

Financial Statements of

ARCAN RESOURCES LTD.

Three and six months ended June 30, 2010 and 2009

ARCAN RESOURCES LTD.

Balance Sheets
(Unaudited)

	June 30, 2010	December 31, 2009
Assets		
Current assets:		
Accounts receivable	\$ 13,685,788	\$ 10,011,769
Prepays and deposits	1,097,099	935,313
	<u>14,782,887</u>	<u>10,947,082</u>
Property, plant, and equipment (note 1)	229,450,792	140,304,312
	<u>\$ 244,233,679</u>	<u>\$ 151,251,394</u>
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 38,143,200	\$ 17,140,125
Bank loans (note 2)	–	28,585,629
	<u>38,143,200</u>	<u>45,725,754</u>
Bank loans (note 2)	33,903,385	–
Asset retirement obligations (note 3)	10,081,820	5,370,818
Future income taxes	3,860,749	4,687,265
	<u>85,989,154</u>	<u>55,783,837</u>
Shareholders' equity:		
Share capital (note 4)	157,078,868	93,714,116
Share purchase loan (note 4)	(100,000)	(100,000)
Contributed surplus (note 5)	5,287,980	4,080,040
Deficit	(4,022,323)	(2,226,599)
	<u>158,244,525</u>	<u>95,467,557</u>
Commitments (notes 4 and 8)		
Subsequent events (note 9)		
	<u>\$ 244,233,679</u>	<u>\$ 151,251,394</u>

See accompanying notes to financial statements.

ARCAN RESOURCES LTD.

Statements of Operations, Comprehensive Loss and Retained Earnings (Deficit)
(Unaudited)

	Three months ended		Six months ended	
	June 30,		June 30,	
	2010	2009	2010	2009
Revenue:				
Petroleum and natural gas	\$ 11,055,831	\$ 7,209,028	\$ 20,047,541	\$ 12,939,995
Interest and other revenue	335	1,527	3,873	2,192
Royalties	(2,491,312)	(1,274,877)	(4,843,754)	(2,552,366)
Unrealized loss on commodity contracts (note 7)	-	(1,114,897)	-	(1,759,331)
Realized loss on commodity contracts (note 7)	-	(221,836)	-	(221,836)
	8,564,854	4,598,945	15,207,660	8,408,654
Expenses:				
Operating	2,143,465	1,593,425	4,530,956	2,945,160
General and administrative	2,666,339	1,152,050	4,138,815	2,208,303
Interest	370,017	397,616	752,448	669,907
Accretion	194,085	104,948	301,555	205,751
Depletion and depreciation	4,138,896	3,098,188	7,357,445	5,817,615
	9,512,802	6,346,227	17,081,219	11,846,736
Loss before income taxes	(947,948)	(1,747,282)	(1,873,559)	(3,438,082)
Future income tax reduction (expense)	(43,995)	433,137	77,835	833,438
Loss and comprehensive loss	(991,943)	(1,314,145)	(1,795,724)	(2,604,644)
Retained earnings (deficit), beginning of period	(3,030,380)	2,225,522	(2,226,599)	3,516,021
Retained earnings (deficit), end of period	\$ (4,022,323)	\$ 911,377	\$ (4,022,323)	\$ 911,377
Loss per share (note 4):				
Basic	\$ (0.01)	\$ (0.03)	\$ (0.03)	\$ (0.07)
Diluted	\$ (0.01)	\$ (0.03)	\$ (0.03)	\$ (0.07)

See accompanying notes to financial statements.

ARCAN RESOURCES LTD.

Statements of Cash Flows
(Unaudited)

	Three months ended		Six months ended	
	June 30,		June 30,	
	2010	2009	2010	2009
Cash provided by (used in):				
Operating:				
Loss	\$ (991,943)	\$ (1,314,145)	\$ (1,795,724)	\$ (2,604,644)
Items not involving cash:				
Depletion and depreciation	4,138,896	3,098,188	7,357,445	5,817,615
Stock-based compensation	1,123,928	193,119	1,562,221	385,824
Accretion	194,085	104,948	301,555	205,751
Unrealized loss on commodity contracts	-	1,114,897	-	1,759,331
Future income tax expense (reduction)	43,995	(433,137)	(77,835)	(833,438)
Reclamation costs	(7,523)	(84,271)	(19,877)	(84,271)
	4,501,438	2,679,599	7,327,785	4,646,168
Change in non-cash working capital	(832,548)	(577,403)	(1,110,525)	(1,182,642)
	3,668,890	2,102,196	6,217,260	3,463,526
Financing:				
Bank loan	7,143,807	(1,566,809)	5,317,756	9,994,675
Issue of common shares, net of costs	381,926	-	62,261,790	-
	7,525,733	(1,566,809)	67,579,546	9,994,675
Investing:				
Property, plant and equipment	(21,237,986)	(228,750)	(39,271,413)	(3,405,507)
Property acquisition (note 1)	(1,539)	-	(52,803,188)	-
Change in non-cash working capital	10,044,902	(306,637)	18,277,795	(10,052,694)
	(11,194,623)	(535,387)	(73,796,806)	(13,458,201)
Change in cash	-	-	-	-
Cash, beginning of period	-	-	-	-
Cash, end of period	\$ -	\$ -	\$ -	\$ -
Supplementary disclosure:				
Interest paid	\$ 469,821	\$ 309,965	\$ 764,854	\$ 601,348

Cash is defined as cash and cash equivalents.

See accompanying notes to financial statements.

ARCAN RESOURCES LTD.

Notes to Financial Statements

Three and six months ended June 30, 2010 and 2009
(Unaudited)

Arcan Resources Ltd. ("Arcan" or the "Company") is a publicly listed company involved in the business of oil and natural gas exploration, development and production in Canada. The interim financial statements of Arcan have been prepared by management in accordance with Canadian generally accepted accounting principles. The interim financial statements have been prepared following the same accounting policies and methods of computation as the financial statements for the year ended December 31, 2009. The following disclosure is incremental to the disclosure included with the December 31, 2009 financial statements. These interim financial statements should be read in conjunction with the financial statements and notes thereto for the year ended December 31, 2009.

1. Property, plant and equipment:

	June 30, 2010	December 31, 2009
Petroleum and natural gas properties	\$ 280,940,727	\$ 184,436,802
Accumulated depletion and depreciation	(51,489,935)	(44,132,490)
	<u>\$ 229,450,792</u>	<u>\$ 140,304,312</u>

At June 30, 2010, petroleum and natural gas properties included undeveloped properties of \$23.3 million (June 30, 2009 - \$11.6 million), which have been excluded from the depletion calculation. Future development costs for proved reserves of \$27.6 million (June 30, 2009 - \$38.2 million) have been included in the depletion calculation.

During the six months ended June 30, 2010, the Company acquired certain working interests in petroleum and natural gas properties for cash of \$52.8 million, with associated asset retirement obligations of \$4.1 million.

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(Unaudited)

2. Bank loans:

The Company has a \$60 million syndicated extendible, revolving term credit facility and a \$10 million non-syndicated extendible revolving operating term credit facility for total available credit facilities of \$70 million (the "Facilities"). The Facilities are available on a revolving basis until May 31, 2011. On May 31, 2011, at the Company's discretion, the Facilities are available on a non-revolving basis for a period of one year, at which time the Facilities would be due and payable. Alternatively, the Facilities may be extended for a further 364 day period at the request of the Company, subject to approval by the lenders. Interest on the Facilities is calculated at the bank prime rate of interest, plus an applicable facility margin depending upon certain ratios. The \$70 million borrowing base is subject to a semi-annual and annual review by the bank. As the available lending limits of the Facilities are based on the bank's interpretation of the Company's reserves and future commodity prices, there can be no assurance as to the amount of the facilities that will be determined at each scheduled review. The Facilities are secured by a \$500 million first floating charge debenture and a general security agreement. Pursuant to the terms of the credit facilities, the Company has provided the covenant that at all times its working capital ratio shall be not less than 1 to 1. The working capital ratio is defined under the terms of the Facilities as current assets, including the undrawn portion of the Facilities, to current liabilities, excluding any current bank indebtedness under the Facilities. The Company is compliant with this covenant at June 30, 2010. This facility had an effective interest rate of 4.75% at June 30, 2010 (June 30, 2009 – 4.75%).

3. Asset retirement obligations:

The Company's asset retirement obligations result from net ownership interests in petroleum and natural gas assets including well sites, gathering systems and processing facilities. The Company estimates the total undiscounted amount of cash flows required to settle its asset retirement obligations at June 30, 2010 is \$20.2 million (December 31, 2009 - \$11.4 million), which will be incurred between 2011 and 2019. The majority of the costs will be incurred between 2011 and 2016. An inflation rate of 2% (December 31, 2009 – 2%) was used to inflate the costs, and a credit-adjusted risk-free rate of 8% - 10% (December 31, 2009 – 8% - 10%) was used to calculate the fair value of the asset retirement obligations.

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Three and six months ended June 30, 2010 and 2009
(Unaudited)

3. Asset retirement obligations (continued):

	June 30, 2010	December 31, 2009
Balance, beginning of period	\$ 5,370,818	\$ 4,785,428
Liabilities incurred	357,180	230,818
Liabilities incurred on acquisition (note 1)	4,072,144	-
Accretion expense	301,555	414,170
Changes in estimates	-	33,116
Reclamation costs	(19,877)	(92,714)
Balance, end of period	\$10,081,820	\$ 5,370,818

4. Share capital:

(a) Authorized:

Unlimited number of common shares without nominal or par value.

(b) Common shares issued and outstanding:

	Number of Shares	Amount
Balance, December 31, 2008	37,868,560	\$ 81,677,404
Issued pursuant to prospectus	9,000,000	11,250,000
Issued pursuant to flow-through private placement	1,071,500	1,500,100
Share issue costs	-	(973,244)
Tax effect of share issue costs	-	259,856
Balance, December 31, 2009	47,940,060	\$ 93,714,116
Issued pursuant to prospectus	26,000,000	65,000,000
Exercise of performance options	750,000	750,000
Exercise of warrants	327,011	616,218
Exercise of stock options	155,833	234,208
Stock-based compensation on exercise of warrants, performance options and stock options	-	354,281
Share issue costs	-	(4,338,636)
Tax effect of share issue costs	-	1,123,706
Tax effect of flow-through shares issued in 2009	-	(375,025)
Balance, June 30, 2010	75,172,904	\$157,078,868

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4. Share capital (continued):

(c) Warrants:

The Company has outstanding warrants that were issued to investors and agents, as commission, in certain equity financings. Each warrant is exercisable into one common share of the Company.

	Weighted average Exercise Price (\$)	Number of Warrants
Balance, at December 31, 2009 and 2008	1.93	586,631
Exercise of warrants	1.88	(327,011)
Expired	1.60	(11,120)
Balance, June 30, 2010	2.00	248,500

The following table indicates the number of exercisable warrants with exercise prices:

	Exercise Price (\$)	Number of Warrants
Issued July 2004	2.00	248,500

The warrants issued in July 2004 expire on October 22, 2010.

(d) Flow-through shares:

On November 20, 2009, the Company issued 1,071,500 flow-through common shares for gross proceeds of \$1,500,100. Under the terms of the flow-through share agreements, the Company renounced the \$1,500,100 of qualifying petroleum and natural gas expenditures effective December 31, 2009 and has until December 31, 2010 to incur the expenditures. As at June 30, 2010, the Company has \$780,000 of qualifying expenditures remaining to incur.

(e) Share purchase loan:

A share purchase loan of \$100,000 (December 31, 2009 - \$100,000) is due from an officer of the Company for the purchase of 40,000 common shares at a price of \$2.50 per common share. This loan is repayable, with interest calculated at the "Prescribed Rate" as determined by the Canada Revenue Agency, currently 1%, on or before April 3, 2012. This loan is secured by the underlying shares.

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4. Share capital (continued):

(f) Stock options:

	Three months ended June 30, 2010		Year ended December 31, 2009	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Stock options outstanding, beginning of period	4,671,166	\$ 2.01	3,638,500	\$ 2.27
Granted	2,862,000	4.20	1,183,500	1.30
Exercised	(155,833)	1.50	-	-
Expired	(64,166)	3.06	(64,999)	2.96
Forfeited	-	-	(85,835)	2.93
Stock options outstanding, end of period	7,313,167	\$ 2.87	4,671,166	\$ 2.01
Exercisable at period-end	3,045,167	\$ 2.25	2,854,166	\$ 2.12

(g) Stock-based compensation:

The fair value of each option granted during the six months ended June 30, 2010 was estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions:

	2010	2009
Fair value of options granted (\$/option)	\$ 3.06	\$ -
Expected life of options (years)	5	-
Expected volatility (%)	94	-
Risk free rate of return (%)	2.89	-
Expected dividend yield (%)	Nil	-

(h) Performance options:

During the six months ended June 30, 2010, 750,000 performance options were exercised at a price of \$1.00 per performance option for gross proceeds of \$750,000. No performance options remain at June 30, 2010.

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(Unaudited)

4. Share capital (continued):

(i) Per share amounts:

The following table summarizes the basis for the determination of basic and diluted per share amounts:

	Three months ended June 30,		Six months ended June 30,	
	2010	2009	2010	2009
Weighted average number of shares – basic	75,028,584	37,828,560	61,748,052	37,828,560
Weighted average number of shares - diluted	75,028,584	37,828,560	61,748,052	37,828,560

In computing diluted per share amounts at June 30, 2010, 7,313,167 options (June 30, 2009 – 3,631,000 options), no performance options (June 30, 2009 – 750,000 performance options), and 248,500 warrants (June 30, 2009 – 586,631 warrants) were excluded for the calculation as their effect was anti-dilutive.

5. Contributed surplus:

	June 30, 2010	December 31, 2009
Balance, beginning of period	\$ 4,080,040	\$ 3,137,804
Stock-based compensation	1,562,221	942,236
Transfer to share capital on exercise of warrants, performance options and share options	(354,281)	–
Balance, end of period	\$ 5,287,980	\$ 4,080,040

6. Related party transactions:

In conjunction with the equity issuance pursuant to the prospectus during the six months ended June 30, 2010, certain officers and directors acquired 68,000 common shares at \$2.50 per share.

In conjunction with the equity issuance pursuant to the prospectus during the year ended December 31, 2009, certain officers and directors acquired 340,000 common shares at \$1.25 per share.

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7. Financial instruments:

Credit Risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Company's receivables from joint venture partners and petroleum and natural gas marketers. As at June 30, 2010 the Company's receivables consisted of \$4.5 million (December 31, 2009 - \$5.0 million) from joint venture partners, \$3.5 million (December 31, 2009 - \$2.0 million) of receivables from petroleum and natural gas marketers and \$5.7 million (December 31, 2009 - \$3.0 million) of other trade receivables.

The carrying amount of accounts receivable represents the maximum credit exposure. The Company has an allowance for doubtful accounts as at June 30, 2010 of \$0.1 million, consistent with the amount provided during the year ended December 31, 2009.

As at June 30, 2010 and December 31, 2009 the Company considers its receivables to be aged as follows:

Aging	June 30, 2010	December 31, 2009
Not past due (less than 120 days)	\$ 13,492,420	\$ 9,048,157
Past due (over 120 days)	193,368	963,612
Total	\$ 13,685,788	\$10,011,769

Liquidity risk

Accounts payable are considered due to suppliers in one year or less. Bank loans, which are subject to renewal after a 364-day revolving period, could be potentially due on May 31, 2012, if the Facilities are not renewed for the 364 day period, in which case the Facilities are converted to a one year term loan.

Market risk

Market risk is the risk that changes in market prices, such as foreign exchange rates, commodity prices, and interest rates will affect the Company's net income or the value of financial instruments.

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 risks.

The Company had no forward exchange rate contracts in place as at or during the six months ended June 30, 2010 or the year ended December 31, 2009.

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Notes to Financial Statements, Page 8

Three and six months ended June 30, 2010 and 2009
(Unaudited)

7. Financial instruments (continued):

Commodity price risk

Commodity price risk is the risk that the fair value of future cash flows will fluctuate as a result of changes in commodity prices.

The Company had no derivative contracts in place as at or during the six months ended June 30, 2010.

During the six months ended June 30, 2009 the Company entered into a fixed price oil swap contract to receive \$64.40 per barrel in exchange for Canadian dollar WTI on oil production of 500 barrels per day for the period from April 1 to December 31, 2009. The Company recognized an unrealized loss of \$1,759,331 on the contract as at and for the six months ended June 30, 2009. The Company also realized a loss on the contract of \$221,836 for the six months ended June 30, 2009.

Interest rate risk

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. The Company is exposed to interest rate fluctuations on its bank debt which bears a floating rate of interest. As at June 30, 2010, if interest rates had been one hundred basis points lower with all other variables held constant, net income for the three and six months ended would have been approximately \$61,000 (2009 - \$70,000) and \$123,000 (2009 - \$140,000) higher, respectively, due to lower interest expense. An equal and opposite impact would have occurred to net income had interest rates been one hundred basis points higher. The sensitivity is lower in 2010 as compared to 2009 because of a decrease in outstanding bank debt.

The Company has no interest rate swap or financial contracts in place as at or during the six months ended June 30, 2010 or the year ended December 31, 2009.

Capital management

The Company manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of the underlying petroleum and natural gas assets. The Company considers its capital structure to include shareholder's equity of \$158.2 million (December 31, 2009 - \$95.5 million), bank debt of \$33.9 million (December 31, 2009 - \$28.6 million) and a working capital deficiency excluding bank debt, of \$23.4 million (December 31, 2009 - \$6.2 million). In order to maintain or adjust the capital structure, the Company may from time to time issue shares and adjust its capital spending to manage current and projected debt levels.

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Notes to Financial Statements, Page 9

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7. Financial instruments (continued):

The Company monitors capital based on the ratio of net debt to quarterly annualized funds from operations. In this ratio, net debt is defined as outstanding bank debt plus or minus working capital, divided by funds from operations for the most recent calendar quarter, annualized (multiplied by four). Funds from operations is defined as cash flow from operating activities before changes in non-cash working capital. The Company's strategy is to maintain a ratio of less than 2 to 1. This ratio may increase at certain times as a result of acquisitions. In order to facilitate the management of this ratio, the Company prepares annual capital expenditure budgets, which are updated as necessary depending on varying factors including current and forecast prices, successful capital deployment and general industry conditions. The annual and updated budgets are approved by the Board of Directors.

As at June 30, 2010 and December 31, 2009, the Company's ratio of net debt to quarterly annualized funds from operations was 3.2 to 1 and 13.0 to 1, respectively. The Company's ratio of net debt to quarterly annualized funds from operations at quarter end and year end was above the 2 to 1 ratio that management targets to maintain due to significant capital spending in 2010 and decreased commodity prices combined with higher operating costs due to workovers in 2009.

The Company's bank completed its semi-annual borrowing base review on May 13, 2010, and the bank credit facility has been established at \$70 million. The next scheduled renewal is on or before May 31, 2011. The Company continually monitors its financing alternatives, and expects to finance its 2010 cash capital expenditures program from internally generated funds from operations, bank debt, and equity.

The net debt to quarterly annualized funds from operations has been calculated as follows:

	June 30, 2010	December 31, 2009
Working capital deficiency (including bank debt)	\$ 57,263,698	\$ 34,778,672
Cash flow from operating activities	3,668,890	130,393
Change in non-cash operating working capital	832,548	537,141
Funds from operations	4,501,438	667,534
Annualizing factor	x4	x4
Annualized funds from operations	\$ 18,005,752	\$ 2,670,136
Ratio	3.2 to 1	13.0 to 1

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Notes to Financial Statements, Page 10

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7. Financial instruments (continued):

The Company's share capital is not subject to external restrictions, however the bank debt facility is based on petroleum and natural gas reserves and subject to certain financial covenants (see note 2). The Company has not paid or declared any dividends since the date of incorporation, nor are any contemplated in the foreseeable future.

There were no changes in the Company's approach to capital management during the period.

Fair value of financial instruments

The Company's financial instruments as at June 30, 2010 and December 31, 2009 includes accounts receivable, accounts payable and accrued liabilities, and bank debt. The fair value of accounts receivable and accounts payable and accrued liabilities approximate their carrying amounts due to their short-terms to maturity.

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

8. Commitments:

(a) Future minimum lease payments relating to operating lease commitments are:

2010	\$ 119,250
2011	244,125
2012	249,750
2013	249,750
2014	249,750
2015 and thereafter	374,625

(b) As a requirement of a sublease for office premises, the Company has provided a letter of Guarantee in favour of the lessor as follows:

March 2010 to February 2011	\$ 60,000
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9. Subsequent events:

Subsequent to June 30, 2010 the Company entered into two costless collar financial oil contracts. The contracts are each for 500 barrels per day of oil with a floor price of \$70.00 per barrel Canadian and a ceiling price of \$100.05 and \$100.30 per barrel Canadian, respectively. Both contracts are for the period from January 1, 2011 to December 31, 2011.

Subsequent to June 30, 2010 the Company approved and paid \$0.8 million in bonuses to the directors, officers, and employees.