

## MANAGEMENT'S DISCUSSION AND ANALYSIS

### Management's Discussion and Analysis

*The following Management's Discussion and Analysis ("MD&A") for Second Wave Petroleum Inc. ("Second Wave" or the "Company") should be read in conjunction with the unaudited financial statements for the three and six months ended June 30, 2009 and the audited consolidated financial statements and notes of the Company for the year ended December 31, 2008. This MD&A incorporates information up to and including August 26, 2009. The financial statements have been prepared in accordance with Canadian Generally Accepted Accounting Principles ("GAAP"). All of the amounts reported in this MD&A are in Canadian dollars, unless otherwise indicated. Certain other information with respect to the Company is available on SEDAR, at [www.sedar.com](http://www.sedar.com) and at the Company's website at [www.secondwavepetroleum.com](http://www.secondwavepetroleum.com). Information can also be obtained by contacting the Company at Second Wave Petroleum Inc, Suite 1700, 520, 5<sup>th</sup> Ave. S.W., Calgary, Alberta, T2P 3R7.*

### NON-GAAP FINANCIAL MEASUREMENTS

*The Company has used certain measures of financial reporting that are commonly used benchmarks within the oil and gas industry in this MD&A that are considered non-GAAP measures. The measures used in this document include "funds from operations", "funds from operations per share", and "operating netback". The term funds from operations contained within the MD&A should not be considered as an alternative to, or more meaningful than, cash flow from operating activities as determined in accordance with GAAP. The Company believes that funds from operations is a useful supplementary measure as investors may use this information to analyze operating performance, leverage and liquidity. Funds from operations, as disclosed within this MD&A, represents cash flow from operating activities before changes in non-cash working capital. The Company presents funds from operations per share whereby per share amounts are calculated consistent with the calculation of net loss and comprehensive loss per share. The Company believes that the term operating netback contained within the MD&A is also a useful supplementary measure as investors may use this information to analyze field level operating performance of the Company's oil and gas properties. Further supplemental indicators of performance common to the oil and gas industry are the measurement of costs and expenses on a per barrel of oil equivalent (boe). These non-GAAP measures may not necessarily be comparable to similarly titled measures used by other entities and readers of this MD&A are cautioned in attempting to make such comparisons.*

### OTHER MEASUREMENTS

*For the purposes of calculating unit costs, natural gas has been converted to a barrel of oil equivalent ("BOE") using 6,000 cubic feet (6 Mcf) of natural gas equal to one barrel of oil (6:1), unless otherwise stated. The BOE conversion ratio of 6 Mcf to 1 barrel is based on an energy equivalency conversion method and does not represent a value equivalency. Therefore BOEs may be misleading if used in isolation. References to natural gas liquids ("NGLs") in this MD&A include condensate, propane, butane and ethane and one barrel of NGLs is considered to be equivalent to one barrel of crude oil equivalent (BOE).*

### ADVISORY REGARDING FORWARD LOOKING STATEMENTS

*Certain statements included or incorporated by reference in the MD&A constitute forward-looking statements or forward-looking information under applicable securities legislation. Forward-looking statements or information typically contain statements with words such as "anticipate", "expect", "plan", "intend", "estimate", "propose", or similar words suggesting future outcomes or statements regarding an outlook. Forward-looking statements in this MD&A include, but are not limited to, statements with respect to reserves, crude oil and natural gas prices, well productivity, operating costs, general and administrative costs, taxation rates, interest rates, and capital expenditure plans for 2009 and beyond. Existing or potential investors should not place undue reliance on forward-looking statements as there can be no assurance that the plans, intentions or expectations they are based on will occur. By their nature, forward-looking statements involve numerous assumptions, known and unknown, risks and uncertainties, both general and specific that contributes to the possibility that although the predictions, forecasts, projections and other forward-looking statements are reasonable, there can be no assurance that such expectations will prove to be correct. Some of the risks and other factors which could cause results to differ materially from those expressed in the forward-looking statements contained in the presentation include general economics, business and market conditions; volatility of energy prices; fluctuations in interest rates; energy supply and demand; competition, access to future funding, timing and amount of capital expenditures, imprecision in estimated future productive*

*capacity, well productivity, operating cost adjustments; cost overruns; and such other risks and uncertainties described from time to time. Existing or potential investors are cautioned that the foregoing list of important factors is not exhaustive. Furthermore, the forward-looking statements contained in this document are made as of the date this report. The forward-looking statements contained herein are expressly qualified by this cautionary statement.*

*This management discussion and analysis is dated as at August 26, 2009.*

## Overview

	Three months ended			Six months ended		
	2009	2008	June 30, %	2009	2008	June 30, %
<i>(\$000s, except share amounts)</i>						
Petroleum and natural gas sales	<b>3,798</b>	6,326	(40)	<b>7,124</b>	9,733	(27)
Royalties	<b>(347)</b>	(803)	(131)	<b>(754)</b>	(1,269)	(41)
Lease operating costs	<b>(2,355)</b>	(1,558)	51	<b>(4,318)</b>	(2,388)	81
Transportation	<b>(106)</b>	(77)	38	<b>(205)</b>	(131)	56
<b>Operating netback<sup>(2)</sup></b>	<b>990</b>	3,888	(75)	<b>1,847</b>	5,945	(69)
Realized loss on financial derivatives	<b>(120)</b>	(211)	(43)	<b>(120)</b>	(211)	(43)
General and administrative	<b>(552)</b>	(922)	(40)	<b>(1,186)</b>	(1,291)	(8)
Financing expenses	<b>(345)</b>	(159)	117	<b>(594)</b>	(230)	158
Asset retirement expenditures	<b>(37)</b>	-	-	<b>(38)</b>	-	-
<b>Funds from operations<sup>(1)</sup></b>	<b>(64)</b>	2,596	(98)	<b>(91)</b>	4,213	(102)
Unrealized loss on financial derivatives	<b>(1,479)</b>	(494)	199	<b>(1,479)</b>	(494)	199
Depletion, depreciation and accretion	<b>(2,321)</b>	(1,558)	49	<b>(4,504)</b>	(2,618)	72
Future income taxes	-	-	-	<b>394</b>	-	-
Accretion of convertible debenture	-	-	-	-	(13)	-
Stock-based compensation	<b>(311)</b>	(282)	10	<b>(624)</b>	(446)	(39)
Asset retirement expenditures	<b>37</b>	-	-	<b>38</b>	-	-
<b>Net income (loss) before non-controlling interest</b>	<b>(4,138)</b>	262	(1,679)	<b>(6,266)</b>	642	(1,076)
Non-controlling interest in loss of Milagro	-	34	-	-	34	-
<b>Net income (loss) and comprehensive income (loss)</b>	<b>(4,138)</b>	296	(1,498)	<b>(6,266)</b>	676	(1,027)
Cash flow per share:						
Basic (\$)	<b>0.02</b>	(0.02)	200	<b>0.03</b>	0.03	-
Diluted (\$)	<b>0.02</b>	(0.02)	200	<b>0.03</b>	0.03	-
Funds from operations per share <sup>(1)</sup> :						
Basic (\$)	-	0.09	-	-	0.16	-
Diluted (\$)	-	0.09	-	-	0.15	-
Net income (loss) and comprehensive income (loss) per share:						
Basic (\$)	<b>(0.11)</b>	0.01	(1,200)	<b>(0.18)</b>	0.03	(700)
Diluted (\$)	<b>(0.11)</b>	0.01	(1,200)	<b>(0.18)</b>	0.02	(1,000)
Average number of shares outstanding (000s):						
Basic	<b>37,052</b>	28,564	30	<b>35,403</b>	25,978	36
Diluted	<b>37,052</b>	30,105	23	<b>35,403</b>	28,347	25

(1) Funds from operations is a non-GAAP measure that does not have a standardized meaning as prescribed by GAAP and is therefore unlikely to be comparable to similar measures presented by other oil and gas companies. We consider it an important measure as it demonstrates our ability to generate the cash flow necessary to fund future growth through capital investment.

(2) Operating netback is a non GAAP measure that does not have a standardized meaning as prescribed by GAAP. We consider it an important measure as it demonstrates our ability to generate the cash flow necessary to fund future growth through capital investment.

As of the reporting date of August 26, 2009, Second Wave had 47,807,340 shares outstanding.

	Three months ended June 30,			Six months ended June 30,		
	2009	2008	% Change	2009	2008	% Change
<i>(\$000s)</i>						
Cash flow from (used in) operating activities (GAAP)	<b>916</b>	(651)	241	<b>1,239</b>	789	57
Change in non-cash working capital (GAAP)	<b>(980)</b>	3,247	(130)	<b>(1,330)</b>	3,424	(139)
Funds from operations (non-GAAP)	<b>(64)</b>	2,596	(102)	<b>(91)</b>	4,213	(102)

**Cash flow from operating activities, Funds from Operations, and Net Income (Loss) and Comprehensive Net Income (Loss)**

<i>(\$000s, except per share)</i>	Three months ended			Six months ended		
	2009	2008	June 30, %	2009	2008	June 30, %
			Change			Change
<b>Cash flow from (used in) operating activities</b>	<b>916</b>	(651)	240	<b>1,239</b>	789	57
Per share:						
Basic (\$)	<b>0.02</b>	(0.02)	200	<b>0.04</b>	0.03	33
Diluted (\$)	<b>0.02</b>	(0.02)	200	<b>0.04</b>	0.03	33

Cash flow from (used in) operating activities for the three months ended June 30, 2009 totalled \$916,000, compared to \$(651,000) for the same period in 2008. This increase is primarily due to changes in non cash working capital during the period.

For the six months ended June 30, 2009, cash flow from operating activities were \$1,239,000, compared to \$789,000 for the same period of 2008.

<i>(\$000s, except per share)</i>	Three months ended			Six months ended		
	2009	2008	June 30, %	2009	2008	June 30, %
			Change			Change
<b>Funds from operations<sup>(1)</sup></b>	<b>(64)</b>	2,596	(102)	<b>(91)</b>	4,213	(102)
Per share:						
Basic (\$)	-	0.09	-	-	0.16	-
Diluted (\$)	-	0.09	-	-	0.16	-

<sup>(1)</sup> Funds from operations is a non-GAAP measure that does not have a standardized meaning as prescribed by GAAP and is therefore unlikely to be comparable to similar measures presented by other oil and gas companies. Management considers it an important measure as it demonstrates the Company's ability to generate the cash flow necessary to fund future growth through capital investment.

Funds from operations for the three months ended June 30, 2009 totalled \$(64,000), compared to \$2,596,000 for the same period in 2008. This decrease is primarily due to significantly lower commodity pricing.

For the six months ended June 30, 2009, funds from operations were \$(91,000), compared to \$4,213,000 for the same period of 2008.

<i>(\$000s, except per share)</i>	Three months ended			Six months ended		
	2009	2008	June 30, %	2009	2008	June 30, %
			Change			Change
<b>Net income (loss) and comprehensive income (loss)</b>	<b>(4,138)</b>	296	(1,679)	<b>(6,266)</b>	676	(1,076)
Per share:						
Basic (\$)	<b>(0.11)</b>	0.01	(1,200)	<b>(0.18)</b>	0.03	(700)
Diluted (\$)	<b>(0.11)</b>	0.01	(1,200)	<b>(0.18)</b>	0.02	(1,000)

Net loss and comprehensive loss for the three month period ended June 30, 2009 was \$(4,138,000) or \$(0.11) per share compared to a net income and comprehensive income of \$296,000, or \$0.01 per share, for the same period in 2008. Almost all metrics were lower during the three months ended June 30, 2009 due to continued depressed commodity prices.

For the six months ended June 30, 2009, net loss and comprehensive loss was \$(6,266,000) or \$(0.18) per share, compared to the net income and comprehensive income for the first half of 2008 of \$676,000 or \$0.03 per share.

## Petroleum and natural gas sales

Sales volumes		Three months ended			Six months ended		
		2009	2008	June 30, %	2009	2008	June 30, %
Crude oil	<i>bbl/d</i>	<b>509</b>	408	25	<b>510</b>	368	39
Natural gas liquids	<i>bbl/d</i>	<b>38</b>	40	(5)	<b>36</b>	31	16
Natural gas	<i>mcf/d</i>	<b>2,637</b>	2,012	31	<b>2,605</b>	1,466	78
Combined (6:1)	<i>boe/d</i>	<b>987</b>	783	26	<b>979</b>	643	52
<b>Commodity weighting (%)</b>							
Oil and liquids		<b>55</b>	57	(3)	<b>56</b>	62	(10)
Natural gas		<b>45</b>	43	5	<b>44</b>	38	16
Total		<b>100</b>	100	-	<b>100</b>	100	-

Sales volumes, on a boe basis, averaged 987 boe per day during the second quarter of 2009, up 26% from the 783 boe per day average in the second quarter of 2008. The increase in sales volumes for both liquids and natural gas is a result of the acquisition of producing properties and successful capital expenditure programs.

Offsetting the impacts of increased production as a result of capital expenditures included a reduction of the Company's 100/12-16-083-12W6 Bear Canyon well when it experienced increased water to gas ratios and was shut-in in May 2009. This Bear Canyon well produced an average of 29 net boe/d (100% gas) to the Company during the first quarter of 2009. The Company anticipates that this well will remain shut-in until natural gas pricing the commodity price environment significantly improves.

Crude oil sales volumes increased 25% to 509 bbl/d in the three months ended June 30, 2009 from 408 bbl/d for the same period in 2008.

Natural gas liquids ("NGL") sales volumes decreased 5% during the second quarter of 2009 as compared to same period in 2008.

Natural gas sales volumes increased 31% to 2,637 mcf/d during the three months ended June 30, 2009 from 2,012 mcf/d for the same period in 2008.

For the first half of the year, sales volumes averaged 979 boe/d, an increase of 52% from the 643 boe/d achieved in the comparable period of 2008.

The Company continues to have a greater percentage of our production derived from oil as apposed to natural gas. Given the current low commodity price environment for natural gas, the Company expects that all drilling operations will target oil prospects.

Revenues (\$000s)	Three months ended			Six months ended		
	2009	2008	June 30, %	2009	2008	June 30, %
Crude oil	<b>2,791</b>	4,241	(34)	<b>4,853</b>	6,823	(29)
Natural gas liquids	<b>161</b>	300	(46)	<b>285</b>	442	(36)
Natural gas	<b>846</b>	1,785	(53)	<b>1,986</b>	2,468	(20)
Total oil and gas	<b>3,798</b>	6,326	(40)	<b>7,124</b>	9,733	(27)

Gross revenue from the sale of petroleum and natural gas in the second quarter of 2009 totaled \$3,798,000 down by 40% from the same quarter last year. Although production volumes were higher this year, lower commodity prices resulted in lower gross revenues.

Crude oil revenue decreased 34% to \$2,791,000 in the three months ended June 30, 2009 from \$4,241,000 in the same period of 2008.

Natural gas liquids revenue dropped 46% to \$161,000 in the three months ended June 30, 2008 from \$300,000 in the same period of 2008.

Overall natural gas sales were \$846,000 for the three months ended June 30, 2009, 53% lower than the \$1,785,000 received in the second quarter of 2008.

For the first half of the year, sales revenues were \$7,124,000, a decrease of 27% from the \$9,733,000 received in the comparable period of 2008.

### Financial derivatives

The Company does not enter into financial derivative contracts of a speculative nature. The Company will from time to time enter into financial derivative contracts to mitigate commodity price risk as a measure to protect its cash flow. During the second quarter of 2009, the Company entered into certain fixed price crude oil and natural gas contracts. As at June 30, 2009, the summary of contracts and their respective fair market values based on third party estimates are as follows:

Daily quantity	Term of contract	Price	Fair market value
<b>Oil (bbls)</b>			
300	May 1, 2009 – December 31, 2009	Fixed per bbl (WTI) CDN\$66.65	\$ (1,038,393)
300	January 1, 2010 – March 31, 2010	CDN\$71.85	(374,437)
<b>Gas (GJs)</b>			
		Fixed per GJ (AECO Monthly)	
1,200	June 1, 2009 – October 31, 2009	CDN\$3.38	(1,907)
1,200	November 1, 2009 – March 31, 2010	CDN\$5.16	(35,272)
600	April 1, 2010 – October 31, 2010	CDN\$5.42	(29,233)
<b>Total</b>			<b>\$ (1,479,242)</b>

Commodity pricing experienced since entering into the contracts has been volatile. For the one month period subsequent to June 30, 2009, the aggregate unrealized and realized losses on the contracts decreased by 46% to \$849,000 from \$1,600,000 (resulting in net gains of \$751,000 for the month of July 2009). Irrespective of this one month gain subsequent to June 30, 2009, commodity pricing has continued to be volatile, therefore there can be no assurances as to the ultimate outcome to be derived in the future from these contracts.

Average Sales Prices <sup>(1)</sup>		Three months ended			Six months ended		
		2009	2008	June 30, %	2009	2008	June 30, %
Oil	\$/bbl	<b>60.26</b>	114.49	(47)	<b>52.62</b>	101.72	(48)
Natural gas liquids	\$/bbl	<b>46.37</b>	81.67	(43)	<b>44.27</b>	79.45	(44)
Natural gas	\$/mcf	<b>3.52</b>	9.75	(64)	<b>4.21</b>	9.25	(54)
Combined (6:1)	\$/boe	<b>42.30</b>	88.82	(52)	<b>40.19</b>	83.12	(52)

(1) Average sales prices do not include the impact of hedging activities

Benchmark Pricing	Three months ended			Six months ended		
	2009	2008	June 30, %	2009	2008	June 30, %
WTI crude oil (US\$/bbl)	<b>59.62</b>	123.95	(52)	<b>51.35</b>	110.91	(54)
WTI crude oil (Cdn\$/bbl)	<b>69.59</b>	124.81	(44)	<b>61.94</b>	112.02	(45)
AECO natural gas (Cdn\$/mcf) <sup>(1)</sup>	<b>3.27</b>	9.44	(65)	<b>3.97</b>	8.32	(52)
Exchange rate (US\$/Cdn\$)	<b>1.1672</b>	1.0070	16	<b>1.2062</b>	1.0100	19

(1) The AECO natural gas price reported is the average daily spot price

The overall average price received from sale of oil and gas products in the second quarter of 2009 was down 52%, to \$42.30/boe, from the \$88.82/boe received during the second quarter last year.

During the third quarter of 2008 commodity prices commenced a steep decline and currently remain at significantly lower levels than the average pricing levels of 2008. As a result, based upon the current market conditions the Company expects its revenue will continue to be negatively impacted during the remainder of 2009.

## Royalties

(\$000s)	Three months ended			Six months ended		
	2009	2008	June 30, %	2009	2008	June 30, %
Crown royalties	85	468	(82)	245	739	(67)
Freehold	212	238	(11)	448	398	13
Gross overriding	50	97	(48)	61	132	(54)
Total	347	803	(57)	754	1,269	(41)
Per boe <sup>(1)</sup>	3.86	11.28	(66)	4.25	10.84	(61)
As % of oil and gas revenues	9%	13%	(31)	11%	13%	(15)

(1) Royalties per boe is a non GAAP measure that does not have a standardized meaning as prescribed by GAAP. Management considers it an important measure as it provides supplemental disclosure of the Company's performance on one of its important costs.

Total royalties decreased significantly in the second quarter of 2009, totaling \$347,000 versus \$803,000 in the same period of 2008. Royalties as a percentage of working interest revenues amounted to 9% during the second quarter of 2009, compared to 13% during the same quarter last year. The absolute dollar decrease in royalties is attributed mainly to the lower commodity price environment experienced during 2009 and an annual GCA credit adjustment of \$80,000.

On October 25, 2007, the Alberta government released a report entitled "The New Royalty Framework" (the "NRF") containing the government's proposals for Alberta's new royalty regime, which became the foundation for the *Mines and Minerals (New Royalty Framework) Amendment Act, 2008*. The Royalty Framework and applicable new legislation became effective on January 1, 2009, and establishes new increased royalty rates for petroleum and natural gas in Alberta.

Implementation of the NRF had a negligible impact on Second Wave's existing production due to low levels of commodity pricing and individual low well productivity.

In response to a drop in commodity prices, and lower industry activity, on November 19, 2008, the Alberta government introduced a new 5 year transitional royalty regime with the objective of promoting the drilling of new wells. Under this program companies drilling new oil and natural gas wells (between 1,000 and 3,500 meters deep) will be given a one-time option, on a well by well basis, to adopt either the new transitional royalty rates until January 1, 2014 (at which time the royalties revert to the "NRF") or those outlined in the Royalty Framework. Wells qualifying for this program must be drilled during the period commencing on November 19, 2008 until December 31, 2013.

On March 3, 2009, the Alberta government announced a three-point incentive program to encourage additional activity in the oil and gas sector, of which only the first two aspects are relevant to oil and gas producers; i) drilling royalty credit, ii) new well incentive program, iii) reclamation and abandonment program for old well sites. A drilling royalty credit will offer \$200 in royalty credits per meter drilled on new conventional oil and natural gas wells spud and rig released between April 1, 2009 and April 1, 2010. The new well incentive program will reduce the royalty to a maximum 5% rate on any wellbore that has not produced between January 1 and April 1, 2009 for the period of the earlier of: i) the production of 50,000 barrels of oil production, ii) 500 million cubic feet (MMcfe) of gas production, or iii) 12 calendar months. Once this incentive expires, royalties will be based on either the transitional royalty rates or the NRF rates, as applicable.

The Company drilled 3 gross (3 net) wells in Alberta during the first quarter of 2009, all of which were successful and all of which did not commence production until subsequent to April 1, 2009. As a result, the Company expects to benefit from the 5% royalty rate on these wells. The Company intends to elect these wells to qualify for the transitional royalty regime.

Subsequent to the end of the second quarter, the Company drilled 1 gross (1 net) successful well on Alberta crown lands and will be eligible for both the 5% crown royalty rate and the drilling incentive credit.

The Company is expects that the Alberta Government will pass the announced incentive programs into law prior to year end.

### Lease Operating Costs

<i>(\$000s, except per boe)</i>	<b>Three months ended</b>			<b>Six months ended</b>		
	<b>2009</b>	2008	June 30, %	<b>2009</b>	2008	June 30, %
Lease operating costs	<b>2,355</b>	1,558	51	<b>4,318</b>	2,388	81
Per boe (\$) <sup>(1)</sup>	<b>26.24</b>	21.88	20	<b>24.36</b>	20.39	19

(1) Lease operating cost per boe is a non GAAP measure that does not have a standardized meaning as prescribed by GAAP. Management considers it an important measure as it provides supplemental disclosure of the Company's performance on one of its important costs.

Total lease operating costs increased 51% from \$1,558,000 in the second quarter of last year to \$2,355,000 in the second quarter of 2009. The absolute dollar increase is primarily due to the acquisition of Milagro adding additional volumes with higher average operating costs. The overall operating expenses in the quarter were additionally impacted by the repair and maintenance costs incurred at the Judy Creek and Battle Creek facilities. In Judy Creek and Battle Creek the Company expended \$200,000 (\$2.25 per boe corporately) in the current quarter for maintenance on equipment and processing facilities at its 100% working interest oil batteries and gas processing plants. These repair and maintenance costs are anticipated to occur every three to four years or as operating conditions dictate. In addition the Company recognized \$215,000 (\$2.42 per boe corporately) in the quarter for property taxes. In the absence of the above mentioned turnaround costs and property taxes the Company's operating costs have remained relatively static from the first quarter of 2009.

On a boe basis, total operating costs increased 20% in the three months ended June 30, 2009 to \$26.24 per boe from \$21.88 per boe in the same period of 2008 primarily due to the additional properties having a higher average operating cost and additional repairs and maintenance work completed in the quarter.

When comparing the second quarter of 2009 to the first quarter of 2009, total operating costs per quarter have increased by \$393,000 or 20%. During the second quarter the Company completed a substantial amount of work on its Judy Creek and Battle Creek facilities in preparation for its upcoming drilling activities in each area. Historically both properties have been burdened by operating costs significantly higher than the corporate average as the production facilities have been substantially underutilized. In 2009, Second Wave has been focusing its capital activities in these two areas and in particular the Company has increased its average production in Judy Creek from 29 boe/d in Q1, to 101 boe/d in Q2, with additional volumes coming on stream in the third quarter from the Company's capital program. In Battle Creek, the Company has delayed capital activities in this field until late in the third quarter due to weak commodity prices and as such area operating costs will remain high until additional production volumes are added.

For the six month period ended June 30, 2009 and 2008, lease operating costs increased by 81% from the comparable period of 2008. On a boe basis, lease operating costs increased 19% from 2008, due to the amount of repairs and maintenance and workovers required on the acquired properties.

## Transportation

(\$000s, except per boe)	Three months ended			Six months ended		
	2009	2008	June 30, %	2009	2008	June 30, %
Transportation	106	77	38	205	131	56
Per boe (\$) <sup>(1)</sup>	1.18	1.08	9	1.16	1.12	4

<sup>(1)</sup> Transportation costs per boe is a non GAAP measure that does not have a standardized meaning as prescribed by GAAP. Management considers it an important measure as it provides supplemental disclosure of the Company's performance on one of its costs.

Transportation costs for the three months ended June 30, 2009 amounted to \$106,000 with the transportation costs for the comparative period in 2008, amounting to \$77,000.

On a boe basis, transportation costs increased 9% in the three months ended June 30, 2009 to \$1.18 per boe from \$1.08 per boe in the same period of 2008. The increase in absolute amount is a result of increased volumes due to acquisitions and production from capital expenditures.

For the six months ended June 30, 2009 and 2008, transportation costs were \$205,000 and \$131,000 respectively.

## Operating Netback

(\$/boe)	Three months ended			Six months ended		
	2009	2008	June 30, %	2009	2008	June 30, %
Petroleum and natural gas sales	42.30	88.82	(52)	40.19	83.12	(52)
Royalties	(3.86)	(11.28)	(66)	(4.25)	(10.84)	(61)
Lease operating costs	(26.24)	(21.88)	20	(24.36)	(20.39)	19
Transportation	(1.18)	(1.08)	9	(1.16)	(1.12)	4
Operating netback <sup>(1)</sup>	11.02	54.58	(80)	10.42	50.77	(79)

<sup>(1)</sup> Operating netback is a non GAAP measure that does not have a standardized meaning as prescribed by GAAP. Management considers it an important measure as it demonstrates the Company's ability to generate the cash flow necessary to fund future growth through capital investment.

Operating netbacks were significantly lower for the three and six months ended June 30, 2009, when compared to the prior year period, due mainly to the decrease in commodity prices and higher operating costs mainly due to repairs and maintenance.

## General and Administrative ("G&A")

(\$000s, except per boe)	Three months ended			Six Months ended		
	2009	2008	June 30, %	2009	2008	June 30, %
G&A expenses	709	1,027	(31)	1,515	1,526	-
Capitalized G&A expenses	(157)	(105)	50	(329)	(235)	40
Net G&A expenses	552	922	(40)	1,186	1,291	(8)
Per boe (\$) <sup>(1)</sup>	6.15	12.94	(52)	6.69	11.03	(39)

<sup>(1)</sup> G&A per boe is a non GAAP measure that does not have a standardized meaning as prescribed by GAAP. Management considers it an important measure as it provides supplemental disclosure of the Company's performance on one of its important costs.

General and administrative expenses, net of capitalized G&A, decreased 40% in the current quarter, to \$552,000 from \$922,000 in the same period last year. Aggregate G&A costs decreased 31% mainly due to severance and restructuring costs incurred in the comparative period. On a boe basis, general and administrative expenses, net of capitalized G&A, were 52% lower in the comparative quarter due mainly to the increase in production volumes.

G&A costs per unit typically trended downward throughout 2008 from \$8.08/boe in the first quarter, \$12.94/boe in the second quarter, \$9.62/boe in the third quarter, and \$4.97/boe in the fourth quarter. Although the Company's G&A per boe has decreased when compared with 2008, due to the drop in commodity prices, the Company has taken initiatives to further reduce its G&A levels in 2009. Subsequent to year end the Company has reduced the number of employees as its capital program has been reduced due to commodity prices. Additional G&A expenses such as software rentals and consultants have also been reduced in 2009 to match reductions in the Company's capital program. Management continues to monitor G&A expenses and will continue to make adjustments as required. As a result of these initiatives, the Company's gross G&A expenses decreased by \$97,000 or 12% from the first quarter of 2009.

General and administrative expenses of \$157,000 were capitalized during the second quarter of 2009 (2008 – \$105,000).

For the six months ended June 30, 2009, general and administrative expenses, net of capitalized G&A, decreased 8% from those of the comparative period last year, however on a per boe basis the decrease was 39%.

### Stock-Based Compensation

Stock-based compensation expense, net of capitalized stock-based compensation, for the three months ended June 30, 2009 was \$312,000, as compared to \$282,000 in the comparative period of 2008. The increase in stock-based compensation expense is due to the overall increase in personnel and stock option grants. Stock-based compensation expenses of \$137,000 were capitalized during the quarter (2008 – \$117,000).

For the six months ended June 30, 2009 and 2008, stock-based compensation expense, net of capitalized stock-based compensation, was \$624,000 and \$446,000 respectively. Stock-based compensation expenses of \$137,000 were capitalized during the six months ended June 30, 2009 (2008 – \$217,000). The lower level of capitalized stock-based compensation in 2009 for the period is a result of a recovery of previously capitalized stock based compensation for forfeited options during the first quarter of 2009.

### Financing Expenses

<i>(\$000s, except per boe)</i>	Three months ended			Six months ended		
	2009	2008	June 30, %	2009	2008	June 30, %
Interest on current portion of debt	308	79	290	441	119	271
Interest on convertible debenture	-	-	-	-	31	-
Interest on long term portion of debt	35	80	(56)	152	80	90
<b>Total financing expenses</b>	<b>344</b>	<b>159</b>	<b>116</b>	<b>594</b>	<b>230</b>	<b>158</b>
<b>Per boe (\$)</b>	<b>3.84</b>	<b>2.23</b>	<b>72</b>	<b>3.35</b>	<b>1.97</b>	<b>70</b>

Financing expenses increased by 116% from \$159,000 in 2008 to \$344,000 in the second quarter of 2009 mainly as a result of increased levels of debt during the quarter in 2009 as compared to the prior year.

Given the global credit crisis and the higher borrowing costs charged by lenders, our borrowing costs are expected to increase in 2009. Although the bank's prime lending rate is currently 2.5%, down from approximately 5.25% at this time last year, the increase in rate premiums offsets the drop in prime interest rates. As Company debt levels are higher than they were at this time in 2008, we expect an aggregate increase in financing costs. Recent amendments to the Company's financing arrangements with its senior lender results in an expected annualized borrowing rate of approximately 6.3% for the majority of the Company's debt.

For the six months ended June 30, 2009, financing expenses increased by 158% to \$594,000 as compared with \$230,000 in 2008.

## Depletion, Depreciation and Accretion

<i>(\$000s, except per boe)</i>	Three months ended			Six months ended		
	2009	2008	June 30, %	2009	2008	June 30, %
			Change			Change
Depletion	2,200	1,473	49	4,263	2,484	72
Depreciation	3	4	(25)	7	8	(13)
Accretion of asset retirement obligations	118	81	46	234	126	86
<b>Total</b>	<b>2,321</b>	<b>1,558</b>	<b>49</b>	<b>4,504</b>	<b>2,618</b>	<b>72</b>
Per boe <sup>1</sup> (\$)	25.85	21.88	18	25.41	22.36	14

(1) Depletion, depreciation and accretion per boe is a non GAAP measure that does not have a standardized meaning as prescribed by GAAP. Management considers it an important measure as it provides supplemental disclosure of the Company's performance on one of its important non cash costs.

Depletion, depreciation and accretion expense increased 49% in the second quarter of 2009 to \$2,321,000 from \$1,558,000 in the same period of 2008. This increase in absolute dollar amount is a result of acquisitions and expenditures incurred from Second Wave's development program.

Depletion, depreciation and accretion expense increased 72% in the six month period ended June 30, 2009 to \$4,504,000 from \$2,618,000 in the same period of 2008.

### Accretion of Convertible Debenture

Accretion of convertible debenture was \$NIL during the six months ended June 30, 2009 and \$13,000 during the comparative period in 2008. As the Company entered into a \$4,000,000 convertible debenture on June 30, 2009 no accretion expense was incurred to June 30, 2009, however accretion expense will commence in the third quarter of 2009.

### Income Taxes

The future income tax provision for the three months ended June 30, 2009 was \$Nil, compared to \$Nil in the comparative period of 2008.

The future income tax recovery for the six months ended June 30, 2009 was \$393,500, compared to \$Nil in the comparative period of 2008.

Income taxes are comprised of two components: current and future income taxes. The expected 2009 income tax rate as a percentage of pre-tax income is 29.2%.

## Capital Expenditures

During the quarter ended June 30, 2009, \$1,992,000 (2008 - \$3,953,000), and for the six months ended June 30, 2008 \$6,895,000 (2008 - \$5,479,000) was expended on capital additions as summarized below:

Capital Expenditures (\$000s)	Three months ended June 30, %			Six months ended June 30, %		
	2009	2008	Change	2009	2008	Change
Land and acquisitions	219	409	(46)	321	607	(47)
Geological and geophysical	18	107	(83)	40	128	(69)
Drilling and completion	535	2,467	(78)	3,864	3,556	(9)
Facilities and equipment	1,063	865	23	2,341	948	(147)
Other	-	-	-	-	5	-
Capitalized G&A	157	105	50	329	235	40
Total cash portion	1,992	3,953	(50)	6,895	5,479	26
Non-cash portion						
Capitalized stock-based compensation	137	117	17	137	217	(37)
Asset retirement obligations additions from drilling and acquisitions	65	-	-	65	-	-
Asset retirement obligations reductions from property sales	(31)	-	-	(52)	-	-
Total non-cash	171	117	46	150	217	(31)
Total capital expenditures	2,163	4,070	(48)	7,045	5,696	24

Drilling results	Three months ended June 30, 2009			Six months ended June 30, 2009		
	gross	net	Working interest %	gross	net	Working interest %
Crude oil wells	-	-	-	3	3	100
Natural gas wells	-	-	-	-	-	-
Dry and abandoned	-	-	-	-	-	-
Total wells	-	-	-	3	3	100

Drilling results	Three months ended June 30, 2008,			Six months ended June 30, 2008		
	gross	net	Working interest %	gross	Net	Working interest %
Crude oil wells	1	1	100	1	1	100
Natural gas wells	1	1	100	1	1	100
Dry and abandoned	1	1	100	2	1.65	82.5
Total wells	3	3	100	4	3.65	91

The decrease in capital expenditures in the three months ended June 30, 2009 was the result of a more significant drilling program in 2008 which including the drilling of 3 gross wells (3.0 net) of which included 1.0 (1.0 net) gas well, 1.0 (1.0 net) oil well and 1.0 (1.0 net) D&A well for a 67% success rate, as compared to no drilling in 2009 comparative quarter.

For the six months ended June 30, 2009, Second Wave has drilled 3 gross wells (3 net), which included 3 gross (3 net) oil wells for a 100% success rate, as compared with 4 gross (3.65 net) wells in the 2008 comparative period.

## Liquidity and Capital Resources

The oil and gas business is inherently risky and capital intensive and can require significant capital and cash resources to expand by growing reserves, production and cashflow. Given the nature of the oil and gas business, and the size of Second Wave, it must be able to continue to access capital markets to raise additional monies to grow.

Recent market events, including disruptions in credit markets and other financial systems and the deterioration of global economic conditions have resulted in significant declines in commodity prices. As at June 30, 2009, the Company had a working capital deficiency of \$3,129,307, had drawn \$11,551,345 of the currently available \$21,500,000 on all of its debt facilities, and incurred a net loss in the six months then ended of \$6,266,341. The \$5,500,000 senior term loan is due on September 30, 2009, at which time the senior lender is scheduled to re-determine the borrowing base of the \$12,500,000 revolving facility. As the available lending limits under the facility are based on the senior lender's interpretation of the Company's reserves and future commodity prices, there can be no assurance as to the amount of the facility that will be available as at September 30, 2009. To help manage its liquidity, management continues to monitor additional financing opportunities to fund future prospects and commitments. Based on its current forecasts of production volumes, and commodity pricing, the Company currently expects that sufficient liquidity will be available to meet its obligations in 2009. Further declines in commodity prices could adversely impact the Company's ability to meet its liquidity requirements in 2009.

In addition to the above noted loans the Company also has a related party term loan of \$3,500,000 which matures in May 2010.

The Company is scheduling its capital program in context with current market environment.

To secure adequate capital resources, the Company may raise funds during the year and/or dispose of certain non-core assets. Although the Company has a significant inventory of low risk prospects to develop, in light of the volatility of commodity prices, the impact of the global credit crisis, current market conditions suggest that the sale of equity at a reasonable price in relation to the Company's net asset value could be challenging. Given the current market and expected oversupply of oil and gas properties available for acquisition, we believe that prices seen for asset acquisitions and dispositions will remain depressed for some time. Given these circumstances, as one of management's goals is to increase the size of the Company and cash flows, the Company also intends to continue to evaluate corporate acquisitions and/or mergers.

On June 30, 2009, the Company closed a private placement equity financing for aggregate gross proceeds of \$10,644,000. The financing was comprised of 5,165,000 common and 5,710,000 flow-through shares issued at \$0.90 and \$1.05 per share respectively. The Company's major shareholder subscribed to 4,445,000 common shares for gross proceeds of \$4,000,500. Under terms of the subscription agreement the Company is required to incur and renounce \$5,995,500 of Canadian Exploration Expenditures to the flow through subscribers on or before December 31, 2010 and February 28, 2010 respectively.

On February 17, 2009, the Company closed a private placement equity financing for aggregate gross proceeds of approximately \$3,980,000. A total of 6,015,131 common shares were issued by the Company on a "flow through" basis. The Company's major shareholder subscribed for 5,757,575 flow through shares at \$0.66 per share for proceeds of \$3,800,000 while management subscribed for 257,556 flow through shares at \$0.70 per share for proceeds of \$180,289. Under the terms of the subscription agreement, the Company is required to incur and renounce \$3,800,000 of eligible Canadian Development Expenditures on or before February 28, 2011 and an additional \$180,289 of eligible Canadian Exploration Expenditures on or before December 31, 2010. As at June 30, 2009, the Company incurred the entire amount of its \$180,289 commitment on qualifying Canadian Exploration Expenditures, and the Company incurred approximately \$3,151,000 of its \$3,800,000 commitment on qualifying eligible Canadian Development Expenditures. As a result of drilling in the third quarter of 2009, the Company expects that it has incurred the remaining \$649,000 on eligible Canadian Development Expenditures.

## Quarterly Financial Summary

	2009		2008				2007	
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3
<i>(\$000's except per boe and per share amounts)</i>								
Average production (boe/d)	987	972	1,042	933	783	504	451	244
Petroleum and natural gas sales	3,799	3,325	4,688	7,197	6,326	3,407	2,494	1,120
Royalties	(346)	(408)	(560)	(905)	(871)	(466)	(338)	(197)
Operating expenses	(2,356)	(1,962)	(2,468)	(2,588)	(1,558)	(829)	(1,047)	(246)
Transportation expenses	(107)	(98)	(163)	(90)	(77)	(54)	(50)	(29)
Operating netback	990	857	1,497	3,614	3,820	2,058	1,059	648
Operating netback (per boe) <sup>(1)</sup>	11.02	9.81	15.61	42.10	54.58	44.87	25.51	28.86
Cash flow from operating activities	916	324	2,445	2,545	(651)	1,440	(935)	(470)
Per share - basic	0.03	0.01	0.08	0.05	(0.02)	0.06	(0.07)	(0.05)
Per share - diluted	0.03	0.01	0.08	0.04	(0.02)	0.06	(0.06)	(0.05)
Funds from operations <sup>(2)</sup>	(64)	(27)	1,069	2,249	2,596	1,617	(345)	(446)
Per share - basic	-	-	0.03	0.07	0.09	0.07	(0.03)	(0.06)
Per share - diluted	-	-	0.03	0.07	0.09	0.07	(0.02)	(0.06)
Net income (loss)	(4,138)	(2,128)	(1,587)	665	296	380	(1,640)	(1,102)
Per share - basic	(0.11)	(0.06)	(0.05)	0.02	0.01	0.01	(0.13)	(0.14)
Per share - diluted	(0.11)	(0.06)	(0.05)	0.02	0.01	0.01	(0.11)	(0.10)
Capital expenditures								
Cash	1,992	4,903	7,256	8,920	3,953	1,527	12,627	1,034
Non-cash	171	(21)	334	3,830	22,801	100	80	36
Total	2,163	4,882	7,590	12,750	26,754	1,627	12,707	1,070

<sup>(1)</sup> Operating netback is a non GAAP measure that does not have a standardized meaning as prescribed by GAAP. We consider it an important measure as it demonstrates our ability to generate the cash flow necessary to fund future growth through capital investment.

<sup>(2)</sup> Funds from operations is a non-GAAP measure that does not have a standardized meaning as prescribed by GAAP and is therefore unlikely to be comparable to similar measures presented by other oil and gas companies. We consider it an important measure as it demonstrates our ability to generate the cash flow necessary to fund future growth through capital investment.

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

In 2008, the CICA confirmed that public entities will be required to adopt IFRS in place of Canadian GAAP for interim and annual reporting effective January 1, 2011. The Company continues to monitor, assess and develop its implementation plan for the convergence of Canadian GAAP to IFRS.

Financial Statements of  
Second Wave Petroleum Inc.

Three and Six Months Ended June 30, 2009

Second Wave Petroleum Inc.  
 Balance Sheets  
 (unaudited)

	As at June 30, 2009	As at December 31, 2008
<b>ASSETS</b>		
Current assets:		
Accounts receivable	\$ 1,863,252	\$ 2,341,161
Prepaid expenses	289,366	626,775
	<b>2,152,618</b>	<b>2,967,936</b>
Property and equipment (note 5)	73,454,772	70,680,994
	<b>\$ 75,607,390</b>	<b>\$ 73,648,930</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 5,281,925	\$ 5,278,977
Loans payable (note 6)	11,438,831	15,675,606
Financial derivatives contracts (note 13)	1,479,242	-
	<b>18,199,998</b>	<b>20,954,583</b>
Loans payable (note 6)	-	7,365,205
Convertible debenture (note 7)	3,779,271	-
Asset retirement obligation (note 8)	6,364,932	6,156,862
	<b>28,344,201</b>	<b>34,476,650</b>
Shareholders' equity		
Share capital (note 9)	45,483,127	32,043,284
Warrants (note 9e)	2,931,553	3,199,698
Contributed surplus (note 9f)	5,219,968	4,175,145
Equity component of convertible debenture (note 7)	140,729	-
Deficit	(6,512,188)	(245,847)
	<b>47,263,189</b>	<b>39,172,280</b>
Contingencies and commitments (note 10)		
Future operations (note 15)		
Subsequent events (note 16)		
	<b>\$ 75,607,390</b>	<b>\$ 73,648,930</b>

See accompanying notes to financial statements.

## Second Wave Petroleum Inc.

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

For the three and six months ended June 30, 2009 and 2008

(unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2009	2008	2009	2008
<b>Revenues</b>				
Petroleum and natural gas sales	\$ 3,798,475	\$ 6,325,760	\$ 7,123,815	\$ 9,732,618
Royalties	(346,707)	(803,011)	(754,186)	(1,269,009)
Realized loss on financial derivatives	(120,231)	(211,352)	(120,231)	(211,352)
Unrealized loss on financial derivatives (note 13)	(1,479,242)	(493,544)	(1,479,242)	(493,544)
	<b>1,852,295</b>	<b>4,817,853</b>	<b>4,770,156</b>	<b>7,758,713</b>
<b>Expenses</b>				
Lease operating costs	2,355,288	1,558,358	4,317,550	2,387,635
Transportation	106,027	77,023	204,873	131,193
General and administrative	551,882	921,783	1,186,115	1,291,672
Depletion, depreciation and accretion	2,321,194	1,558,259	4,503,636	2,617,988
Stock-based compensation	311,754	281,516	623,816	445,968
Financing expense	344,501	158,798	594,007	229,853
Accretion of convertible debenture	-	-	-	12,683
	<b>5,990,646</b>	<b>4,555,737</b>	<b>11,429,997</b>	<b>7,116,992</b>
<b>Income (loss) before income taxes</b>	<b>(4,138,351)</b>	262,116	<b>(6,659,841)</b>	641,721
Future income tax recovery	-	-	393,500	-
<b>Income (loss) before non-controlling interest</b>	<b>(4,138,351)</b>	262,116	<b>(6,266,341)</b>	641,721
Non-controlling interest in loss of Milagro	-	34,482	-	34,482
<b>Net income (loss) and comprehensive income (loss)</b>	<b>(4,138,351)</b>	296,598	<b>(6,266,341)</b>	676,203
Deficit – beginning of period	(2,373,837)	(32,623,777)	(245,847)	(33,003,382)
Restatement of stated capital (note 9i)	-	33,003,382	-	33,003,382
<b>Retained earnings (deficit) – end of period</b>	<b>\$ (6,512,188)</b>	<b>\$ 676,203</b>	<b>\$ (6,512,188)</b>	<b>\$ 676,203</b>
<b>Net income (loss) and comprehensive income (loss) per share:</b>				
Basic	\$ (0.11)	\$ 0.01	\$ (0.18)	\$ 0.03
Diluted	\$ (0.11)	\$ 0.01	\$ (0.18)	\$ 0.02
Average number of shares outstanding:				
Basic	37,051,845	28,563,517	35,403,300	25,978,048
Diluted	37,051,845	30,105,191	35,403,300	28,346,828

See accompanying notes to financial statements.

## Second Wave Petroleum Inc.

### Statements of Cash Flow

For the three and six months ended June 30, 2009 and 2008

(unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2009	2008	2009	2008
<b>Cash flow from operating activities:</b>				
Net income (loss)	\$ (4,138,351)	\$ 296,598	\$ (6,266,341)	\$ 676,203
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:				
Depletion, depreciation and accretion	2,321,194	1,558,259	4,503,636	2,617,988
Stock-based compensation	311,754	281,516	623,816	445,968
Unrealized loss on financial derivatives	1,479,242	493,544	1,479,242	493,544
Non-controlling interest in Milagro loss	-	(34,482)	-	(34,482)
Accretion of convertible debenture	-	-	-	12,683
Abandonment costs incurred	(37,672)	-	(37,672)	-
Future income tax recovery	-	-	(393,500)	-
	(63,833)	2,595,435	(90,819)	4,211,904
Change in non-cash working capital (note 12)	979,872	(3,246,536)	1,330,389	(3,422,897)
	916,039	(651,101)	1,239,570	789,007
<b>Cash flow used in investing activities:</b>				
Expenditures on property and equipment	(1,991,885)	(3,952,500)	(6,895,041)	(5,479,582)
Corporate acquisitions (note 4)	-	(487,245)	-	(487,245)
Change in non-cash working capital (note 12)	(2,259,551)	3,770,343	(613,274)	3,126,507
	(4,251,436)	(669,402)	(7,508,315)	(2,840,320)
<b>Cash flow from financing activities:</b>				
Issuance of shares and warrants	10,644,000	10,192,596	14,624,289	15,975,612
Share and warrant issue costs	(734,021)	(286,747)	(753,922)	(297,084)
Exercise of stock options	-	12,337	-	12,337
Loan advances	-	7,500,000	-	7,500,000
Loan repayments	(9,122,504)	(15,491,179)	(7,681,980)	(20,541,931)
Repurchase and cancellation of shares	-	-	(20,793)	-
Change in non-cash working capital (note 12)	147,922	(606,504)	101,151	(597,621)
	935,397	1,320,503	6,268,745	2,051,313
Decrease in cash and cash equivalents	(2,400,000)	-	-	-
Cash and cash equivalents - beginning of period	2,400,000	-	-	-
<b>Cash and cash equivalents - end of period</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>
<b>Supplementary Cash Flow Information</b>				
Interest paid	\$ 427,082	\$ 355,256	\$ 650,327	\$ 415,058

See accompanying notes to financial statements.

# Second Wave Petroleum Inc.

## Notes to the Financial Statements

For the three and six months ended June 30, 2009 and 2008  
(unaudited)

### 1. Nature of business

Second Wave Petroleum Inc. ("Second Wave" or "the Company") is the continuing corporation following the amalgamation of Second Wave and its wholly owned subsidiary, Milagro Energy Inc., under the *Business Corporations Act* (Alberta) on January 1, 2009.

The Company's common shares trade under the symbol "SCS" on the TSX Venture Exchange. The Company is engaged in the acquisition, development and exploration of petroleum and natural gas in Western Canada.

### 2. Basis of Presentation

These interim financial statements have been prepared in accordance with Canadian generally accepted accounting principles and followed the same accounting policies as the audited financial statements for the year ended December 31, 2008, except as disclosed in note 3. Certain information and disclosures normally required to be included in the notes to the annual consolidated financial statements have been omitted or condensed. These interim financial statements should be read in conjunction with the financial statements as at and for the year ended December 31, 2008.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

### 3. Changes in Accounting Policies

#### (a) Changes in accounting policies

On January 1, 2009, the Company adopted the Canadian Institute of Chartered Accountants (CICA) Section 3064, Goodwill and intangible assets. This section clarifies the criteria for the recognition of assets, intangible assets and internally developed intangible assets. Adoption of this new accounting standard did not result in any changes to Second Wave's financial statements.

In January 2009, the CICA issued EIC-173, "Credit Risk and the Fair Value of Financial Assets and Financial Liabilities" which requires the Corporation to consider its own credit risk as well as the credit risk of its counterparty when determining the fair value of financial assets and liabilities, including derivative instruments. The accounting treatments provided in EIC-173 have been applied in the preparation of these financial statements and as required have been applied retrospectively without restatement of prior periods. The adoption of this standard did not have an impact on the financial statements.

## Second Wave Petroleum Inc.

### Notes to the Financial Statements

For the three and six months ended June 30, 2009 and 2008

(unaudited)

### 3. Significant accounting policies (continued)

#### (b) Accounting pronouncements

In June 2009, the CICA issued amendments to the CICA Handbook Section 3862, Financial Instruments – Disclosures. The amendments include enhanced disclosures related to the fair value of financial instruments and the liquidity risk associated with financial instruments. The amendments will be effective for annual financial statements for fiscal years ending after September 30, 2009. The amendments are consistent with recent amendments to financial instrument disclosure standards in IFRS. The Company will include these additional disclosures in its annual financial statements for the year ending December 31, 2009.

In 2008, the CICA confirmed that for public entities International Financial Reporting Standards (“IFRS”) will become Canadian GAAP for interim and annual reporting effective January 1, 2011. The Company continues to monitor, assess and develop its implementation plan for the convergence of Canadian GAAP to IFRS.

#### (c) Reclassifications

Certain amounts from the prior period have been reclassified to conform to the current years presentation.

### 4. Acquisitions

#### Acquisition of Milagro Energy Inc.

During the year ended December 31, 2008, the Company acquired all of the outstanding shares of Milagro Energy Inc. (“Milagro”) for total consideration of \$2,514,294. On May 8, May 23, June 6, June 24, July 16, July 30, and August 28, 2008 the Company acquired 68.8%, 6.2%, 8.4%, 3.0%, 1.9%, 0.6%, 1.7% of the outstanding shares of Milagro respectively for a total of 90.6%. As the offer for Milagro was accepted by the holders of more than 90% of the Milagro shares, on August 29, 2008 the Company immediately exercised its right to acquire the remaining Milagro shares pursuant to the compulsory acquisition provisions of the Business Corporations Act (Alberta).

Under the terms of the agreement, the Company issued a total of 4,995,300 Class A shares and 4,995,300 Class A share purchase warrants for the shares of Milagro tendered into the offer. Each whole warrant was exercisable into one Class A share of the Company at \$0.40 per warrant until they expired on May 8, 2009. As a result of a 1 for 10 share consolidation that occurred on June 25, 2008, the Company issued 499,530 common shares and 499,530 warrants which were exercisable into common shares at \$4.00 per warrant. The acquisition has been recorded using the purchase method and the estimated fair value of the assets and liabilities acquired have been allocated as follows:

## Second Wave Petroleum Inc.

### Notes to the Financial Statements

For the three and six months ended June 30, 2009 and 2008

(unaudited)

#### 4. Acquisitions (continued)

The purchase price consists of:	
Units consisting of 1 share and 1 warrant	\$ 1,684,276
Acquisition costs	830,018
	<hr/>
	\$ 2,514,294
Fair value of assets and liabilities:	
Property and equipment	\$ 26,410,802
Current assets (including cash of \$200,483)	1,356,252
Accounts payable	(3,845,282)
Debt	(17,950,514)
Asset retirement obligation	(3,456,964)
	<hr/>
	\$ 2,514,294

An additional 260,714 Class A shares (26,071 post consolidated common shares) of Second Wave valued at \$73,000 were issued to executive management of Milagro for severance.

Milagro's results are included in the results of the Company subsequent to May 8, 2008 which is the date that it acquired control of Milagro.

#### 5. Property and equipment

June 30, 2009

	Cost	Accumulated Depletion, Depreciation and Amortization	Net Book Value
Petroleum and natural gas properties	\$ 119,628,588	\$ 46,216,884	\$ 73,411,704
Office equipment	131,128	88,060	43,068
	<hr/>	<hr/>	<hr/>
	\$ 119,759,716	\$ 46,304,944	\$ 73,454,772

December 31, 2008

	Cost	Accumulated Depletion, Depreciation and Amortization	Net Book Value
Petroleum and natural gas properties	\$ 112,584,610	\$ 41,953,884	\$ 70,630,726
Office equipment	131,128	80,860	50,268
	<hr/>	<hr/>	<hr/>
	\$ 112,715,738	\$ 42,034,745	\$ 70,680,994

## Second Wave Petroleum Inc.

### Notes to the Financial Statements

For the three and six months ended June 30, 2009 and 2008

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#### 5. Property and equipment (continued)

As at June 30, 2009, \$8,164,590 (December 31, 2008 - \$8,055,232) of undeveloped land costs have been excluded from the depletion base and \$715,000 (December 31, 2008 - \$Nil) of deposits on asset acquisitions. Future development costs of \$7,334,000 (December 31, 2008 - \$7,484,000) were included in the calculation of depletion. In the three and six month periods ended June 30, 2009, \$156,923 and \$329,326 (2008 - \$105,289 and \$234,856) of general and administrative costs and \$136,631 and \$136,631 (2008 - \$117,189 and \$216,804) of stock based compensation have been capitalized.

#### 6. Loans payable

	June 30, 2009	December 31, 2008
Cheques issued in excess of bank balance	\$ 1,301,345	\$ 2,475,606
Revolving operating loan facility (note 6a)	1,195,443	13,200,000
Term loan payable (note 6a)	5,481,806	-
Term loan payable (note 6b)	3,460,237	7,365,205
<b>Balance, end of period</b>	<b>\$ 11,438,831</b>	<b>\$ 23,040,811</b>
Current portion	11,438,831	15,675,606
Long term portion	-	7,365,205
	<b>\$ 11,438,831</b>	<b>\$ 23,040,811</b>

##### (a) Senior revolving operating loan and term facility

On May 7, 2009, the Company executed a commitment letter with its senior lender for a new \$18,000,000 facility. The new facility consists of a \$12,500,000 demand revolving operating line and a \$5,500,000 non-revolving term loan due on September 30, 2009. The revolving line bears interest at the lender's prime rate plus 1.5% while the non-revolving portion bears interest at the lender's prime rate plus 5%. The debt facility has the first security charge on all of the assets of the Company. A re-determination of the borrowing base for the facility will occur on or before September 30, 2009. The facility also included a letter of guarantee posted for potential contingent liabilities in connection with a previous asset acquisition. Upon Court resolution and payment of liabilities as per note 10(a), the letter of guarantee was cancelled in June 2009. Unamortized loan service fees amounting to \$54,557 and \$18,194 were offset against the \$1,250,000 and \$5,500,000 principal amounts of the revolving and term loans outstanding, respectively.

Consistent with terms under Second Wave's previous senior credit facility, Second Wave is required to meet certain covenants including providing certain financial and engineering information on a timely basis. The Company is also required to maintain a 1:1 working capital ratio as defined in the agreement. As at June 30, 2009 the Company was in compliance with its financial debt covenants.

## Second Wave Petroleum Inc.

### Notes to the Financial Statements

For the three and six months ended June 30, 2009 and 2008

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#### 6. Loans payable (continued)

##### (b) Term loan payable

Concurrently with the equity offering that closed on June 30, 2009, the Company issued a \$4,000,000 convertible debenture to its major shareholder to repay an equivalent amount of the \$7,500,000 term loan. The remaining \$3,500,000 term loan is due on May 8, 2010, bears interest at a fixed rate of 7% per annum, and continues to be secured by assets of the Company with the maturity date remaining May 8, 2010. Unamortized loan service fees amounting to \$39,763 was offset against the \$3,500,000 principal amount of the loan outstanding.

Second Wave is required to meet certain covenants including providing certain financial information on a timely basis. The Company is required to maintain a 1:1 working capital ratio as defined in the agreement. As at June 30, 2009 the Company was in compliance with its financial debt covenants.

#### 7. Convertible debenture

The Company classifies convertible debentures as debt with a portion of the proceeds allocated to equity to represent the inherent value of the conversion option. In the event that the debentures are converted into common shares of the Company, the debt and equity components are reclassified into share capital. The debt balance associated with the convertible debentures accretes over time to the amount owing at maturity with the accretion reflected as non-cash interest expense in the statement of operations.

Convertible debenture	June 30, 2009		December 31, 2008	
	Equity Component	Debt Component	Equity Component	Debt Component
Balance, beginning of period	\$ -	\$ -	\$ 506,481	\$ 8,585,844
Conversion of debenture	-	-	(506,481)	(8,493,519)
Transfer of excess of carrying amount of debenture to contributed surplus	-	-	-	(105,008)
Debenture issued	-	3,859,271	-	-
Equity portion	140,729	-	-	-
Issue costs	-	(80,000)	-	-
Accretion of non-cash interest expense	-	-	-	12,683
<b>Balance, end of period</b>	<b>\$ 140,729</b>	<b>\$ 3,779,271</b>	<b>\$ -</b>	<b>\$ -</b>

## Second Wave Petroleum Inc.

### Notes to the Financial Statements

For the three and six months ended June 30, 2009 and 2008

(unaudited)

#### 7. Convertible debenture (continued)

Concurrently with the equity offering that closed on June 30, 2009, the Company issued a \$4,000,000 convertible debenture to its major shareholder to repay \$4,000,000 of a \$7,500,000 term loan due May 8, 2010. The convertible debenture bears interest at a fixed rate of 7% per annum, matures on June 30, 2011, and is convertible at the holder's option into common shares of the Company at a conversion price of \$1.20 per share. The convertible debenture is secured by assets of the Company.

The equity portion of the convertible debenture was calculated using the residual valuation approach, where the liability component is valued and the difference between the proceeds of the debenture and the fair value of the liability is assigned to the equity component. A market interest rate of 9.0% was used in the calculation.

#### 8. Asset retirement obligation

The Company's asset retirement obligations result from net ownership interest in petroleum and natural gas properties. A credit adjusted risk free rate of 9.0% (2008 - 7.5%) and an inflation rate of 2.0% (2008 - 2.0%) were used to calculate the fair value of the asset retirement obligation. Undiscounted estimated cash flow of \$8,226,000 (2008 - \$8,382,000) are required to settle the obligation at estimated dates in the future ranging from 2009 to 2025.

	<b>June 30, 2009</b>	December 31, 2008
Balance, beginning of period	\$ 6,156,862	\$ 2,374,826
Liabilities incurred	64,696	101,238
Liability dispositions	(52,390)	-
Accretion expense	233,436	398,583
Acquired on asset acquisitions	-	57,589
Acquired on business acquisitions	-	3,456,964
Changes in accounting estimates	-	(19,796)
Abandonments	(37,672)	(212,542)
<b>Balance, end of period</b>	<b>\$ 6,364,932</b>	<b>\$ 6,156,862</b>

#### 9. Share capital

(a) Authorized

The authorized share capital consists of an unlimited number of common shares.

## Second Wave Petroleum Inc.

### Notes to the Financial Statements

For the three and six months ended June 30, 2009 and 2008  
(unaudited)

#### 9. Share capital (continued)

##### (b) Issued and outstanding

	June 30, 2009	
Common Shares	Number of Shares	Amount
Balance, beginning of period	30,953,709	\$ 32,043,284
Issued for cash (note 9c)	16,890,131	14,624,289
Share issue costs	-	(753,922)
Future tax effect of flow-through shares	-	(393,500)
Shares repurchased and cancelled under the normal course issuer bid (note 9g)	(36,500)	(37,024)
<b>Balance, end of period</b>	<b>47,807,340</b>	<b>\$ 45,483,127</b>

##### (c) Issued for cash

On June 30, 2009, the Company closed a private placement equity financing for aggregate gross proceeds of \$10,644,000. The financing was comprised of 5,165,000 common and 5,710,000 flow-through shares issued at \$0.90 and \$1.05 per share respectively. The Company's major shareholder subscribed to 4,445,000 common shares for gross proceeds of \$4,000,500. Under terms of the subscription agreement the Company is required to incur and renounce \$5,995,500 of Canadian Exploration Expenditures to the flow through subscribers on or before December 31, 2010.

On February 17, 2009, the Company closed a private placement equity financing for aggregate gross proceeds of \$3,980,289. A total of 6,015,131 common shares were issued by the Company on a "flow through" basis. The Company's major shareholder subscribed for 5,757,575 flow through shares at \$0.66 per share for proceeds of \$3,800,000 while management subscribed for 257,556 flow through shares at \$0.70 per share for proceeds of \$180,289. Under the terms of the subscription agreement the Company is required to incur and renounce to subscribers \$3,800,000 of eligible Canadian Development Expenditures on or before February 28, 2011 and an additional \$180,289 of eligible Canadian Exploration Expenditures on or before December 31, 2010.

##### (d) Stock option plan

The Company has a stock option plan for directors, officers, employees and consultants. The Company may grant up to 10% of the aggregate number of common shares outstanding and no one optionee is permitted to hold more than 5% of the total options granted. Options vest as to one third on each of the first, second and third anniversary dates. All options expire five years from the date of grant.

## Second Wave Petroleum Inc.

### Notes to the Financial Statements

For the three and six months ended June 30, 2009 and 2008

(unaudited)

#### 9. Share capital (continued)

	June 30, 2009		December 31, 2008	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Balance, beginning of period	2,507,500	\$ 2.64	1,267,500	\$ 2.30
Granted	1,587,000	0.69	1,752,500	2.76
Cancelled	(522,500)	2.66	-	-
Exercised	-	-	(10,000)	1.20
Forfeited	(285,000)	2.29	(502,500)	2.20
<b>Balance, end of period</b>	<b>3,287,000</b>	<b>\$ 1.72</b>	<b>2,507,500</b>	<b>\$ 2.64</b>
<b>Exercisable – end of period</b>	<b>611,669</b>	<b>\$ 3.15</b>	<b>380,000</b>	<b>\$ 2.84</b>

June 30, 2009	Options outstanding		Options exercisable	
Exercise Price	Number	Weighted Average Remaining Life (years)	Number	Weighted Average Remaining Life (years)
\$0.46	80,000	4.71	-	-
\$0.70	1,507,000	4.64	-	-
\$2.00	660,000	3.19	353,335	2.95
\$2.40	265,000	3.54	88,334	3.54
\$2.60	190,000	3.66	63,333	3.66
\$2.80	200,000	3.93	66,667	3.93
\$3.33	345,000	4.04	-	-
\$10.00	40,000	2.02	40,000	2.02
	<b>3,287,000</b>		<b>611,669</b>	

The weighted average price per option granted in 2009 was \$0.69 (2008 - \$2.76).

The fair value of options granted during the six month period ended June 30, 2009 was \$462,120 (December 31, 2008 – \$3,426,900), calculated using a risk free rate of 1.95%, dividend yield of 0%, volatility factor of 75%, and expected life of 5 years. The value of the options was recorded as stock based compensation expense, with an offsetting amount to contributed surplus based on the vesting terms. During the three and six months ended June 30, 2009 \$136,631 and \$136,631 (2008 – \$117,189 and \$216,804) of stock based compensation has been capitalized.

## Second Wave Petroleum Inc.

### Notes to the Financial Statements

For the three and six months ended June 30, 2009 and 2008

(unaudited)

#### 9. Share capital (continued)

In February 2009, the Company cancelled all of the 522,500 previously granted and outstanding stock options to all of its non-executive employees, and concurrently granted a total of 392,000 stock options to replace the cancelled options. The cancelled options had exercise prices ranging between \$0.90 and \$3.33 per option, and were replaced with options having an exercise price of \$0.70 per option. For stock based compensation purposes, the cancellation and re-issue of the options was treated as a modification of the existing stock option grants. Accounting treatment for the modification of the previously issued stock options resulted in an additional \$94,070 of stock based compensation expensed over the three year term of the modified stock options.

##### (e) Warrants

	June 30, 2009	
	Number of Warrants	Amount
Balance, beginning of period	3,498,509	\$ 3,199,698
Expiry of warrants	(498,020)	(268,145)
<b>Balance, end of period</b>	<b>3,000,489</b>	<b>\$ 2,931,553</b>

Outstanding Warrant Expiry Table	Number of Warrants	Exercise Price	Warrant Expiry Date
January 2008 private placement	600,489	\$2.00	January 17, 2010
May 2008 private placement	2,400,000	\$3.125	May 8, 2010
	<b>3,000,489</b>	<b>\$2.90</b>	

All warrants issued by the Company have been valued using the Black-Scholes option pricing model calculated using risk free rates of between 3% and 4%, dividend yield of 0%, volatility factor of 75%, and expected life equal to the life of warrant.

On May 8, 2009, all of the remaining 498,020 warrants related to the acquisition of Milagro Energy Inc. expired unexercised.

## Second Wave Petroleum Inc.

### Notes to the Financial Statements

For the three and six months ended June 30, 2009 and 2008

(unaudited)

#### 9. Share capital (continued)

##### (f) Contributed surplus

A summary of changes in the Company's contributed surplus balance for the period ended June 30, 2009 and December 31, 2008 is as follows:

	<b>June 30, 2009</b>	December 31, 2008
Balance, beginning of period	<b>\$ 4,175,145</b>	\$ 1,265,096
Stock based compensation related to fair value of options granted	<b>760,446</b>	1,875,467
Expiry of warrants	<b>268,145</b>	895,014
Shares repurchased and cancelled	<b>16,232</b>	41,226
Stock options exercised	-	(6,666)
Conversion of convertible debenture	-	105,008
<b>Balance, end of period</b>	<b>\$ 5,219,968</b>	\$ 4,175,145

##### (g) Shares repurchased and cancelled

In October 2008, the Company received approval from the TSX Venture Exchange to purchase and cancel up to a maximum of 1,559,000 shares under its normal course issuer bid. The issuer bid terminates on October 6, 2009.

In 2009, the Company purchased and cancelled 36,500 shares for total consideration of \$20,793. The amount was recorded as a \$37,024 reduction to share capital and a \$16,232 increase to contributed surplus.

##### (h) Per share data

The basic weighted average number of shares outstanding during the three and six month periods ended June 30, 2009 was 37,051,845, and 35,403,300 (2008 – 28,563,517 and 25,978,048 respectively).

Diluted weighted average number of shares outstanding during the three and six month periods ended June 30, 2009 was 37,051,845, and 35,403,300 (2008 – 30,105,191 and 28,346,828 respectively). During the periods ended June 30, 2009 all warrants and options would have an anti-dilutive effect on the loss per share as the Company was in a loss position. The dilutive effect of outstanding options and warrants is calculated using the treasury stock method.

##### (i) Reduction of stated capital

On June 24, 2008, shareholders of the Company voted to reduce the Company's stated capital account by \$33,003,382. The reduction of the stated capital was offset by a corresponding elimination of the Company's deficit.

## Second Wave Petroleum Inc.

### Notes to the Financial Statements

For the three and six months ended June 30, 2009 and 2008

(unaudited)

#### 10. Contingencies and commitments

- (a) In connection with an asset acquisition that closed in October 2007, the Company had an outstanding letter of guarantee in the amount of \$320,539 as security for a contingent liability associated with the acquisition. The claim was for entitlement ahead of the Company's acquisition of assets from the receiver. The Trial Justice had found that the Plaintiffs were entitled to the guarantee, however the Company appealed the ruling on the basis that it was inconsistent with current law. The appeal was heard on March 11, 2009 and the Appeal Court's decision was released on May 14, 2009. The Court's decision, was in favor of the Company and resulted in a payment of approximately \$45,800 from the Company to the plaintiffs during the second quarter of 2009.

Subsequent to the end of the second quarter the Plaintiffs have applied for a Motion of Leave to appeal the decision to the Supreme Court of Canada. The Supreme Court will review the facts of the case to determine if it is worthy in the National interest to hear the case. Should the Supreme Court of Canada decide to hear the case, management believes that it is unlikely that the Court will rule in against the Company, therefore no liability has been accrued as at June 30, 2009.

- (b) In connection with a asset acquisition, the Company has committed to acquire certain oil and natural gas assets in 2009 for approximately \$1,315,000. As of June 30, 2009 the Company has a deposit of \$715,000 recorded in property and equipment with a remaining balance of \$600,000 to be paid prior to October 31, 2009.
- (c) In connection with the equity offering that closed on June 30, 2009 (note 9c), the Company is committed to incur \$5,995,500 on qualifying flow through Canadian Exploration Expenditures prior to December 31, 2010.
- (d) In connection with the flow through equity offering in February 2009 (note 9c), the Company was committed to incur a total of \$3,980,289 on qualifying flow through expenditures. As at June 30, 2009, the Company incurred the entire amount of its \$180,289 commitment on qualifying Canadian Exploration Expenditures, and the Company incurred approximately \$3,151,000 of its \$3,800,000 commitment on qualifying eligible Canadian Development Expenditures. The Company has approximately \$649,000 remaining to be incurred on eligible Canadian Development Expenditures prior to February 28, 2011.
- (e) In connection with a flow through equity agreement entered into during 2006, the Company was required under the income tax act to expend amounts renounced to subscribers prior to December 31, 2007. The Company was temporarily delayed and did not complete activities related to \$982,906 of expenditures until February 2008. The Company has advised the Canada Revenue Agency ("CRA"), of the circumstances, paid appropriate interest and penalties and does not intend to re-file. In the event that the CRA reassesses the Company, the Company could be liable for indemnities to flow through subscribers relating to the delayed expenditures for approximately \$383,000.

## Second Wave Petroleum Inc.

### Notes to the Financial Statements

For the three and six months ended June 30, 2009 and 2008

(unaudited)

#### 11. Related party transactions

- (a) During the three and six month periods ended June 30, 2009, the Company incurred \$160,600 and \$252,200 (2008 – \$64,700 and 581,400) for financing expenses paid to the Company's major shareholder.
- (b) During the three and six month periods ended June 30, 2009, the Company incurred \$176,300 and \$764,300 (2008 – \$128,700 and \$128,700) for drilling and well services from companies who are under common control and significant influence by Second Wave's major shareholder.

All transactions have been completed on the basis of general market terms and conditions and have been recorded at exchange amounts.

#### 12. Changes in non-cash working capital

	Three months ended		Six months ended	
	2009	June 30, 2008	2009	June 30, 2008
Decrease (increase) in non-cash working capital				
Accounts receivable	\$ 513,480	\$ (514,978)	\$ 477,909	\$ (597,462)
Prepaid expenses	553,854	157,229	337,409	(272,974)
Accounts payable and accrued liabilities	(2,199,091)	440,446	2,948	(23,575)
Net change in non-cash working capital	\$ (1,131,757)	\$ 82,697	\$ 818,266	\$ (894,011)
Relating to:				
Operations	\$ 979,872	(3,246,536)	\$ 1,330,389	(3,422,897)
Investing	(2,259,551)	3,770,343	(613,274)	3,126,507
Financing	147,922	(606,504)	101,151	(597,621)
	\$ (1,131,757)	82,697	\$ 818,266	(894,011)

#### 13. Financial risk management

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

- a. Credit risk
- b. Liquidity risk
- c. Market risk

## Second Wave Petroleum Inc.

### Notes to the Financial Statements

For the three and six months ended June 30, 2009 and 2008

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#### **13. Financial risk management (continued)**

There have not been any changes to the Company's exposure to risks, or the objectives, policies and processes to manage these risks from December 31, 2008, except as noted below:

##### Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due. The Company's approach to managing liquidity is to ensure that, 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 Company's reputation.

At June 30, 2009, the majority of Second Wave's third party loans payable are on a revolving reserve based credit facility that was reviewed by the senior lender in April 2009. A further review of the borrowing base is scheduled to occur on or before September 30, 2009. The Company also has a \$3,500,000 term loan payable to its major shareholder that matures on May 8, 2010. The Company anticipates that it will be able to meet these obligations.

##### Market risk

Market risk is the risk that changes in market prices, such as changes in foreign exchange rates, commodity prices and interest rates will affect the Company'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.

Second Wave uses financial derivatives to manage market risk. All such transactions are conducted in accordance with the risk management policy that has been approved by the Board of Directors.

##### 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 petroleum and natural gas are impacted not only by the relationship between the Canadian and United States dollar, as outlined below, but also global economic events that dictate the levels of supply and demand. During 2009, the Company has attempted to mitigate commodity price risk through the use of financial derivative contracts as indicated below. If commodity prices were \$1.00 per barrel and \$0.10 per mcf higher with all other variables held constant, net loss for the three and six month periods ended June 30, 2009 would have been \$73,000 and \$146,000 lower respectively, due to higher revenues.

## Second Wave Petroleum Inc.

### Notes to the Financial Statements

For the three and six months ended June 30, 2009 and 2008

(unaudited)

#### 13. Financial risk management (continued)

The Company had the following fixed price crude oil and natural gas contracts outstanding as at June 30, 2009:

Daily quantity	Term of contract	Price	Fair market value
<b>Oil (bbls)</b>		Fixed per bbl (WTI)	
300	May 1, 2009 – December 31, 2009	CDN\$66.65	\$ (1,038,393)
300	January 1, 2010 – March 31, 2010	CDN\$71.85	(374,437)
<b>Gas (GJs)</b>		Fixed per GJ (AECO Monthly)	
1,200	June 1, 2009 – October 31, 2009	CDN\$3.38	(1,907)
1,200	November 1, 2009 – March 31, 2010	CDN\$5.16	(35,272)
600	April 1, 2010 – October 31, 2010	CDN\$5.42	(29,233)
		Total	\$ (1,479,242)

#### 14. 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 shareholders' equity, loans payable, convertible debenture, and working capital which at June 30, 2009 totaled \$67,089,840 (December 31, 2008 – \$64,524,132). 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.

The Company's share capital is not subject to external restrictions, however the operating and loan facility is based on petroleum and natural gas reserves and financial covenants, which are discussed in note 6. The Company has not paid or declared any dividends since the date of incorporation, nor are any contemplated in the foreseeable future.

There have been no significant changes in the Company's objectives, policies and processes around capital.

## Second Wave Petroleum Inc.

### Notes to the Financial Statements

For the three and six months ended June 30, 2009 and 2008

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#### **15. Future operations**

As at June 30, 2009, the Company had a working capital deficiency of \$3,129,307, had drawn \$11,551,345 of the currently available \$21,500,000 on all of its debt facilities, and incurred a net loss in the six months then ended of \$6,266,341. The \$5,500,000 senior term loan is due on September 30, 2009, at which time the senior lender is scheduled to re-determine the borrowing base of the \$12,500,000 revolving facility. As the available lending limits under the facility are based on the senior lender's interpretation of the Company's reserves and future commodity prices, there can be no assurance as to the amount of the facility that will be available as at September 30, 2009. To help manage its liquidity, management continues to monitor additional financing opportunities to fund future prospects and commitments. Based on its current forecasts of production volumes, and commodity pricing, the Company currently expects that sufficient liquidity will be available to meet its obligations in 2009. Further declines in commodity prices could adversely impact the Company's ability to meet its liquidity requirements in 2009.

The accompanying financial statements have been prepared assuming the Company will continue to operate as a going concern which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. The financial statements do not include any adjustments relating to the recoverability and reclassification of recorded asset amounts and the amount and classification of liabilities that might be necessary should the Company be unable to continue as a going concern, and these reclassifications and adjustments could be material.

#### **16. Subsequent events**

On July 21, 2009, the Company granted stock options to certain directors, officers, employees, and consultants to purchase an aggregate of 831,000 shares of the Company at an exercise price of \$0.90 per share.