



## **Financial Statements Unaudited**

For the Three Months Ended  
March 31, 2009 and 2008

### **NOTICE OF NO AUDITOR REVIEW OF INTERIM FINANCIAL STATEMENTS**

Under National Instrument 51-102, Part 4, subsection 4.3(3)(a), if an auditor has not performed a review of the interim financial statements they must be accompanied by a notice indicating that the financial statements have not been reviewed by an auditor. The accompanying unaudited interim financial statements of Solara Exploration Ltd. (the "Corporation") have been prepared by and are the responsibility of the management of the Corporation. The Corporation's independent auditor has not performed a review of these financial statements in accordance with standards established by the Canadian Institute of Chartered Accountants for a review of interim financial statements by an entity's auditor.



## Balance Sheets

(Unaudited)

	March 31, 2009	December 31, 2008
	\$	\$
<b>Assets</b>		
<b>Current assets</b>		
Accounts receivable	734,461	809,752
Due from shareholder (Note 3)	85,000	85,000
Deposits and prepaids	82,363	81,566
	<u>901,824</u>	<u>976,318</u>
<b>Property, plant and equipment (Note 4)</b>	<u>25,633,130</u>	<u>26,219,859</u>
	<u>26,534,954</u>	<u>27,196,177</u>
<b>Liabilities and Shareholders' Equity</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities	1,411,322	1,923,833
Bank debt (Note 5)	8,361,155	7,523,469
	<u>9,772,477</u>	<u>9,447,302</u>
<b>Asset retirement obligations (Note 6)</b>	1,831,150	1,918,014
<b>Convertible debentures (Note 7)</b>	2,532,851	2,508,056
<b>Future income taxes (Note 8)</b>	2,702,447	2,938,516
	<u>16,838,925</u>	<u>16,811,888</u>
<b>Shareholders' equity</b>		
<b>Capital stock (Note 9)</b>	15,574,187	15,665,049
<b>Equity portion of convertible debenture (Note 7)</b>	404,808	404,808
<b>Contributed surplus (Note 10)</b>	1,561,274	1,487,968
<b>Deficit</b>	<u>(7,844,240)</u>	<u>(7,173,536)</u>
	<u>9,696,028</u>	<u>10,384,289</u>
	<u>26,534,954</u>	<u>27,196,177</u>

Basis of presentation and future operations

Commitments (Note 13)

Subsequent events (Note 15)

See accompanying notes to the financial statements.



## Statements of Operations, Comprehensive Loss and Deficit (Unaudited)

	Three Months Ended March 31, 2009 \$	Three Months Ended March 31, 2008 \$
<b>Revenue</b>		
Oil and gas income	916,727	1,890,363
Royalties	(70,688)	(189,813)
	846,039	1,700,550
Interest and other income	10,295	-
	856,334	1,700,550
<b>Expenses</b>		
Operations	506,793	344,161
General and administrative	207,177	204,571
Depletion, depreciation and accretion	907,022	1,020,423
Stock based compensation (Note 10)	11,987	65,109
Interest and accretion on convertible debentures	161,328	188,399
	1,794,307	1,822,663
<b>Loss before income taxes</b>	(937,973)	(122,113)
<b>Future income tax reduction (Note 8)</b>	267,269	170,955
<b>Net (loss) income and comprehensive (loss) income</b>	(670,704)	48,842
<b>Deficit - beginning of period</b>	(7,173,536)	(6,540,056)
<b>Deficit - end of period</b>	(7,844,240)	(6,491,214)
<b>Loss per share</b>		
<b>Basic and diluted (Note 9)</b>	<b>(0.02)</b>	<b>0.00</b>
<b>Weighted average shares outstanding</b>		
<b>Basic and diluted</b>	<b>34,463,981</b>	<b>34,237,848</b>

See accompanying notes to the financial statements.



## Statements of Cash Flows

(Unaudited)

	Three Months Ended March 31, 2009	Three Months Ended March 31, 2008
	\$	\$
<b>Operating Activities</b>		
Net loss and comprehensive loss	(670,704)	48,842
Items not affecting cash		
Depletion, depreciation and accretion	907,022	1,020,423
Stock based compensation	11,987	65,109
Accretion on convertible debentures	24,795	24,795
Future income tax reduction	(267,269)	(170,955)
	5,831	988,214
Changes in non-cash working capital (Note 12)	219,346	(262,855)
	225,177	725,359
<b>Financing Activities</b>		
Issue of common shares	-	-
Bank debt	837,686	1,302,803
Repurchase of shares	(8,150)	(44,920)
Issue costs and commissions	-	-
	829,536	1,257,883
<b>Investing Activities</b>		
Acquisitions of property and equipment	-	(1,136,091)
Additions to property, plant and equipment	(397,350)	(457,846)
Changes in non-cash working capital (Note 12)	(657,363)	(389,305)
	(1,054,713)	(1,983,242)
<b>Decrease in cash and cash equivalents during the period</b>	-	-
<b>Cash and cash equivalents beginning of period</b>	-	-
<b>Cash and cash equivalents end of period</b>	-	-
<b>Supplemental information</b>		
Cash interest paid	76,468	89,439
Cash interest received	-	-
Cash taxes paid	-	-

See accompanying notes to the financial statements.

# **Solara Exploration Ltd.**

## **Notes to the Financial Statements (Unaudited)**

### **For the Three Months ended March 31, 2009 and 2008**

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#### **Basis of Presentation and Future Operations**

Solara Exploration Ltd., (the “Corporation” or “Solara”), is involved in the exploration, development and production of petroleum and natural gas in Canada.

These financial statements have been prepared on a going concern basis which presumes that the Corporation will be able to discharge its obligations and realize its assets in the normal course of business. As at March 31, 2009, the Corporation had a working capital deficiency of \$8,870,653 of which \$8,361,155 was demand bank debt on a demand revolving credit facility of \$9,000,000. (See note 5) The Corporation had a net loss and comprehensive loss of \$670,704 (2008 – net income and comprehensive income of \$48,842) and cash flow from operating activities of \$225,177 (2008 - \$725,359) for the three months ended March 31, 2009 and 2008 respectively.

As at March 31, 2009, the Corporation was compliant with its lender’s covenants. Management believes that they have the continued financial support of the Corporation’s lender as described in note 5 and will have sufficient cash flow from operations in subsequent periods to satisfy its ongoing financial obligations. Consequently, management believes that the going concern assumption is appropriate for these financial statements. Should the going concern assumption be inappropriate, adjustments to the carrying amounts of the assets and liabilities, revenues and expense and the balance sheet classifications used would be necessary.

#### **1. Significant Accounting Policies**

The unaudited interim financial statements have been prepared by management in accordance with Canadian Generally Accepted Accounting Principles ("GAAP"), using the same accounting policies as those set out in note 1 to the audited financial statements for the year ended December 31, 2008, except as described in note 2 below. The unaudited interim financial statements contain disclosures that are supplemental to the Corporation’s December 31, 2008 audited financial statements. Certain disclosures, which are normally required to be included in the notes to the audited annual financial statements, have been condensed or omitted. In the opinion of management, these unaudited interim financial statements present fairly the Corporation’s financial position as at March 31, 2009 and the results of its operations for the three months ended March 31, 2009. The unaudited interim financial statements should be read in conjunction with the Corporation’s audited financial statements and notes thereto for the year ended December 31, 2008.

#### **2. New Accounting Pronouncements**

Goodwill and intangible assets

On January 1, 2009 the Corporation will be required to adopt a new accounting standard for Goodwill and Intangible Assets, which defines the criteria for the recognition of intangible assets.

Business combinations

On January 1, 2011, the Corporation will be required to adopt a new accounting standard for Business Combinations, which harmonizes existing Canadian standards with International Financial Reporting Standards (“IFRS”). Early adoption of the new standard is permitted.

Convergence with IFRS

On January 1, 2011, the Corporation will be required to adopt IFRS. The transition from current GAAP to IFRS is a significant undertaking that may materially affect the Corporation’s reported financial position and results of operations amendments and exemptions to IFRS 1. One such exemption relating to full cost oil and gas accounting is expected to reduce the administrative burden in the transition from the current Canadian Accounting Guideline 16 to IFRS. It is anticipated that this

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exposure draft will not result in an amended IFRS 1 standard until late 2009. The amendment will potentially permit the Corporation to apply IFRS prospectively to its full cost pool, rather than the retrospective assessment of capitalized exploration and development expenses, with the proviso that an impairment test under IFRS standards be conducted at the transition date.

The Corporation has not completed development of its IFRS changeover plan, which will include project structure and governance, resourcing and training, analysis of key difference between IFRS and GAAP, as well as a phased plan to assess accounting policies under IFRS and any potential IFRS 1 exemptions. The Corporation anticipates the completion of its project scoping, which will include a timetable for assessing the impact on data system, internal controls over financial reporting, and business activities, such as financing and compensation arrangements, by late 2009.

**3. Due from Shareholder**

The Corporation loaned an officer \$85,000 for the purchase of 340,000 Class A Shares of the Corporation in November, 2005. The demand loan is interest bearing at the bank prime rate plus one quarter percent and is secured by the Class A Shares purchased, and personally guaranteed. The demand loan is due for repayment on or before December 31, 2009 (see note 14).

**4. Property, Plant and Equipment**

	<b>March 31, 2009</b>	December 31, 2008
	\$	\$
Petroleum and natural gas properties - at cost	<b>42,349,474</b>	42,071,984
Office equipment and other assets – at cost	<b>141,510</b>	141,510
Accumulated depletion and depreciation	<b>(16,857,854)</b>	(15,993,635)
	<b>25,633,130</b>	26,219,859

As at March 31, 2009, costs of unproved properties of \$1,206,870 (2008 - \$881,521) and salvage values of \$1,255,510 (2008 - \$1,554,310) have been excluded from the depletion calculation. Future development costs of \$1,795,720 related to proved non-producing properties (2008 - \$847,000) have been included in costs subject to depletion.

General and administrative expenses for the three months ended March 31, 2009 of \$122,070 (2008 - \$142,130) and stock based compensation expense of \$9,807 (2008 - \$NIL) directly relating to exploration and development projects were capitalized.

The Corporation performed a ceiling test calculation at March 31, 2009 and determined there was no impairment of its petroleum and natural gas properties.

The price forecast used in the reserve evaluation prepared by the independent engineering firm for the December 31, 2008 financial statements is outlined in the table below and is adjusted for quality differential and location. The Corporation performed a sensitivity analysis from the year end engineering reserve report to reflect the lower published prices at the end of the quarter for purposes of performing a ceiling test.

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**Price Forecast – January 1, 2009**

	<b>Oil</b> <b>CDN\$/Bbl</b>	<b>Gas</b> <b>AECO C</b> <b>CDN\$/mmbtu</b>
2009	68.61	7.58
2010	78.94	7.94
2011	83.54	8.34
2012	90.92	8.70
2013	95.91	8.95
2014	97.84	9.14
2015	99.82	9.34
2016	101.83	9.54
2017	103.89	9.75
2018	105.99	9.95

Future prices incorporate a US/CDN exchange rate of 2009 – 0.825, 2010 – 0.85, 2011 – 0.875, 2012 – 0.925 thereafter, escalated at 2% per year thereafter.

**5. Bank Debt**

As at March 31, 2009 the Corporation has a demand revolving credit facility (reviewed on February 17, 2009) of \$9,000,000. The interest rate charged on advances under the credit facility is payable monthly at the bank prime rate plus 1.25%. The credit facility is secured by a \$10,000,000 fixed and floating charge debenture on the assets of the Corporation.

The amount of the credit facility is subject to a borrowing base test performed on a periodic basis by the lender, based primarily on reserves and using commodity prices estimated by the lender, as well as other factors. A decrease in the borrowing base could result in a reduction to the credit facility. The next such review is scheduled for late in the first half of 2009.

**6. Asset Retirement Obligations**

	<b>March 31</b> <b>2009</b> <b>\$</b>	<b>December 31</b> <b>2008</b> <b>\$</b>
Balance – beginning of period	<b>1,918,014</b>	1,379,141
Acquired	-	702,557
Revisions	<b>(129,668)</b>	(374,901)
Incurred	-	56,003
Accretion expense	<b>42,804</b>	155,214
Balance – end of period	<b>1,831,150</b>	1,918,014

The total future asset retirement obligation was estimated by management based on the Corporation's net ownership interest in the 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 expected cost of

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site reclamations was estimated by the Corporation's management using the Alberta Energy Utilities Board guidelines for certain areas and actual well abandonment costs for these areas in Alberta. Note that all of the Corporation's assets are located in Alberta.

As at March 31, 2009, the undiscounted cash flow of the asset retirement obligation was \$2,562,567 (2008 – \$2,498,481). The Corporation expects the obligation to occur on average over 6 years and will be funded from general corporate resources at the time of abandonment. The present value of the obligation has been calculated using a discounted credit adjusted risk free rate of 9.00%, and an annual inflation rate of 2.5%.

**7. Convertible Debentures**

In July, 2006, the Corporation raised \$2,756,000 through the issue of 8.5% fixed rate unsecured subordinated convertible debentures which mature on July 7, 2011. Each \$1,000 debenture is convertible at any time prior to July 7, 2011 (debenture expiry date) into 667 Class A Shares at a price of a \$1.50 per share. The debentures are redeemable at the option of the Corporation at any time after July 6, 2007 at \$1,050 per debenture provided that the average trading price of the Class A Shares exceed a \$1.80 for 20 consecutive trading days prior to the notice date.

The fair value of the conversion feature, calculated using the effective interest method, was estimated to be \$404,808, has been classified as equity. The debt component is classified as a liability and recorded as the present value of the obligation to make future interest payments in cash. The convertible debentures are subordinated to the fixed and floating debenture in favor of the Corporation's lender (see note 5).

The carrying value of the convertible debenture debt component is accreted to the original face value of the instruments over their useful life. Accretion expense of \$ 24,795 has been recorded during the three months ended March 31, 2009 (2008 - \$24,795)

**8. Income Taxes**

The provision for income taxes is different from the amount computed by applying the combined Canadian Federal and Provincial tax rates to the loss before income taxes. The principal reasons for the difference are as follows:

	<b>Three Months Ended March 31, 2009</b>	Three Months Ended March 31, 2008
	\$	\$
Corporate income tax rate	<b>29.0%</b>	29.5%
Loss before income taxes	<b>(937,973)</b>	(122,113)
Expected income tax (reduction)	<b>(272,012)</b>	(36,023)
Add (deduct)		
Stock based compensation	<b>3,476</b>	19,207
Rate change effect	-	(45,192)
Change in prior year estimate	-	(109,891)
Other	<b>1,267</b>	944
Income tax reduction	<b>(267,269)</b>	(170,955)

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The net future income tax liability is composed of temporary differences and the following table shows the tax-effected amounts of those items.

	<b>Three Months Ended March 31, 2009</b>	<b>Year Ended December 31, 2008</b>
	<b>\$</b>	<b>\$</b>
Property, plant and equipment	<b>(3,828,954)</b>	(4,087,607)
Non-capital losses	<b>411,480</b>	411,480
Share issue costs	<b>258,107</b>	258,107
Asset retirement obligations	<b>456,920</b>	479,504
Other		-
Future income tax liability	<b>(2,702,447)</b>	(2,938,516)

As at March 31, 2009 the Corporation had non-capital losses of approximately \$1,646,000 that will expire in the years 2016 to 2019.

**9. Capital Stock**

**a) Authorized and Issued**

Unlimited number of Class A Shares with no par value.

Unlimited number of Class B Shares with no par value.

Unlimited number of preferred shares with no par value, of which none have been issued.

The Corporation may issue an unlimited number of Class A Shares and Class B Shares both of which are voting shares. The Class B Shares are convertible at the option of the Corporation, at any time after March 31, 2009, into Class A Shares on the basis of \$10.00 for each Class B Share, divided by the greater of \$1.00 or the market price of Class A Shares at the time of conversion. Any Class B Shares not converted by December 31, 2010 will automatically be converted pursuant to the same conversion formula.

On February 28, 2009 the Corporation recorded the renouncement of expenditures relating to the flow through shares issued in December 2008. The cumulative tax effect adjustment relating to the flow through shares in the quarter was \$31,200.

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	Three months ended March 31, 2009		Year ended December 31, 2008	
	Number of Shares	Amount \$	Number of Shares	Amount \$
<b>Class A Shares</b>				
Balance – opening	24,620,937	13,385,075	25,324,192	13,935,414
Issued for cash – flow through	-	-	600,000	120,000
Issued for cash – flow through	-	-	-	-
Share purchase financing	-	-	-	(15,557)
Repurchase of shares	(110,000)	(59,662)	(1,303,255)	(654,782)
Balance – closing	24,510,937	13,325,413	24,620,937	13,385,075
<b>Class B Shares</b>				
Balance – opening	986,700	9,867,000	1,044,000	10,440,000
Repurchase of shares	-	-	(57,300)	(573,000)
Balance – closing	986,700	9,867,000	986,700	9,867,000
Cumulative tax effect adjustment relating to the following				
Flow – through shares	-	(5,528,657)	-	(5,497,457)
Share issue costs	-	(2,089,569)	-	(2,089,569)
	-	7,618,226	-	(7,587,026)
Balance - closing	25,497,637	15,574,187	25,607,637	15,665,049

**b) Stock Options**

The Corporation has a stock option plan under which it may grant options to directors, officers, employees, consultants and certain service providers. Stock options are granted at the discretion of the Board of Directors and subject to the applicable regulations, vest over two years and expire five years after the date of grant. The following table summarizes the status of the stock option plan as at March 31, 2009, and December 31, 2008.

	Number of Stock Options	Weighted Average Exercise Price (\$/share)
Outstanding, December 31, 2007	1,486,661	0.42
Granted	1,190,000	0.30
Forfeited	(325,000)	0.33
Outstanding, December 31, 2008	2,351,661	0.37
Outstanding, March 31, 2009	2,351,661	0.37
Exercisable, March 31, 2009	1,924,995	0.40

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The following table summarizes stock options outstanding at March 31, 2009 and December 31, 2008.

Weighted Average Exercise Price (\$/Share)	Number of Stock Options Outstanding	Weighted Average Remaining Contractual Life (years)	Number of Stock Options Excisable
0.35	1,141,661	1.75	1,141,661
0.95	170,000	2.50	170,000
0.30	800,000	3.75	533,334
0.30	185,000	4.25	61,667
0.30	55,000	4.50	18,333
0.37	2,351,661	2.75	1,924,995

**c) Normal Course Issuer Bid**

Under the normal course issuer bid, the Corporation received approval commencing May 6, 2009 to purchase up to 5% of its outstanding Class A Shares until May 5, 2010. During the quarter ended March 31, 2009 the Corporation repurchased and cancelled 110,000 Class A Shares (2008 – 64,500) at a net cost of \$8,150 (2008 - \$16,793) The average carrying value of the Class A Shares repurchased of \$59,662 (2008 - \$39,524) was charged to share capital with the difference of \$51,512 (2008 - \$22,732) included in contributed surplus.

Under the normal course issuer bid, the Corporation received approval commencing May 6, 2009 to purchase up to 5% of its outstanding Class B Shares until May 6, 2010. During the quarter ended March 31, 2009 the Corporation repurchased and cancelled NIL Class B Shares (2008– 15,500) at a net cost of \$NIL (2008 - \$27,986). The average carrying value of the Class B Shares repurchased of \$NIL (2008 - \$155,014) was charged to share capital with the difference of \$NIL (2008 - \$127,015) included in contributed surplus.

**d) Per Share Information**

The weighted average number of Class A Shares outstanding as at March 31, 2009, for basic and diluted was 34,463,981 Class A Shares (2008 – 34,237,848 basic and diluted). Due to net losses realized for the periods ended March 31, 2009 and 2008, the inclusion of stock options is anti-dilutive.

**10. Contributed Surplus**

Stock based compensation expense was calculated using the Black-Scholes Option Pricing Model, using a risk free interest rate of 3.62% (2008 – 3.62%), expected life of five years, expected average volatility factor of 117% (2008 – 117%) and no dividends. The convertible debentures are convertible into Class A Shares of the Corporation at a price of \$1.50 (2008 – \$1.50).

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	Three months ended March 31, 2009	Year ended December 31, 2008
	\$	\$
Balance – beginning of year	1,487,968	323,016
Stock based compensation expense	11,987	98,722
Stock based compensation capitalized	9,807	94,944
Shares purchased for cancellation	51,512	971,286
Balance – end of period	1,561,274	1,487,968

**11. Financial Risk Management**

**Overview**

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

- Credit risk
- Liquidity risk
- Market risk

This note presents information about Solara’s exposure to each of the above risks, the Corporation’s objectives, policies and processes for measuring and managing risk, and the Corporation’s management of capital. Further quantitative disclosures are included throughout these financial statements. The Board of Directors has overall responsibility for the establishment and oversight of the Corporation’s risk management framework. The Board is in the process of implementing risk management policies. Solara’s risk management policies will be designed to identify and analyze the risks faced by the Corporation, to set appropriate risk limits and controls, and to monitor risks and adherence to market conditions and the Corporation’s activities.

**Credit Risk**

Credit risk is the risk of financial loss to the Corporation if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from Solara’s accounts receivables from joint interest partners and petroleum and natural gas marketers. As at March 31, 2009, Solara’s accounts receivables consisted of \$385,156 from joint interest partners, and \$349,305 of receivables from petroleum and natural gas marketers. Receivables from petroleum and natural gas marketers are normally collected on the 25th day of the month following production. Solara’s policy to mitigate credit risk associated with these balances is to establish marketing relationships with established purchasers. The Corporation historically has not experienced any collection issues with its petroleum and natural gas marketers, and currently has no such collection issues. Joint interest receivables are typically collected within one to three months of the joint interest bill being issued to the partner. Solara attempts to mitigate the risk from joint interest receivables by obtaining partner approval of significant capital expenditures prior to expenditure. However, the receivables are from participants in the petroleum and natural gas sector, and collection of the outstanding balances is dependent on industry factors, such as commodity price fluctuations, escalating costs and the risk of

unsuccessful drilling. In addition, further risk exists with joint interest partners as disagreements occasionally arise that increases the potential for non-collection. Solara does not typically obtain collateral from petroleum and natural gas marketers or joint interest partners; however, Solara does have the ability to withhold production from joint interest partners in the event of non-payment, to

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take its share of production in kind and cash call partners for their share of capital expenditures. The carrying amount of accounts receivable represents the maximum credit exposure. Solara did not have an allowance for doubtful accounts as at March 31, 2009 and did not provide for any doubtful accounts, nor was it required to write-off any receivables during the three months ended March 31, 2009.

As at March 31, 2009 and December 31, 2008, Solara considers its trade receivables to be aged as follows:

	<b>March 31, 2009</b>	December 31, 2008
	\$	\$
Past due (less than 90 days)	<b>539,210</b>	674,878
Past due (91 - 150 days)	<b>195,251</b>	134,874
	<b>734,461</b>	809,752

As of May 28, 2009, the Corporation had collected \$70,748 of the past due trade receivables. The remaining \$124,503 relates to prior period gross overriding royalties and joint interest billings. Solara is currently working with these accounts to resolve payment of the outstanding amounts. The Corporation has the right of offset with respect to approximately \$65,000 of royalty revenue from one of the parties.

**Liquidity Risk**

Liquidity risk is the risk that the Corporation will not be able to meet its financial obligations as they are due. Solara's approach to managing liquidity is to ensure, as far as possible, that it will have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking harm to the Corporation's reputation. Solara prepares annual capital expenditure budgets, which are regularly monitored and updated as considered necessary. Further, the Corporation utilizes authorizations for expenditures on both operated and non-operated projects to further manage capital expenditures. To facilitate the capital expenditure program, Solara has a revolving reserves based credit facility, as outlined in note 5, which is reviewed at least annually by its lender.

**Market Risk**

Market risk is the risk that changes in market prices, such as foreign exchange rates, commodity prices and interest rates, will affect the Corporation's net earnings or the value of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable limits, while maximizing returns. The Corporation may from time to time utilize both financial derivatives and physical delivery sales contracts to manage market risks. The Corporation had no such contracts as at March 31, 2009. (see note 15)

**(a) Foreign Currency Exchange Rate Risk**

Foreign currency exchange rate risk is the risk that the fair value or future cash flows will fluctuate as a result of changes in foreign exchange rates. Although substantially all of Solara's oil and natural gas sales are denominated in Canadian dollars, the underlying market prices in Canada for oil and natural gas are impacted by changes in the exchange rate between the Canadian and United States dollar. The Corporation had no forward exchange rate contracts in place as at or during the year ended December 31, 2008 and the period ended March 31, 2009.

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**(b) Commodity Price Risk**

Commodity price risk is the risk that the fair value or future cash flows will fluctuate as a result of changes in commodity prices. Commodity prices for oil and natural gas are impacted by not only the relationship between the Canadian and United States dollar, as outlined above, but also world economic events that dictate the levels of supply and demand. The Corporation has put in place two commodity price contracts effective April 1, 2009. (see note 15)

**(c) Interest Rate Risk**

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. Solara is exposed to interest rate fluctuations on its bank debt, which bears a floating rate of interest. At March 31, 2009, if interest rates had been 1% lower with all other variables held constant, the after tax net loss for the period would have been \$19,899 lower (2008 - \$10,760 higher), due to lower interest expense. An equal and opposite impact would have occurred to the net loss had interest rates been 1% higher. The Corporation had no interest rate swap or financial contracts in place as at or during the three months ended March 31, 2009. (see Note 15)

**Capital Management**

General adverse economic conditions globally, including the possibility of a recession in Canada and a worldwide economic slowdown, recent disruptions to the credit and financial markets in Canada and worldwide and local economic turmoil may adversely affect the value of the Corporation's business and value of its securities.

The Corporation's policy is to maintain a sufficient capital base to sustain the future development of the business and to maintain investor, creditor and market confidence. The Corporation manages its capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying petroleum and natural gas assets. The Corporation considers its capital structure to include shareholders' equity and bank debt. In order to maintain or adjust the capital structure, the Corporation may, from time to time, issue shares and adjust its capital spending to manage current and projected debt levels. The Corporation monitors capital based on the ratio of bank debt to funds from operations for the most recent 12 month period. Funds from operations is calculated based on cash provided by operating activities before changes in non-cash working capital and expenditures on asset retirement obligations. The Corporation's strategy is to endeavor to maintain a ratio of bank debt to annual funds from operations of approximately 2.5 to 1 or lower. This ratio may increase at certain times as a result of acquisitions and/or large capital projects. As at March 31, 2009, the Corporation's ratio of net debt to annual funds from operations was approximately 3.4 to 1. The Corporation anticipates that the ratio will exceed the target range by a significant margin throughout 2009 due to reduced funds from operations affected by lower commodity prices relative to 2008. The Corporation's share capital is not subject to external restrictions; however, the bank debt facility is based on petroleum and natural gas reserves (see note 5), and contains certain financial covenants. The Corporation has not paid or declared any dividends since the date of incorporation, nor are any contemplated in the foreseeable future. Management is reviewing all of its field operating and general and administrative expenses and has deferred all major capital projects until such time that funds from operations warrant capital investments. Our corporate emphasis is on trade debt reduction and retiring a portion of the bank line of credit for the balance of 2009.

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**Fair Value of Financial Instruments**

Solara's financial instruments as at March 31, 2009 and the year ended December 31, 2008 include accounts receivable, an amount due from shareholder, accounts payable and accrued liabilities, bank debt and convertible debenture. The fair value of these amounts, excluding bank debt, approximate their carrying amounts due to their short terms to maturity. Bank debt is payable on demand and bears interest at a floating market rate, and accordingly, the fair market value approximates the carrying amount.

**12. Cash Flow Information**

Changes in non-cash working capital were as follows:

	<b>2009</b>	2008
Three Months Ended March 31,	\$	\$
<b>Changes in non-cash working capital balances</b>		
Accounts receivable	<b>75,291</b>	(468,266)
Advances and prepaids	<b>(797)</b>	(23,574)
Accounts payable and accrued liabilities	<b>(512,511)</b>	(160,320)
	<b>(438,017)</b>	(652,160)
	<b>2009</b>	2008
Three Months Ended March 31,	\$	\$
<b>Changes in non-cash working capital relates to</b>		
Operating	<b>219,346</b>	(262,855)
Investing	<b>(657,363)</b>	(389,305)
	<b>(438,017)</b>	(652,160)

**13. Commitments**

- a) The Corporation is committed to office lease payments totalling \$179,168 to March 1, 2011 based on current operating costs. These obligations are as follows.

	\$
2009	70,109
2010	93,479
2011	15,580

- b) The Corporation has an obligation to incur \$120,000 in qualifying expenditures by December 31, 2009 resulting from the private placement of flow through shares completed in December 2008.

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**14. Related Party Transactions**

The President and CEO, and a director of the Corporation is a major shareholder of a private Alberta company that provides management consulting services to the Corporation. During the three months ended March 31, 2009 the Corporation paid a total of \$25,000 for various fees (2008 - \$27,500). The Corporation has provided a demand loan in the amount of \$85,000 to purchase 340,000 Class A Shares of the Corporation to the President and CEO in November, 2005. The loan is secured by the Class A Shares and a demand promissory note bearing interest at bank prime plus one quarter of one percent. The note is due on or before December 31, 2009 (see note 3).

The Corporate Secretary of the Corporation is counsel with a law firm that provides legal services to the Corporation. During the three months ended March 31, 2009, the Corporation paid a total of \$15,989 (2008 - \$42,936) for such services.

For the three months ended March 31, 2009, consulting services were provided by a company controlled by the Vice President, Engineering and Operations of the Corporation for \$15,000 (2008 - \$45,500).

These transactions have been recorded at the exchange amount of the consideration which is the amount agreed upon between the parties.

**15. Subsequent Events**

- a) The Corporation has entered into a commodity price contract with its lender which provides for a minimum price of \$5.21 per gigajoule (GJ) on 350 GJs per day for the period commencing on April 1, 2009 until December 31, 2009, and a ceiling price of \$7.50 per GJ commencing on January 1, 2010 and ending March 31, 2011.
- b) The Corporation has entered into a second commodity price contract with its lender which provides for a minimum price of \$5.00 per GJ on 200 GJs per day for the period commencing on April 1, 2009 until December 31, 2009, and a ceiling price of \$6.675 per GJ commencing on January 1, 2010 and ending March 31, 2011.