results, performance or achievements to vary from those current expectations or estimates expressed or implied by the forward-looking information. However, there may be other factors that cause results, performance or achievements not to be as expected or estimated and that could cause actual results, performance or achievements to differ materially from current expectations. Other risks and uncertainties include, but are not limited to, the following:

- Normal risks common to the oil and natural gas industry, including various operational risks in the carrying out of exploration, development and production operations,
- Risks and uncertainty of oil and gas geological deposits,
- Revisions, amendments or changes to capital expenditure plans including exploration, development and exploitation projects,
- Risks as to the availability and pricing of appropriate financing alternatives, and
- Potential changes in income tax regulations, governmental policies, rules, practices or approval process changes, or delays, or enhancements.

**There can be no assurance that forward-looking information will prove to be accurate, as results and future events could differ materially from those expected or estimated in such statements. Accordingly, readers should not place undue reliance on forward-looking information.** From time to time, Painted Pony's management makes estimates and forms opinions on which the forward-looking statements are based. The Company assumes no obligation to update forward-looking statements if circumstances, management's estimates, or opinions change unless prescribed by securities laws.

## Overview

From incorporation on August 12, 1999, the Company was a provider of web, logistics, financial and marketing services to U.S. merchants servicing the international market. In October 2002, a partnership agreement was entered into with Canada Post to jointly operate the Company's merchant activities. This partnership interest was disposed of in 2005. In November 2005, the auction business was sold. At that time the Company ceased to carry on active business, as it reorganized its affairs.

In February 2007, the Company entered into a series of agreements whereby it reorganized itself. The Company was continued into Alberta under the Business Corporation Act (Alberta), “ABCA”, and articles of amendment were filed effecting name changes. All of the assets and liabilities were sold or assigned, and a private placement consisting of 240,000 Common Voting Shares and a convertible debenture in the principal amount of \$347,500 was completed. The convertible debenture was secured, bore interest at the rate of 5% per annum during the first two years of its term and at bank prime rate plus 3% thereafter and was convertible into Common Non-Voting Shares of the Company at a price of \$0.15625 per Common Non-Voting Share. The Company created an unlimited number of non-voting common shares and consolidated the issued common shares on the basis that up to 2,500 of such shares became one common share. The Company then had 196 issued and outstanding common voting shares.

On March 27, 2007, the Company entered into a financing agreement (“Financing Agreement”) pursuant to which the Company reconstituted the Company's board of directors, reorganized the share capital of the Company and filed articles of amendment to change the name to Painted Pony Petroleum Ltd., all of which were approved by the shareholders of the Company on March 29, 2007 and which were effected on April 3, 2007.

The 196 issued and outstanding common voting shares were exchanged for:

- 29,400 issued and outstanding Class A shares on the basis of 150 Class A shares for each existing common voting share, and
- 6,615 issued and outstanding Class B shares on the basis of 33.75 Class B shares for each existing common voting share.

Completion of the reorganization of the Company, as contemplated in the Financing Agreement was conditional upon the closing of the initial public offering, which occurred on May 17, 2007.

Painted Pony commenced commercial operations on April 3, 2007 upon completion of a financial reorganization as part of an overall restructuring of the Company. Pursuant to “Comprehensive Revaluation of Assets and Liabilities” of the Canadian Institute of Chartered Accountants (“CICA”) Handbook, the Company is entitled to use “fresh start” accounting which means that prior or comparative financial information is not required to be presented, as it would not be meaningful to the reader. Accordingly, financial information is presented commencing on April 3, 2007. Consequently, comparative financial information for the statements of operations and cash flows is not presented.

On May 23, 2007, subsequent to completion of an initial public offering on May 17, 2007, the Class A shares and Class B shares of Painted Pony Petroleum Ltd. began trading on the TSX Venture Exchange under the symbols “PPY.A” and “PPY.B” respectively. Painted Pony then commenced an active operated exploration program, focused on S.E. Saskatchewan and N.E. British Columbia.

### **Net Earnings and Funds Flow from Operations**

Painted Pony generated funds flow from operations of \$1,073,860 for the three months ended March 31, 2008. Basic and diluted funds flow from operations per share is \$0.06 for the first quarter of 2008.

Painted Pony produced earnings of \$3,345,551 for the three months ended March 31, 2008. Basic and diluted earnings per share are \$0.19 for the first quarter of 2008.

## Sales

During the three months ended March 31, 2008, production generated 13,480 bbls of light crude oil, of which approximately 58% was during the month of March 2008. Crude oil sales were from 13 gross wells (4.5 net wells) in the Midale, Kisbey and Alameda areas of Saskatchewan. Revenue (before transportation costs) from sales of crude oil totalled \$1,354,759 for the three months ended March 31, 2008. The Company received an average price of \$100.50 per bbl, slightly greater than the first quarter Edmonton light reference price. The light oil Painted Pony sold during the first quarter of 2008 is a premium light crude with low sulphur content.

To date, Painted Pony has not undertaken any hedging or commodity price contracts. Transportation costs of \$77,667 were approximately 5.7% of gross revenues, reflecting the trucking costs of hauling oil to the various sales points to compensate for occasional capacity issues. Transportation charges are anticipated to reduce with the expansion in the area of the main sales pipeline enabling Painted Pony closer access to delivery sales points.

### Revenue

	Three months ended March 31, 2008
Light oil sales	\$ 1,354,759
Transportation	(77,667)
Net	\$ 1,277,092

### Average Q1 2008 Commodity Prices

Exchange rate (US\$/ Cdn.\$)	0.9956
WTI (US\$/bbl)	\$ 97.87
Edmonton par – light oil (\$/bbl)	\$ 98.16
Painted Pony's average price, before transportation (\$/bbl)	\$ 100.50

## Royalties

For the three months ending March 31, 2008, total royalties were \$226,079, or approximately 16.7% of sales (before transportation costs), reflecting the combined impact of freehold royalties and gross overriding royalty obligations along with low crown royalties, due to the Saskatchewan crown royalty incentive programs. During the quarter, approximately 89% of the sales occurred on freehold lands.

### Royalties by Type

	Three months ended March 31, 2008
Crown royalties	\$ 5,239
Freehold royalties	160,636
Gross overriding royalties	60,204
	\$ 226,079

## Production Expenses

For the quarter ended March 31, 2008, production expenses totalled \$112,831, or an average of \$8.37/bbl. Operating costs include incremental cold weather related costs, equipment rentals, and salt water hauling and disposal fees. Equipment rentals are incurred to initially rent gas engines to run the pump jacks prior to electrification of each battery site. Salt water hauling and disposal fees averaged \$3.15/bbl during the first quarter of 2008. Subsequent to the end of the quarter, the Company has drilled a salt water disposal well and is constructing a multi-well battery and treating facility in the Kisbey area, which are expected to reduce operating costs by the end of the second quarter. In addition, the Company is constructing a gathering system in the Kisbey area during the second quarter of this year, which is expected to reduce transportation and operating costs and minimize the impact of Spring breakup-related trucking disruptions.\*

## Operating Netbacks

For the three months ended March 31, 2008, field operating netbacks averaged \$69.60/bbl. Strong light crude oil commodity prices combined with crown royalty incentives are the primary contributing factor to this positive unit price.

### Field Operating Netback

	Three months ended March 31, 2008
Sales	\$ 100.50
Transportation	(5.76)
Royalties	(16.77)
Production expense	(8.37)
Field operating netback	\$ 69.60

## General and Administrative

Net general and administrative expenses for the quarter ended March 31, 2008 were \$80,540. Total general and administrative costs, prior to capitalization and recoveries were for salaries and consulting costs for eight full-time and two part-time people, office rent and parking, credit facility charges and computer software licenses and rentals plus annual charges for audit, reserve reports and TSXV costs. During the first quarter of 2008, the Company recovered \$276,349 of administrative costs primarily from operated capital expenditures. During the second quarter of 2008, with spring breakup, capital expenditure levels are anticipated to be lower, hence recoveries should similarly be less. \*

### General and Administrative Costs

	Three months ended March 31, 2008
Gross costs	\$ 486,552
Capitalized	(129,663)
Recoveries	(276,349)
Net costs	\$ 80,540

\*This paragraph contains forward-looking information. Please refer to "Forward-looking Statements" and "Business Risks, Uncertainties and Forward Looking Information" for a discussion of the risks and uncertainties related to such information.

## Capital and Other Taxes

Capital and other taxes for the three months ended March 31, 2008 were \$87,627. Saskatchewan capital taxes of \$23,031 are determined as a prescribed percentage of the greater of the capital employed in the province and the sales revenue generated from production in the province. Part XII.6 tax of \$64,596 was incurred to March 31, 2008 on unexpended flow-through funds renounced on a “look-back” basis.

### Capital and Other Taxes

	Three months ended March 31, 2008
Capital tax	\$ 23,031
Part XII.6 tax	64,596
	\$ 87,627

## Interest and Other Income

Painted Pony invests cash in short-term term deposits. These activities generated \$173,483 of interest income during the three months ending March 31, 2008. Also in the period, the Company recorded other income of \$130,362 from the use of purchased tubular pipe that was used for company-operated fracture stimulations on a rental basis, on terms consistent with industry standards.

Management expects that interest income will remain at a substantial level for the next quarter, gradually diminishing as the funds raised from the issuance of shares is expended in the capital program. \*

## Depletion, Depreciation and Accretion

Depletion, depreciation and accretion expense for the three months ended March 31, 2008 was \$635,031. Painted Pony has not excluded from the depletion calculation any costs for undeveloped properties or undeveloped land, except for the NE BC assets purchased March 31, 2008.

### Depletion, Depreciation and Accretion Costs

	Three months ended March 31, 2008
Depletion	\$ 628,279
Depreciation	3,859
Accretion	2,893
Total	\$ 635,031

Depreciation expense of \$3,859 was incurred in the quarter ended March 31, 2008 on office equipment, computer hardware and software, and office furniture determined on a 20% per annum declining balance basis.

\*This paragraph contains forward-looking information. Please refer to “Forward-looking Statements” and “Business Risks, Uncertainties and Forward Looking Information” for a discussion of the risks and uncertainties related to such information.

Depletion rates reflect the incremental capital costs incurred by the Company in comparison to the revenue interest, as Painted Pony earned the land position in the farm-out lands drilled on during the period. The Company expects that, in future periods, as the promotion phase in farm-outs ends and the capital and revenue working interests more closely approximate each other, the depletion rate should benefit from this. \*

### Stock-Based Compensation

Stock-based compensation costs for the three months ended March 31, 2008 was \$1,588,781, of which \$486,542 was capitalized and \$1,102,239 was expensed. The stock-based compensation reflects the costs of the 1,347,000 options granted to purchase Class A shares at \$3.97 per share, of which one-third vested immediately, one-third will vest in one year and the final one-third will vest after two years.

### Capital Expenditures

The Company incurred capital expenditures of \$30,586,484 during the quarter ended March 31, 2008. On March 31, 2008, Painted Pony closed the acquisition of natural gas properties located in NE BC for a total cost of \$19,415,563, including closing costs and adjustments. Capital expenditures in SE Saskatchewan during the first quarter were \$9,603,404 with the drilling of 11 gross (4.16 net capital interest) (3.74 net revenue interest) successful Bakken horizontal wells and one (1.0 net) step-out stratigraphic exploration well in a new area.

#### Capital Expenditures

	Three months ended March 31, 2008
Lease acquisitions & retention	\$ 1,501,070
Drilling & completion costs	7,150,978
Facilities & equipment	951,356
Exploration & development	9,603,404
Property acquisition	19,415,563
Asset retirement cost	1,561,040
Head office expenditures	6,477
Total expenditures	\$ 30,586,484

Painted Pony continues to develop its land base through earning land by drilling operations and participation at crown land sales. At March 31, 2008, the Company had approximately 19,635 net acres of undeveloped land in S.E. Saskatchewan and 74,047 net acres of undeveloped land in N.E. British Columbia.

The Company executed a farm-in agreement during 2007 whereby the Company has committed to drill three wells at an estimated net cost of \$2.23 million to the Company.

\*This paragraph contains forward-looking information. Please refer to "Forward-looking Statements" and "Business Risks, Uncertainties and Forward Looking Information" for a discussion of the risks and uncertainties related to such information.

The Company executed another farm-in agreement in the first quarter of 2008 whereby Painted Pony will pay a gross overriding royalty and has committed to drill two wells at an estimated net cost of \$1.95 million to the Company. The farm-in is subject to a non-performance penalty of \$0.5 million per well.

In conjunction with the March 31, 2008 property acquisition described in Note 4 of the Interim Consolidated Financial Statements, the Company acquired a commitment to drill one well by August 26, 2008 at an estimated net cost of \$0.5 million to the Company.

At March 31, 2008, the Company is committed to a take or pay delivery contract for 5 Mmcf per day of northeast BC natural gas production. The estimated cost of the commitment is:

	Amount
2008	\$ 508,750
2009	675,250
2010	562,400

### **Ceiling Test**

The Company performed a ceiling test calculation at March 31, 2008 resulting in undiscounted future cash flows from proved reserves and unproved properties exceeding the carrying amount of oil and gas assets. Consequently, no impairment in oil and gas assets was identified.

At March 31, 2008, the Company calculated the ceiling test using weighted average prices of \$87.70 per bbl for light gravity crude oil, \$7.90 per mcf for natural gas, and \$68.26 per bbl for natural gas liquids. The future prices used in the ceiling test calculation are based on a benchmark commodity price forecast used by the Company's independent reserve evaluators, adjusted for varied delivery points and quality differentials in the products delivered.

### **Capital Resources**

During the first quarter of 2008, Painted Pony secured a \$7.5 million demand revolving credit facility and a \$5.0 million demand non-revolving acquisition / development facility with a Canadian chartered bank. Interest is payable at the lender's prime rate plus one quarter percent (0.25%) on the demand revolving facility and at the lender's prime rate plus one half percent (0.50%) on the demand non-revolving facility. A standby fee is charged on one eighth of one percent (0.125%) on the undrawn portion of the credit facilities. Security is provided by a first fixed and floating charge debenture of \$50 million. Painted Pony has provided a negative pledge and undertaking to provide fixed charges over major petroleum and natural gas reserves in certain circumstances.

The availability under the demand revolving credit facility is subject to an interim review date of May 31, 2008 and an annual review on or before May 31, 2009. As at March 31, 2008, Painted Pony has no long-term debt, nor funds advanced under either credit facility.

### **Share Capital**

On May 17, 2007, the Company sold 12,000 units at a price of \$1,000 per unit for gross proceeds of \$12.0 million (the "Offering"). Each unit was comprised of 400 Class A shares and 90 Class B shares issued on a "flow-through" basis. Share issue costs were \$1,046,545.

Subsequent to the closing of the Offering, Painted Pony issued 386,600 Class A shares and 86,985 Class B shares to a third party in satisfaction of the \$347,500 convertible debenture and other debt in the amount of \$619,000 (the "Debt Satisfaction").

Immediately after the closing of both the Offering and the Debt Satisfaction, a non-brokered private placement (the "Private Placement") was completed for 5,900,000 Class A Shares at a price of \$0.25 per share to the new Directors, Officers, employees and certain of their associates and affiliates.

In accordance with the policies of the TSXV, the 5,900,000 Class A Shares which were issued pursuant to the Private Placement were placed in escrow. Under the terms of the Escrow Agreement, ten percent (10%) of such Class A Shares were released from escrow upon receipt of notice from the TSXV confirming the listing of the Class A Shares on the TSXV (the "Listing Notice"), which was dated on May 22, 2007. The remaining ninety percent (90%) of such Class A Shares are to be released from escrow in fifteen percent (15%) tranches during consecutive six month intervals over the following 36 months, commencing on November 22, 2007. The above escrow release schedule is subject to acceleration in accordance with NP 46-201 Escrow for Initial Public Offerings and the policies of the TSXV in the event that the Company subsequently meets certain listing requirements.

On December 6, 2007, the Company completed a second private placement of 4,166,700 Class A Shares at a price of \$2.40 per share on a bought deal private placement basis for total gross proceeds of \$10,000,080. The shares issued are subject to a four-month holding period. Share issue costs were \$723,564.

On March 31, 2008, the Company issued 4,110,000 Class A shares at a deemed price of \$4.33 per share as partial consideration for an acquisition of producing properties and undeveloped land located in NE British Columbia. Share issue costs were \$69,603. The Class A share holdings of the vendor (Crescent Point Energy Trust) represent approximately 20% of the total issued and outstanding voting shares of the Company as of the date of the acquisition.

On April 30, 2008, the Company completed a private placement of 8,800,000 Class A Shares at a price of \$4.35 per share on a bought deal private placement basis for total gross proceeds of \$38,280,000. The shares issued are subject to a four-month holding period.

As at March 31, 2008, 19,392,700 Class A shares and 1,173,600 Class B shares were issued and outstanding. As at May 28, 2008, 28,192,700 Class A shares and 1,173,600 Class B shares were issued and outstanding. As at March 31, 2008 and May 28, 2008 no Common Voting, Common Non-Voting or Preferred Shares were outstanding.

The Company has a Stock Option Plan whereby options to purchase Class A Shares may be granted by the Board of Directors to directors, officers, employees of, and consultants to the Company. The Plan has reserved for issuance a number of Class A shares equal to ten percent of the aggregate number of Class A Shares and Class B Shares issued and outstanding from time to time. As at March 31, 2008 and May 28, 2008, 1,347,000 options were issued and outstanding. The options are exercisable over a 5-year period at \$3.97 per share with one-third vesting immediately, one-third vesting one year from date of grant, and one-third vesting two years from date of grant.

## **Income Taxes**

On May 17, 2007, the Company issued 12,000 units at \$1,000 per unit for total proceeds of \$12.0 million, on a flow-through basis, and has committed to spend these funds on qualified exploration and development expenditures by December 31, 2008. In February of 2008, the Company renounced the full \$12.0 million effective December 31, 2007. The tax effect of the tax benefits renounced to subscribers was recognized in the consolidated financial statements when the renouncement documents were filed in February, 2008. As at March 31, 2008, the Company had expended approximately \$6.6 million of funds on qualified expenditures related to this financing. The remaining commitment of \$5.4 million as at March 31, 2008 is to be incurred by December 31, 2008.

The Company has income tax pools as at March 31, 2008 of approximately \$42 million including a tax loss carry forward of approximately \$13.7 million. The future income tax recovery of \$4,008,961 recorded during the first quarter of 2008 relates to the recognition of the income tax effect of the \$12.0 million renounced in February 2008 pursuant to the May 2007 flow-through share issuance. No tax asset for the value of these pools has been recorded for accounting purposes as the Company does not believe that it currently meets the criteria of the losses being utilized being more likely than not. \*

## **Dividends**

The Company has not declared or paid any dividends. Any decision to pay dividends on its shares will be made by the board of directors on the basis of earnings, financial requirements and other conditions existing at such future time.

## **Comprehensive Income**

As Painted Pony does not have any comprehensive income, the consolidated financial statements do not include a Statement of Comprehensive Income describing the components, nor is a section needed in shareholders' equity, nor is a Statement of Accumulated Other Comprehensive Income presented (which would provide a continuity of the balance).

## **Liquidity**

As at March 31, 2008, Painted Pony had current assets of \$23.0 million and current liabilities of \$18.3 million. Available cash has been, and is currently, on deposit in term deposits in a major Canadian financial institution. Management has received confirmation from the financial institution that these funds are available on demand.

On April 30, 2008, the Company closed a bought deal private placement of \$38,280,000 before costs.

In 2007, the Company committed to spending \$12.0 million on qualifying exploration and development expenditures prior to December 31, 2008 relating to a flow-through agreement, of which approximately \$6.6 million has been expended as at March 31, 2008.

\*This paragraph contains forward-looking information. Please refer to "Forward-looking Statements" and "Business Risks, Uncertainties and Forward Looking Information" for a discussion of the risks and uncertainties related to such information.

Management believes the Company has sufficient financial resources with which to carry out the planned capital expenditures. \*

### **Outlook \***

The Company continues evaluation of its existing and farm-in lands for multi-zone light oil potential. During the first quarter of 2008, the Company has drilled 11 (3.74 net) successful horizontal Bakken wells for light sweet oil. Painted Pony drilled 7 (1.84 net) in the Kisbey area and had placed 6 (1.58 net) of the wells on production prior to the end of the first quarter of 2008. In the Midale area, the Company drilled 4 gross (1.9 net revenue interest) wells and placed 2 (1.0 net revenue interest) on production prior to March 31, 2008.

As Painted Pony's operations are focused within Saskatchewan and British Columbia, the Company will not be directly affected by the recently announced amendments to royalty rates for assets located within Alberta.

Currently the Company receives a crude oil price approximately equal to the Edmonton light reference price. As exploration is extended onto new Bakken trends in 2008, this discount may change depending on the quality of the oil found. Management anticipates future royalty rates to approximate the first quarter rate as drilling continues on a combination of freehold and crown royalty lands combined with gross overriding royalty obligations, reduced by the Saskatchewan royalty incentive programs for crown royalties and freehold mineral tax obligations. In 2008, the Company is planning to construct a crude oil central battery and gathering system in the Kisbey area, which is anticipated to reduce trucking and operating costs for crude oil.

Operating costs are anticipated to reflect the normal incremental costs inherent to production operations during periods of extreme cold over the winter season, as operational issues such as freezing pipes are accommodated. Similarly, during spring breakup, potential temporary production disruptions may occur due to an inability to access locations to truck product or conduct maintenance procedures.

Painted Pony's 2008 capital expenditures will be determined on an on-going basis, as consideration is given to expected cash flows, the availability of credit facilities and investment capital. It is the intention of the Company's management to maintain a maximum net debt to historical cash flow ratio of 1.0 : 1.0. The capital program will be adjusted accordingly. The Company plans an active drilling program of up to 40 Bakken horizontal wells during the last three quarters of 2008. Capital activity on the BC assets that the Company purchased at the end of the first quarter 2008 will be determined in conjunction with discussions with various industry partners.

### **Off Balance Sheet Arrangements**

The Company also entered into an arrangement with a joint venture partner whereby Painted Pony was carried for approximately \$241,627 of land costs incurred by the joint venture partner in exchange for an equivalent value in the drilling of wells by the Company in 2008. This obligation was satisfied during the first quarter of 2008.

\*This section contains forward-looking information. Please refer to "Forward-looking Statements" and "Business Risks, Uncertainties and Forward Looking Information" for a discussion of the risks and uncertainties related to such information.

## **Related Party Transactions**

The Company utilizes the services of a law firm in which the Corporate Secretary is a Partner. During the period ended March 31, 2008, the Company incurred \$68,066 on services obtained from the firm.

All related party transactions are in the normal course of business and have been measured at the agreed to terms and exchange values, being the consideration established and agreed to by the parties and on normal commercial terms comparable to those negotiated with third parties.

## **Financial Instruments and Other Instruments**

The fair values of the Company's term deposits, accounts receivables, accounts payables and accrued liabilities approximate their carrying amounts due to the short-tem nature of these financial instruments.

The Company's accounts receivables are primarily with industry partners and are subject to normal industry credit risks. As the Company extends unsecured credit to these entities, therefore, the collection of any receivables may be affected by changes in the economic environment or other conditions. Management believes the risk is mitigated by the financial position of the entities, and the Company's practice of requesting cash call advances for funds estimated to be incurred. \*

To date, the Company has not participated in any hedges or commodity price contracts.

## **Financial Reporting Update**

### **Capital Disclosures**

The CICA issued a new accounting standard, "Capital Disclosures", which requires the disclosure of both qualitative and quantitative information that provides users of financial statements with information to evaluate the entity's objective, policies, and processes for managing capital. This new section was adopted by the Company beginning January 1, 2008.

### **Financial Instruments**

Two new accounting standards were issued by the CICA, "Financial Instruments Disclosures", and "Financial Instruments Presentation". These sections replaced "Financial Instruments Disclosure and Presentation", once adopted. The objective is to provide users with information to evaluate the significance of instruments, and how the entity manages those risks. The provisions deal with the classification of financial instruments, related interest, dividends, losses and gains, and the circumstances in which financial assets and financial liabilities are offset. These new sections were adopted by the Company beginning January 1, 2008.

\*This paragraph contains forward-looking information. Please refer to "Forward-looking Statements" and "Business Risks, Uncertainties and Forward Looking Information" for a discussion of the risks and uncertainties related to such information.

### **International Financial Reporting Standards (“IFRS”)**

In September 2007, the Accounting Standards Board (“AcSB”) issued a bulletin relating to the transition to IFRS from Canadian GAAP and based on work undertaken to date, no significant impediments to adopting IFRS by the proposed transition date have been identified. Painted Pony is monitoring industry discussion regarding the replacement of the CICA’s Accounting Guideline 16 with IFRS 6, which is expected to have material implications for Painted Pony’s current full cost accounting policies. In February 2008, the AcSB confirmed the transition date for adopting IFRS will be January 1, 2011.

### **Business Risks, Uncertainties and Forward Looking Statements**

Statements in this document may contain forward-looking information including expectations of future production, components of cash flow and earnings, expected future events and/or financial results that are forward looking in nature and subject to substantial risks and uncertainties. The reader is cautioned that assumptions used in the preparation of such information may prove to be incorrect. The Company cautions the readers that actual performance will be affected by a number of factors, as many may respond to changes in economic and political circumstances throughout the world. Events or circumstances may cause actual results to differ materially from those predicted, a result of numerous known and unknown risks, uncertainties, and other factors, many of which are beyond the control of the Company. These risks include, but are not limited to; the risks associated with the oil and gas industry, commodity prices and exchange rate changes. Industry related risks could include, but are not limited to; operational risks in exploration, development and production, delays or changes in plans, risks associated with the uncertainty of reserve estimates, health and safety risks and the uncertainty of estimates and projections of production, costs and expenses. These external factors beyond the Company’s control may affect the marketability of oil and natural gas produced, industry conditions including changes in laws and regulations, changes in income tax regulations, increased competition, fluctuations in commodity prices, interest rates, and variations in the Canadian/United States dollar exchange rate. The reader is cautioned not to place undue reliance on this forward looking information.

Painted Pony’s production and exploration activities are concentrated in the Western Canadian Sedimentary Basin, where activity is highly competitive and includes a variety of different sized companies ranging from smaller junior producers to the much larger integrated petroleum companies. Painted Pony is subject to the various types of business risks and uncertainties including:

- Finding and developing oil and natural gas reserves at economic costs,
- Production of oil and natural gas in commercial quantities, and
- Marketability of oil and natural gas produced.

In order to reduce exploration risk, the Company strives to employ highly qualified and motivated professional employees with a demonstrated ability to generate quality proprietary geological and geophysical prospects. To help maximize drilling success, Painted Pony combines exploration in areas that afford multi-zone prospect potential, targeting a range of low to moderate risk prospects with some exposure to select high-risk plays with high-reward opportunities. Painted Pony also explores in areas where the Company’s officers and employees have significant drilling experience.

The Company mitigates its risk related to producing hydrocarbons through the utilization of the most appropriate technology and information systems. In addition, Painted Pony seeks to maintain operational control of the majority of its prospects.

Oil and gas exploration and production can involve environmental risks such as pollution of the environment and destruction of natural habitat, as well as safety risks such as personal injury. In order to mitigate such risks, Painted Pony conducts its operations at high standards and follows safety procedures intended to reduce the potential for personal injury to employees, contractors and the public at large. The Company maintains current insurance coverage for general and comprehensive liability as well as limited pollution liability. The amount and terms of this insurance are reviewed on an ongoing basis and adjusted as necessary to reflect changing corporate requirements, as well as industry standards and government regulations. Painted Pony may periodically use financial or physical delivery hedges to reduce its exposure against the potential adverse impact of commodity price volatility, as governed by formal policies approved by senior management, subject to controls established by the Board of Directors.

### **Critical Accounting Estimates**

The reader is cautioned that the preparation of financial statements in accordance with GAAP requires management to make certain judgments and estimates that affect the reported amounts of assets, liabilities, revenues and expenses. Estimating reserves is also critical to several accounting estimates and requires judgments and decisions based upon available geological, geophysical, engineering and economic data. Estimated reserves are also utilized by Painted Pony's bank in determining credit facilities. Reserves affect net income through depletion, site restoration and abandonment estimates and the ceiling test calculation. Estimating reserves is very complex, requiring many judgments based on available geological, geophysical, engineering and economic data. Changes in these judgments could have a material impact on the estimated reserves. These estimates may change, having either a negative or positive effect on net earnings as further information becomes available, and as the economic environment changes. Changes in these judgments and estimates could have a material impact on the financial results and financial condition of the Company. The "Management's Discussion and Analysis" outlines the accounting policies and practices that are critical to determining Painted Pony's financial results.

In following the liability method of accounting for income taxes, related assets and liabilities are recognized for the estimated tax consequences between amounts included in the financial statements and their tax base, using substantively enacted future income tax rates. Timing of future revenue streams and future capital spending changes can affect the timing of any temporary differences, and accordingly affect the amount of the future income tax liability calculated at a point in time. These differences could materially impact earnings.

With the above risks and uncertainties, the reader is cautioned that future events and results may vary substantially from that which the Company currently foresees.

### **Legal, Environmental, Remediation and Other Contingent Matters**

The Company reviews legal, environmental remediation and other contingent matters to both determine whether a loss is probable based on judgment and interpretation of laws and regulations, and determine that the loss can reasonably be estimated. When the loss is determined, it is charged to earnings. The Company's management monitor known and potential contingent matters and make appropriate provisions by charges to earnings when warranted by circumstances.

## **Internal Controls**

As of March 31, 2008, the Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO") have evaluated the design and effectiveness of the Company's disclosure controls and procedures. The small size of the current organization contributes in a large part to senior management being fundamentally aware of material information that would require disclosure by the Company and this, in part, supports management's assessment that its disclosure controls are adequate and effective to ensure accurate and complete disclosure, except as described below.

The Chief Executive Officer and Chief Financial Officer of Painted Pony are responsible for designing internal controls over financial reporting, or causing them to be designed under their supervision, in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of consolidated financial statements for external purposes in accordance with Canadian generally accepted accounting principles. Painted Pony management has assessed the design of internal controls over financial reporting. During this process, certain material weaknesses in internal controls over financial reporting were identified as follows:

- Due to the limited number of staff at Painted Pony, it is not economically feasible to achieve segregation of incompatible duties. Painted Pony currently, as of March 31, 2008, had eight full time and two part-time employees. The limited number of staff may also result in identifying weaknesses with respect to accounting for complex and non-routine accounting transactions that may arise as the Company does not have a sufficient number of finance personnel with technical accounting knowledge to address all complex and non-routine accounting matters that may arise, and
- Many of Painted Pony's information systems are subject to general control deficiencies including a lack of effective controls over spreadsheets, access and documentation.

These weaknesses in internal controls over financial reporting result in a more than remote likelihood that a material misstatement would not be prevented or detected. Management and the Board of Directors try to mitigate the risk of material misstatement; however, reasonable assurance does not exist that this risk can be reduced to a remote likelihood of a material misstatement. Painted Pony has no current plans to remediate these weaknesses.

Because of their inherent limitations, disclosure controls as well as internal controls over financial reporting may not prevent or detect fraud, misstatements, or errors. Control systems can provide only reasonable and not absolute assurance that the objectives of the control system and the Company are achieved.

## **Selected Consolidated Quarterly Information**

Painted Pony commenced commercial operations on April 3, 2007 upon completion of a financial reorganization as part of an overall restructuring of the Company. Pursuant to "Comprehensive Revaluation of Assets and Liabilities" of the CICA Handbook, the Company is entitled to use "fresh start" accounting which means that prior or comparative financial information is not required to be presented as it would not be meaningful to the reader. Accordingly, financial information is presented commencing on April 3, 2007. Consequently, comparative financial information for the balance sheet, statements of operations and cash flows is not presented.

The following table sets forth selected consolidated financial information of the Corporation for the most recently completed quarters ending at the first quarter of 2008.

### Selected Consolidated Quarterly Information

Quarter ended (unaudited) (\$)	June 30, 2007	Sept 30, 2007	Dec 31, 2007	Mar 31, 2008
Gross revenues <sup>(1)</sup>	64,322	192,746	924,194	1,658,604
Funds flow (used in) from operations	(52,793)	79,885	575,864	1,073,860
Funds flow (used in) from operations Basic and diluted, per share	(0.01)	0.00	0.04	0.06
Net earnings (loss)	(53,661)	46,254	164,855	3,345,551
Net earnings (loss) per share Basic and diluted	(0.01)	0.00	0.01	0.19
Capital expenditures, net	497,615	3,027,516	2,532,377	30,586,484
Total assets	13,865,033	17,054,020	26,194,023	58,660,444
Long-term financial liabilities (ARO)	5,081	26,954	92,340	1,656,273

(1) Before royalties and transportation, including interest and other income

### Reader Advisory

Statements in this document may contain forward-looking information including expectations of future production and components of funds flow and earnings. The reader is cautioned that assumptions used in the preparation of such information may prove to be incorrect. Events or circumstances may cause actual results to differ materially from those predicted, a result of numerous known and unknown risks, uncertainties, and other factors, many of which are beyond the control of the Company. These risks include, but are not limited to; the risks associated with the oil and gas industry, commodity prices and exchange rate changes. Industry related risks could include, but are not limited to; operational risks in exploration, development and production, delays or changes in plans, risks associated with the uncertainty of reserve estimates, health and safety risks and the uncertainty of estimates and projections of production, costs and expenses. The reader is cautioned not to place undue reliance on this forward-looking information.

The reader is further cautioned that the preparation of consolidated financial statements in accordance with GAAP requires management to make certain judgments and estimates that affect the reported amounts of assets, liabilities, revenues and expenses. Estimating reserves is also critical to several accounting estimates and requires judgments and decisions based upon available geological, geophysical, engineering and economic data. These estimates may change, having either a negative or positive effect on net earnings as further information becomes available, and as the economic environment changes.

**PAINTED PONY PETROLEUM LTD.**

**INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

**THREE MONTHS ENDED MARCH 31, 2008**

**(UNAUDITED)**

**PAINTED PONY PETROLEUM LTD.**  
**Interim Consolidated Balance Sheets**  
**(unaudited)**

<b>As At</b>	<b>March 31, 2008</b>	<b>December 31, 2007</b>
<b>ASSETS</b>		
<b>Current assets</b>		
Cash and cash equivalents	\$14,366,053	\$17,349,245
Accounts receivable	8,506,903	3,075,578
Prepaid expenses and deposits	128,802	64,860
	<u>23,001,758</u>	<u>20,489,683</u>
Property and equipment (notes 4 & 5)	35,658,686	5,704,340
	<u>\$58,660,444</u>	<u>\$26,194,023</u>
<b>LIABILITIES and SHAREHOLDERS' EQUITY</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities	\$18,315,722	\$4,238,890
Asset retirement obligations (note 7)	1,656,273	92,340
	<u>19,971,995</u>	<u>4,331,230</u>
<b>Shareholders' equity</b>		
Capital stock (note 8)	34,600,669	22,709,345
Contributed surplus (note 9)	1,588,781	-
Retained earnings (deficit)	2,498,999	(846,552)
	<u>38,688,449</u>	<u>21,862,793</u>
	<u>\$58,660,444</u>	<u>\$26,194,023</u>
Basis of Presentation (note 2)		
Commitments (note 13)		
Subsequent event (note 16)		
See accompanying notes to the interim consolidated financial statements.		

## PAINTED PONY PETROLEUM LTD.

### Interim Consolidated Statements of Operations and Retained Earnings (Deficit) (unaudited)

	Three months ended March 31, 2008
<b>Revenue</b>	
Petroleum sales	\$1,354,759
Royalties	(226,079)
Interest income	173,483
Other income	130,362
	<u>1,432,525</u>
<b>Expenses</b>	
Operating	112,831
Transportation	77,667
General and administrative	80,540
Capital and other taxes	87,627
Stock-based compensation (note 8)	1,102,239
Depletion, depreciation and accretion	635,031
	<u>2,095,935</u>
Loss before income taxes	(663,410)
Future income tax reduction (note 11)	4,008,961
Net income for the period	3,345,551
Deficit, beginning of period	(846,552)
<b>Retained earnings, end of period</b>	<u>\$2,498,999</u>
Net income per share (note 10)	
Basic and diluted	\$0.19

See accompanying notes to the interim consolidated financial statements.

**PAINTED PONY PETROLEUM LTD.**  
**Interim Consolidated Statement of Cash Flows**  
**(unaudited)**

	Three months ended March 31, 2008
<b>Cash provided by (used in):</b>	
<b>Operating activities</b>	
Net income for the period	\$3,345,551
Items not affecting cash:	
Stock-based compensation (note 8)	1,102,239
Depletion, depreciation, and accretion	635,031
Future income tax reduction	(4,008,961)
	1,073,860
Change in non-cash working capital	240,746
	1,314,606
<b>Financing activities</b>	
Share issuance costs	(69,976)
Change in non-cash working capital	(1,665)
	(71,641)
<b>Investing activities</b>	
Expenditures on property and equipment	(12,568,642)
Change in non-cash working capital	8,342,485
	(4,226,157)
<b>Change in cash and cash equivalents</b>	(2,983,192)
<b>Cash and cash equivalents, beginning of period</b>	17,349,245
<b>Cash and cash equivalents, end of period</b>	\$14,366,053
<b>Cash and cash equivalents is comprised of:</b>	
Balances with banks	\$766,053
Short term deposits	13,600,000
	\$14,366,053

See accompanying notes to the interim consolidated financial statements.

**PAINTED PONY PETROLEUM LTD.**  
**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**  
**(UNAUDITED)**  
**Three months ended March 31, 2008**

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**1. Nature of Operations**

Painted Pony Petroleum Ltd.'s ("Painted Pony" or the "Company") principal business activity is the exploration, development and production of petroleum and natural gas resources in western Canada.

**2. Basis of Presentation**

The interim consolidated financial statements of Painted Pony Petroleum Ltd. have been prepared by management in accordance with Canadian generally accepted accounting principles. The interim consolidated financial statements have been prepared following the same accounting policies and methods of computation as the audited consolidated financial statements of the Company for the period ended December 31, 2007, except as described in Note 3. The disclosures which follow are incremental to the disclosures included in the December 31, 2007 consolidated financial statements of the Company. These interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto for the period ended December 31, 2007. These consolidated financial statements include the accounts of Painted Pony Petroleum Ltd. and its wholly-owned subsidiary, Painted Pony Petroleum Corporation.

The Company commenced commercial operations on April 3, 2007 upon completion of a financial reorganization. Consequently, comparative financial information for the statements of operations and cash flows is not presented.

**3. Significant Accounting Policies**

**Change in Accounting Policies**

On January 1, 2008, the Company adopted the new accounting standard, "Capital Disclosures", which establishes the standards for disclosing information about an entity's objectives, policies and processes for how it manages its capital. A company must also disclose qualitative data about what the entity regards as capital, and whether the company has complied with any capital requirements and, if not, the consequences of such non-compliance (see Note 14).

The Company also adopted, on January 1, 2008, two new accounting standards for financial instruments, "Financial Instruments - Disclosures", and "Financial Instruments - Presentation". These accounting standards replaced "Financial Instruments - Disclosure and Presentation".

The accounting standard, "Financial Instruments - Disclosures", describes the required disclosures to evaluate the significance of financial instruments for the entity's financial position and performance, as well as, the nature and extent of risks arising from both recognized and unrecognized financial instruments to which the entity is exposed and how the entity manages those risks (see Note 15).

The accounting standard, "Financial Instruments - Presentation", establishes standards for presentation of financial instruments and non-financial derivatives (see Note 15).

#### 4. Property Acquisition

On March 31, 2008, the Company completed the acquisition of certain natural gas properties in northeast British Columbia (“the Assets”). The acquisition was accounted for at \$3.83 per share for the 4,110, 000 Class A shares of the Company issued and \$3.7 million cash and transaction costs, for a total purchase price of \$19.5 million.

The following table summarizes the estimated fair value of the assets acquired at the date of acquisition.

Consideration:	
Issue of 4,110,000 Class A shares	\$ 15,741,300
Cash	3,560,774
Transaction costs	183,092
Total consideration	\$ 19,485,166
Allocated to:	
Property and equipment	\$ 20,993,137
Asset retirement obligations	(1,507,971)
	\$ 19,485,166

The above amounts are estimates made by management based on currently available information. Revisions may be made to the purchase equation as cost estimates and balances are finalized.

#### 5. Property and Equipment

March 31, 2008	Cost	Accumulated depletion & depreciation	Net book value
Petroleum properties, including exploration and development thereon	\$36,649,107	\$1,063,751	\$35,585,356
Other	84,773	11,443	73,330
	\$36,733,880	\$1,075,194	\$35,658,686

December 31, 2007	Cost	Accumulated depletion & depreciation	Net book value
Petroleum properties, including exploration and development thereon	\$6,069,101	\$435,473	\$5,633,628
Other	78,295	7,583	70,712
	\$6,147,396	\$443,056	\$5,704,340

For the three months ending March 31, 2008, the Company capitalized general and administrative expenses in the amount of \$129,663, relating to exploration and development activities, in addition to capitalized stock-based compensation in the amount of \$486,542. The Company has included \$15,150,300 (December 31, 2007: \$3,823,200) for future development costs and excluded \$nil (December 31, 2007: \$nil) for undeveloped land and salvage values from the depletion calculation during the period ended March 31, 2008.

## 6. Bank Debt

At March 31, 2008, Painted Pony had no bank debt. The Company has available a \$7.5 million demand revolving credit facility and a \$5 million demand non-revolving acquisition/development facility with a Canadian chartered bank. Interest is payable at the lender's prime rate plus one quarter percent (0.25%) on the demand revolving facility and at the lender's prime rate plus one half percent (0.50%) on the demand non-revolving facility. Security is provided by a first fixed and floating charge demand debenture of \$50 million. Painted Pony has provided a negative pledge and undertaking to provide fixed charges over major petroleum and natural gas reserves in certain circumstances. A standby fee is charged on one eighth of one percent (0.125%) on the undrawn portion of the credit facilities. The availability under the demand revolving credit facility is subject to an interim review date of May 31, 2008 and an annual review on or before May 31, 2009.

## 7. Asset Retirement Obligations

The total future asset retirement obligations were estimated by management based on the Company's net ownership in 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 total undiscounted asset retirement obligations to be \$4,552,417 as at March 31, 2008 (December 31, 2007: \$226,000). These payments are expected to be made over the next 20 years, with the majority estimated to be spent between 2017 and 2027. The Company used a credit adjusted risk free rate of 8% and an inflation rate of 2% to calculate the present value of the asset retirement obligations. Settlement of the obligations will be funded from general corporate funds at the time of retirement or removal. As at March 31, 2008, no funds have been set aside to settle these obligations.

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

	Three months ended March 31, 2008	Period ended December 31, 2007
Obligation, beginning of period	\$ 92,340	\$ -
Liabilities incurred	53,069	89,888
Liabilities acquired on property acquisition (see Note 4)	1,507,971	-
Accretion	2,893	2,452
Obligation, end of period	\$1,656,273	\$ 92,340

## 8. Capital Stock

### a) Authorized

Unlimited Common voting shares, of which none are outstanding as at March 31, 2008  
 Unlimited Common non-voting shares, of which none are outstanding as at March 31, 2008  
 Unlimited Class A shares  
 Unlimited Class B shares  
 Unlimited Preferred shares, of which none are outstanding as at March 31, 2008

### b) Issued and Outstanding

#### Common Voting Shares

	Period ended December 31, 2007	
	Number of Shares	Amount
Balance, beginning of period	100	\$ 5,000
Shares issued	96	37,500
Financial reorganization	-	(5,000)
April 3, 2007 prior to financial reorganization	196	37,500
Exchange into Class A and Class B Shares	(196)	(37,500)
Balance, after financial reorganization	-	\$ -

#### Class A and Class B Shares

	Class A Shares		Class B Shares	
	Number of Shares	Amount	Number of Shares	Amount
Common voting shares exchanged into Class A and Class B shares pursuant to the financial reorganization	29,400	\$ 3,750	6,615	\$ 33,750
Flow-through shares issued	4,800,000	1,200,000	1,080,000	10,800,000
Shares issued in satisfaction of debt	386,600	96,650	86,985	869,850
Private placement to founders	5,900,000	1,475,000	-	-
Private placement	4,166,700	10,000,080	-	-
Share issuance costs, allocated	-	(827,845)	-	(941,890)
Balance, December 31, 2007	15,282,700	11,947,635	1,173,600	10,761,710
Shares issued for asset acquisition	4,110,000	15,741,300	-	-
Share issuance costs	-	(69,976)	-	-
Income tax effect of flow-through share renouncement, allocated	-	(378,000)	-	(3,402,000)
Balance, March 31, 2008	19,392,700	\$ 27,240,959	1,173,600	\$ 7,359,710

### c) Stock Option Plan

The Company has a Stock Option Plan (the "Plan") pursuant to which options to purchase Class A Shares may be granted by the board of directors to directors, officers, employees of, and consultants to the Corporation. The Plan has reserved for issuance a number of Class A shares equal to 10% of the aggregate number of Class A Shares and Class B Shares issued and outstanding from time to time.

As at March 31, 2008, 1,347,000 options are issued and outstanding, at an average exercise price of \$3.97 and with a weighted-average life of 4.8 years. One third of the options are vested and the remainder vest in equal tranches on the first and second anniversaries of the date of grant. The options expire 5 years from date of grant.

The following tables summarize information regarding stock options for the three month period ended March 31, 2008:

	Weighted Average Exercise Price	Number
Balance, December 31, 2007	-	-
Granted	\$3.97	1,347,000
Balance, March 31, 2008	\$3.97	1,347,000

#### Stock Options Outstanding, March 31, 2008

Number of Options	Exercise Price	Weighted Average Remaining Life (yrs)	Exercisable Options
1,347,000	\$3.97	4.8	nil

#### d) Stock-Based Compensation

The Company accounts for its stock options granted to employees, consultants, officers, and directors using the fair value method. In accordance with the Company's incentive stock plan, these options have an exercise price equal to the fair value of the security at the date of grant. The fair value of each option granted is estimated on the date of grant using the Black-Scholes option-pricing model. The following assumptions have been used:

	Three months ended March 31, 2008
Fair value per option	\$2.62
Risk free rate (%)	3.34
Expected life (years)	5
Expected volatility	80
Expected dividends	-

## 9. Contributed Surplus

	Three months ended March 31, 2008
Balance, beginning of period	\$ -
Stock-based compensation (see note 8(c))	1,588,781
Balance, end of period	\$ 1,588,781

For the three months ended March 31, 2008, the Company recorded \$1,588,781 of compensation cost related to stock options issued during the period, of which \$486,542 was capitalized to oil and gas properties and \$1,102,239 was expensed.

## 10. Per Share Amounts

The weighted average number of Class A shares outstanding during the three months ended March 31, 2008 was 15,327,865. The weighted average number of Class B shares outstanding during the three months ended March 31, 2008 was 1,173,600. The weighted average number of Class A shares outstanding after deemed conversion of the Class B shares was 17,989,761, for the three months ending March 31, 2008.

The 1,347,000 options are excluded from diluted earnings per share as they are anti-dilutive.

## 11. Income Tax

The provision for income tax differs from that which would be obtained from applying the combined Canadian federal and provincial income tax rate to loss before income taxes. The difference results from the following:

	Three months ended March 31, 2008
Loss before taxes	\$ (663,410)
Combined corporate tax rate	32%
Computed "expected" income tax reduction	(212,291)
Non-deductible expenses	23,424
Stock-based compensation	339,728
Change in valuation allowance	(4,049,311)
Change in tax rates	(117,466)
Other	6,955
Income tax reduction	\$ (4,008,961)

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

	As at March 31, 2008
Non-capital losses	\$ 4,390,770
Property and equipment	(2,750,910)
Share issue costs	343,462
Asset retirement obligations	447,194
	2,430,516
Less: valuation allowance	(2,430,516)
	\$ -

At March 31, 2008, the Company had a non-capital loss of approximately \$13.7 million, expiring in varied amounts over the next 18 years, which may be applied to reduce future years' taxable income.

## 12. Related Party Transactions

The Company utilizes the services of a law firm in which the Corporate Secretary is a Partner. During the three months ended March 31, 2008, the Company incurred \$68,066 on services obtained from the firm.

All related party transactions are in the normal course of business and have been valued at the agreed to terms and exchange values, being the consideration established and agreed to by the parties.

## 13. Commitments

The Company is committed to incurring \$12,000,000 on qualifying exploration and development expenditures prior to December 31, 2008 relating to a flow-through agreement, of which approximately \$6,598,000 has been expended as at March 31, 2008.

The Company executed a farm-in agreement during 2007 whereby the Company has committed to drill three wells at an estimated net cost of \$2.23 million to the Company.

The Company executed another farm-in agreement in the first quarter of 2008 whereby Painted Pony will pay a gross overriding royalty and has committed to drill two wells at an estimated net cost of \$1.95 million to the Company. The farm-in is subject to a non-performance penalty of \$0.5 million per well.

In conjunction with the March 31, 2008 property acquisition described in Note 4, the Company acquired a commitment to drill one well by August 26, 2008 at an estimated net cost of \$0.5 million to the Company.

At March 31, 2008, the Company is committed to a take or pay delivery contract for 5 mmcf per day of northeast BC natural gas production. The estimated cost of the commitment is:

	Amount
2008	\$ 508,750
2009	675,250
2010	562,400

At March 31, 2008, the Company was committed to future payments totalling \$24,327 for office space rental, a proportionate share of operating costs, and office furnishings for the second quarter of 2008. Also at March 31, 2008, the Company had committed to another office lease and future payments for rental of office space and a proportionate share of operating costs resulting in combined future commitments as follows:

	Amount
2008	\$ 195,109
2009	341,563
2010	341,563
2011	341,563
2012	341,563
2013	170,781

## 14. Capital Disclosures

At March 31, 2008, the Company considers its capital structure to include shareholders' equity and working capital. The Company will adjust its capital structure to manage any projected deficiencies of working capital through the issuance of shares, the use of available credit facilities, and/or adjusting its capital spending. The Company monitors its capital spending program based on the current and projected ratios of net debt to funds flow.

The Company's objectives in managing its capital structure are to:

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

The Company monitors its capital structure using primarily the non-GAAP financial measure of net debt to annualized funds flow from operations ratio. The Company's objective is to maintain a net debt to funds flow from operations ratio of one times or less. To facilitate the management of this ratio, the Company prepares an annual budget, which is updated as required throughout the year for any significant acquisition, a change in economic circumstances outside the control of the Company, and success or failure of capital deployed. Each of the annual budgets and periodic updates are approved by the Board of Directors. As at March 31, 2008, the Company had no debt and had positive working capital of \$4.7 million as detailed below:

	Three months ended March 31, 2008
Current assets	\$23,001,758
Accounts payable and accrued liabilities	(18,315,722)
Net working capital	\$ 4,686,036

## 15. Financial Instruments

Management has primary responsibility for monitoring and managing financial instrument risks under direction from the Board of Directors which has overall responsibility for establishing the Company's risk management framework. In certain circumstances, for example, price fixing of future production revenue, the Board has established policies and has established risk limits and controls and monitors these risks in relation to market conditions. In other circumstances, for example extending credit to purchasers of the Company's products, the Board has delegated responsibility for credit assessment to management, but receives frequent financial and operating reports.

The Company's financial instruments recognized on the unaudited interim consolidated balance sheet at March 31, 2008 consist of cash and cash equivalents, accounts receivable and accounts payable and accrued liabilities. The fair value of these financial instruments approximates their carrying amounts based on the short term to maturity.

- a) Credit risk: A substantial portion of the Company's accounts receivable are concentrated with a limited number of purchasers of commodities and joint venture partners in the oil and gas industry and are subject to normal industry credit risk. Management considers these concentrations of credit risk to be minimal, as commodity purchasers are major industry participants, and receivables from partners are protected by effective industry standard legal remedies. In addition, the Company requires cash calls from its partners on major field projects in advance of commencement. Receivables related to the sale of the Company's production are normally collected on the 25<sup>th</sup> day of the month following delivery. The Company has not experienced any credit loss in the collection of its accounts receivable.

As at March 31, 2008, the accounts receivable was comprised of the following:

(\$000)	
Sales revenue accounts receivable	\$1,989
Joint interest accounts receivable	4,150
Cash call accounts receivable	1,400
Accrued and other accounts receivable	968
<b>Total accounts receivable</b>	<b>\$8,507</b>

The carrying amount of the accounts receivable represents the maximum credit exposure. The Company has no allowance for doubtful accounts as at March 31, 2008. As at March 31, 2008 the Company estimates its trade accounts receivable to be aged as follows:

Aging (\$000)	
Not past due (less than 30 days)	\$4,054
Past due 0-30 days	2,725
Past due 31-90 days	137
Past due more than 90 days	1,591
<b>Total</b>	<b>\$8,507</b>

- b) Market risk: Market risks are as follows and are largely outside of the control of the Company:

Commodity Prices

The Company is constantly exposed to the risk of declining prices for its products with a corresponding reduction in cash flow. Reduced cash flow may result in lower levels of capital being available for field activity, thus compromising the Company's capacity to grow production while at the same time replacing continuous declines from existing properties. In certain circumstances, usually when debt levels are forecast to increase due to capital expenditures exceeding cash flow, or where the Company has financed, in whole or in part, an acquisition using bank debt, the Company may enter into oil and natural gas hedging contracts in order to provide stability to future cash flow. These contracts reduce the fluctuation in production revenue by fixing prices of future deliveries of oil and natural gas. At March 31, 2008, the Company had no fixed price contracts or financial instruments associated with future production.

As at March 31, 2008, if oil prices had been US\$1 per barrel lower, with all other variables held constant, after tax net earnings for the period would have been \$11,050 lower. An equal and opposite impact would have occurred to net earnings had oil prices been US\$1 per barrel higher.

### Interest Rates

Interest on the Company's revolving bank facility varies, and is most commonly based on the lender's prime rate. The Company is thus exposed to increased borrowing costs during periods of increasing interest rates, with a corresponding reduction in both cash flows and project economics. The Company had no bank debt at March 31, 2008 and have had no interest rate swaps or similar contracts. The Company invests available cash in short-term term deposits from which interest income will vary with changes in prime rates.

As at March 31, 2008, if interest rates had been 1% lower with all other variables held constant, after tax net earnings for the period would have been \$42,524, due to lower interest income. An equal and opposite impact would have occurred to net earnings had interest rates been 1% higher.

### Foreign Exchange

Although the Company'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. As at March 31, 2008, the Company had no contracts in place to reduce foreign exchange risk.

### Liquidity Risk

Liquidity difficulties would emerge if the Company was unable to meet its financial obligations as they fell due within normal credit terms. This may be the consequence of diminished cash flows resulting from lower product prices, production interruptions, or unexpected operating or capital cost increases. Liquidity difficulties could also occur if the Company's bankers were unable to continue to provide credit at a level and on terms compatible with the Company's capital requirements. Generally the Company will, over a reasonable period of time, limit its capital programs to funds flow from operations and available cash. In addition, the Company endeavours to maintain its debt at a level to ensure financial flexibility to deal with unforeseen or rapidly changing circumstances.

## **16. Subsequent Event**

On April 30, 2008, the Company completed a bought deal private placement of 8,800,000 Class A shares at a price of \$4.35 per share for gross proceeds of \$38,280,000.

# Corporate Information

## BOARD OF DIRECTORS

Ronald R. Talbot, Chairman  
Exploration Consultant  
Calgary, Alberta

Glenn R. Carley  
Executive Chairman & Director  
Galleon Energy Inc.  
Calgary, Alberta

Kevin Angus  
Executive Vice President & Director  
Pegasus Oil & Gas Inc.  
Calgary, Alberta

Allan K. Ashton  
Chairman of the Board  
AJM Petroleum Consultants  
Priddis, Alberta

Craig Reed  
Director, Cross Border Services  
Pitney Bowes Inc.  
Toronto, Ontario

Patrick R. Ward  
President & Chief Executive Officer  
Painted Pony Petroleum Ltd.  
Calgary, Alberta

## HEAD OFFICE

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Website: [www.paintedpony.ca](http://www.paintedpony.ca)

## EXCHANGE LISTING

The TSX Venture Exchange  
PPY.A  
PPY.B

## OFFICERS

Patrick R. Ward  
President and Chief Executive Officer

Joan E. Dunne  
Vice President, Finance and Chief Financial Officer

James H. French  
Vice President, Engineering

Bruce Mezei  
Vice President, Geology

James S. Thomson  
Vice President, Land

Donald J. Slater  
Vice President, Geophysics

Mary Kay Axford  
Controller

Douglas McCartney  
Partner, Burstall Winger LLP  
Corporate Secretary

**LEGAL COUNSEL**  
Burstall Winger LLP

**AUDITORS**  
KPMG LLP

**BANKERS**  
National Bank of Canada

**EVALUATION ENGINEERS**  
McDaniel & Associates Consultants Ltd

**REGISTRAR AND TRANSFER AGENT**  
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