

## 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 nine months ended September 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 November 27, 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.*

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

- the expected increase in the 2009 exit commodity production rates and related expected downward trend in operating costs on a per boe basis over the next couple of quarters as a result of the fourth quarter 2009 capital program; this is subject to the risk and uncertainty that actual 2009 exit production rates, and related new well operating costs may differ materially from what is currently anticipated.*
- The expected recovery of income taxes during the fourth quarter of 2009 and first quarter of 2010, as a result of renunciations of qualifying expenditures to flow-through subscribers; this is subject to the risk and uncertainty that the Company's corporate tax rate may differ materially from what is currently anticipated.*

*This management discussion and analysis is dated as at November 27, 2009.*

## Overview

	Three months ended September 30,			Nine months ended September 30,		
	2009	2008	% Change	2009	2008	% Change
<i>(\$000s, except share amounts)</i>						
Petroleum and natural gas sales	<b>4,006</b>	7,197	(44)	<b>11,130</b>	16,929	(34)
Royalties	<b>(342)</b>	(905)	(62)	<b>(1,096)</b>	(2,174)	(50)
Lease operating costs	<b>(2,224)</b>	(2,588)	(14)	<b>(6,542)</b>	(4,975)	31
Transportation	<b>(98)</b>	(90)	9	<b>(303)</b>	(211)	44
<b>Operating netback<sup>(2)</sup></b>	<b>1,342</b>	3,614	(63)	<b>3,189</b>	9,559	(67)
Realized loss on financial derivatives	<b>(170)</b>	(162)	5	<b>(290)</b>	(373)	(22)
General and administrative	<b>(500)</b>	(826)	(39)	<b>(1,686)</b>	(2,117)	(20)
Financing expenses	<b>(339)</b>	(249)	36	<b>(933)</b>	(479)	95
Asset retirement expenditures	-	(128)	-	<b>(38)</b>	(128)	(70)
<b>Funds from operations<sup>(1)</sup></b>	<b>333</b>	2,249	(85)	<b>242</b>	6,462	(96)
Unrealized gain (loss) on financial derivatives	<b>945</b>	471	101	<b>(534)</b>	(22)	2,327
Depletion, depreciation and accretion	<b>(2,650)</b>	(1,692)	57	<b>(7,154)</b>	(4,311)	66
Future income taxes	-	-	-	<b>393</b>	-	-
Accretion of convertible debenture	<b>(17)</b>	-	-	<b>(17)</b>	(13)	31
Stock-based compensation	<b>(256)</b>	(504)	(49)	<b>(880)</b>	(950)	(7)
Asset retirement expenditures	-	128	-	<b>38</b>	128	(70)
<b>Net income (loss) before non-controlling interest</b>	<b>(1,645)</b>	652	(352)	<b>(7,912)</b>	1,294	(711)
Non-controlling interest	-	13	-	-	47	-
<b>Net income (loss) and comprehensive income (loss)</b>	<b>(1,645)</b>	665	(347)	<b>(7,912)</b>	1,341	(690)
Funds from operations per share <sup>(1)</sup>						
Basic (\$)	<b>0.01</b>	0.07	(86)	<b>0.01</b>	0.23	(96)
Diluted (\$)	<b>0.01</b>	0.07	(86)	<b>0.01</b>	0.22	(95)
Cash flow from (used in) operating activities per share:						
Basic (\$)	<b>(0.01)</b>	0.08	(113)	<b>0.02</b>	0.12	(83)
Diluted (\$)	<b>(0.01)</b>	0.08	(113)	<b>0.02</b>	0.11	(82)
Net income (loss) and comprehensive income (loss) per share:						
Basic (\$)	<b>(0.03)</b>	0.02	(250)	<b>(0.20)</b>	0.05	(500)
Diluted (\$)	<b>(0.03)</b>	0.02	(250)	<b>(0.20)</b>	0.05	(500)
Average number of shares outstanding (000s):						
Basic	<b>47,807</b>	31,127	54	<b>39,583</b>	27,707	43
Diluted	<b>47,807</b>	32,451	47	<b>39,583</b>	29,553	34

(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 November 27, 2009, Second Wave had 60,287,940 shares outstanding.

	Three months ended September 30,			Nine months ended September 30,		
	2009	2008	% Change	2009	2008	% Change
<i>(\$000s)</i>						
Cash flow from (used in) operating activities (GAAP)	<b>(547)</b>	2,545	(121)	<b>693</b>	3,334	(79)
Change in non-cash working capital (GAAP)	<b>880</b>	(296)	397	<b>(451)</b>	3,128	(114)
Funds from operations (non-GAAP)	<b>333</b>	2,249	(85)	<b>242</b>	6,462	(96)

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

<i>(\$000s, except per share)</i>	Three months ended September 30, %			Nine months ended September 30, %		
	2009	2008	Change	2009	2008	Change
<b>Funds from operations<sup>(1)</sup></b>	<b>333</b>	2,249	(85)	<b>242</b>	6,462	(96)
Per share:						
Basic (\$)	<b>0.01</b>	0.07	(86)	<b>0.01</b>	0.23	(96)
Diluted (\$)	<b>0.01</b>	0.07	(86)	<b>0.01</b>	0.22	(95)
<b>Cash flow from (used in) operating activities</b>	<b>(547)</b>	2,545	(121)	<b>693</b>	3,334	(79)
Per share:						
Basic (\$)	<b>(0.01)</b>	0.08	(113)	<b>0.02</b>	0.12	(83)
Diluted (\$)	<b>(0.01)</b>	0.08	(113)	<b>0.02</b>	0.11	(82)

(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. 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 and cash flow from (used in) operating activities for the three months ended September 30, 2009 decreased significantly as compared with the same period in 2008. These decreases are primarily due to significantly lower commodity pricing in 2009. As a result of the drop in commodity prices, the Company's operating netback decreased from \$3,614,000 during the third quarter of 2008 to \$1,342,000 in the current quarter.

Funds from operations and cash flow from (used in) operating activities for the nine months ended September 30, 2009 also decreased significantly from 2008 levels. These decreases are primarily due to the impact of lower commodity prices on our operations and the changes in non-cash working capital this year when compared to the prior period. Comparative operating netbacks decreased from \$9,559,000 to \$3,189,000 for the comparative nine month periods.

<i>(\$000s, except per share)</i>	Three months ended September 30, %			Nine months ended September 30, %		
	2009	2008	Change	2009	2008	Change
<b>Net income (loss) and comprehensive income (loss)</b>	<b>(1,645)</b>	665	(347)	<b>(7,912)</b>	1,341	(690)
Per share:						
Basic (\$)	<b>(0.03)</b>	0.02	(250)	<b>(0.20)</b>	0.05	(500)
Diluted (\$)	<b>(0.03)</b>	0.02	(250)	<b>(0.20)</b>	0.05	(500)

Net loss and comprehensive loss for the three month period ended September 30, 2009 was \$(1,645,000) or \$(0.03) per share compared to a net income and comprehensive income of \$665,000, or \$0.02 per share, for the same period in 2008. Almost all metrics were lower during the three months ended September 30, 2009 due to lower commodity prices in 2009.

For the nine months ended September 30, 2009, net loss and comprehensive loss was \$(7,912,000) or \$(0.20) per share, compared to the net income and comprehensive income for the comparable nine month period in 2008 of \$1,341,000 or \$0.05 per share.

## Petroleum and natural gas sales

Sales volumes		Three months ended September 30,			Nine months ended September 30,		
		2009	2008	Change %	2009	2008	Change %
Crude oil	<i>bbl/d</i>	<b>499</b>	515	(3)	<b>506</b>	418	21
Natural gas liquids	<i>bbl/d</i>	<b>54</b>	36	50	<b>42</b>	32	31
Natural gas	<i>mcf/d</i>	<b>2,624</b>	2,293	14	<b>2,612</b>	1,743	50
Combined (6:1)	<i>boe/d</i>	<b>990</b>	933	6	<b>993</b>	741	34
<b>Commodity weighting (%)</b>							
Oil and liquids		<b>56</b>	59	(5)	<b>56</b>	61	(8)
Natural gas		<b>44</b>	41	7	<b>44</b>	39	13
Total		<b>100</b>	100	-	<b>100</b>	100	-

Sales volumes averaged 990 boe per day during the third quarter of 2009, up 6% from 933 boe per day average in the third quarter of 2008. The increase in sales volumes for both liquids and natural gas is a result of a successful drilling program in Provost and Judy Creek, capital expenditures on gas conservation initiatives and facility improvements in the Provost and Coronation areas.

The Company has shut-in approximately 160 boe/d in 2009 due to low commodity prices in combination with high processing costs from non-owned facilities. This production is currently shut-in and is expected to remain shut-in until 2010 when commodity pricing is predicted to improve. These volumes have been offset by production gains from the capital expenditure program.

Crude oil sales volumes decreased 3% to 499 bbl/d in the three months ended September 30, 2009 from 515 bbl/d for the same period in 2008.

Natural gas liquids (“NGL”) sales volumes increased 50% during the third quarter of 2009 as compared to same period in 2008.

Natural gas sales volumes increased 14% to 2,624 mcf/d during the three months ended September 30, 2009 from 2,293 mcf/d for the same period in 2008.

For the three quarters ended in 2009, sales volumes averaged 993 boe/d, an increase of 34% from the 741 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 drilling operations will target oil prospects.

Although fourth quarter 2009 average volumes are not expected to be materially different than that of the third quarter average of 2009, the Company has embarked on a significant capital program during the fourth quarter of 2009 in its core areas of Judy Creek and Battle Creek. Subsequent to September 30, 2009, the Company has drilled 6 gross (6 net) wells, comprised of 5 horizontal and 1 vertical wells, with 2 horizontal and 1 vertical well being drilled at Judy Creek. As of November 27, 2009, 6 of the 6 wells have been completed, equipped and have been tied-in for production to Company owned facilities. At Judy Creek we have two acid stimulations to complete, with one currently scheduled in each of the months of December 2009 and January 2010. Due to the timing of the expected production additions, although the fourth quarter average rate it is not expected to be materially different, management is expecting a substantial increase from the third quarter 2008 average to the 2009 exit production rate.

Revenues (\$000s)	Three months ended September 30, %			Nine months ended September 30, %		
	2009	2008	Change	2009	2008	Change
Crude oil	2,992	5,076	(41)	7,845	11,899	(34)
Natural gas liquids	233	310	(25)	518	751	(31)
Natural gas	781	1,811	(57)	2,767	4,279	(35)
Total oil and gas	4,006	7,197	(44)	11,130	16,929	(34)

Gross revenue from the sale of petroleum and natural gas in the third quarter of 2009 totaled \$4,006,000 down by 44% from the same period last year. Although production volumes were slightly higher this year, lower commodity prices resulted in lower gross revenues.

Crude oil revenue decreased 41% to \$2,992,000 in the three months ended September 30, 2009 from \$5,076,000 in the comparable period of 2008.

Natural gas liquids revenue dropped 25% to \$233,000 in the three months ended September 30, 2009 from \$310,000 in the same period of 2008.

Overall natural gas sales were \$781,000 for the three months ended September 30, 2009, 57% lower than the \$1,811,000 received in the third quarter of 2008.

For the first three quarters of the year, sales revenues were \$11,130,000, a decrease of 34% from the \$16,929,000 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 and September 30, 2009, the summary of contracts and their respective remaining fair market values based on third party estimates are as follows:

Daily quantity	Term of contract	Price	Fair market value at June 30, 2009 (liability)/asset	Fair market value at September 30, 2009 (liability)/asset
<b>Oil (bbls)</b>				
		Fixed per bbl (WTI)		
300	May 1, 2009 – December 31, 2009	CDN\$66.65	\$ (1,038,393)	\$ (333,189)
300	January 1, 2010 – March 31, 2010	CDN\$71.85	(374,437)	(151,101)
<b>Gas (GJs)</b>				
		Fixed per GJ (AECO Monthly)		
1,200	June 1, 2009 – October 31, 2009	CDN\$3.38	(1,907)	23,260
1,200	November 1, 2009 – March 31, 2010	CDN\$5.16	(35,272)	(47,449)
600	April 1, 2010 – October 31, 2010	CDN\$5.42	(29,233)	(25,310)
Total			\$ (1,479,242)	\$ (533,789)

Commodity pricing experienced since entering into the contracts has been volatile. Oil pricing has remained strong since entering into the contracts, however forward pricing strips have weakened during the third quarter of 2009. Natural gas pricing continues to remain weak. During the quarter the company recorded \$945,000 of unrealized gains and \$170,000 of realized losses as a result of these contracts. Irrespective of this net quarterly gain 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 September 30,			Nine months ended September 30,		
		2009	2008	Change %	2009	2008	Change %
Oil	<i>\$/bbl</i>	<b>65.20</b>	107.18	(39)	<b>56.80</b>	103.98	(45)
Natural gas liquids	<i>\$/bbl</i>	<b>47.34</b>	92.69	(49)	<b>45.60</b>	84.40	(46)
Natural gas	<i>\$/mcf</i>	<b>3.23</b>	8.58	(62)	<b>3.88</b>	8.96	(57)
Combined (6:1)	<i>\$/boe</i>	<b>43.99</b>	83.82	(48)	<b>41.48</b>	83.41	(50)

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

Benchmark Pricing		Three months ended September 30,			Six months ended September 30,		
		2009	2008	Change %	2009	2008	Change %
WTI crude oil ( <i>US\$/bbl</i> )		<b>68.19</b>	118.21	(42)	<b>57.00</b>	113.34	(50)
WTI crude oil ( <i>Cdn\$/bbl</i> )		<b>74.80</b>	123.15	(39)	<b>66.43</b>	115.45	(43)
AECO natural gas ( <i>Cdn\$/mcf</i> ) <sup>(1)</sup>		<b>2.98</b>	7.81	(62)	<b>4.10</b>	8.72	(53)
Exchange rate ( <i>US\$/Cdn\$</i> )		<b>1.0969</b>	1.0418	5	<b>1.1655</b>	1.0186	14

(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 third quarter of 2009 was down 48%, to \$43.90/boe, from the \$83.82/boe received during the third 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 comparable pricing levels of 2008. As a result, based upon the current market conditions the Company expects its revenue will continue to be impacted by the volatility of the commodity markets during the remainder of 2009.

## Royalties

(\$000s)	Three months ended September 30,			Nine months ended September 30,		
	2009	2008	Change %	2009	2008	Change %
Crown royalties	<b>119</b>	409	(71)	<b>364</b>	1,148	(68)
Freehold	<b>177</b>	416	(57)	<b>625</b>	814	(23)
Gross overriding	<b>46</b>	80	(43)	<b>107</b>	212	(50)
Total	<b>342</b>	905	(62)	<b>1,096</b>	2,174	(50)
Per boe <sup>(1)</sup>	<b>3.75</b>	10.54	(64)	<b>4.08</b>	10.71	(62)
As % of oil and gas revenues	<b>9%</b>	13%	(31)	<b>10%</b>	13%	(23)

(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 third quarter of 2009, totaling \$342,000 versus \$905,000 in the same period of 2008. Royalties as a percentage of working interest revenues amounted to 9% during the third 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, an increase in the monthly gas cost allowance (GCA) and an annual gas cost allowance 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.

During the third quarter and fourth quarter to date, the Company has drilled 1 gross (1 net), and 3 gross (3 net) successful wells on Alberta crown land, respectively. All of these wells will be eligible for both the 5% crown royalty rate and the drilling incentive credit. At this time based on current levels of commodity pricing and sales volumes, Company is not able to fully utilize the drilling incentive credits as the amount of crown royalty payments are currently not sufficient to draw against the amount of drilling credits from the program. The Company will continue to explore its options to utilize the incentive credits through the crown program.

### Lease Operating Costs

(\$000s, except per boe)	Three months ended			Nine months ended		
	2009	2008	Change	2009	2008	Change
Lease operating costs	2,224	2,588	(14)	6,542	4,975	31
Per boe (\$) <sup>(1)</sup>	24.42	30.13	(19)	24.38	24.51	(1)

(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 decreased 14% from \$2,588,000 in the third quarter of last year to \$2,224,000 in 2009. Even though a material reduction in costs occurred on a year over year basis the operating expenses in the quarter were adversely impacted by the Company's Judy Creek and Battle Creek fields. Year to date these fields have accounted for 27% of the Company's operating costs while contributing only 16% of the production. Both of these fields are currently burdened with processing facilities that are underutilized. However in the second half of 2009 virtually all of the Company's capital has been focused in Judy Creek and Battle Creek with 1 (1.0 net) well being drilled in Judy Creek late

in the third quarter and a total of 6 (6.0 net) wells being drilled in Judy Creek and Battle Creek in the fourth quarter. With the increase in capital investment and thus production rates in both Judy Creek and Battle Creek the Company would expect that operating costs will continue to trend downwards over the next couple of quarters.

On a boe basis, total operating costs decreased 19% in the three months ended September 30, 2009 to \$24.42 per boe from \$30.13 per boe in the same period of 2008 primarily due to the success of the Company's optimization programs.

When comparing the third quarter of 2009 to the second quarter of 2009, total operating costs per quarter have decreased by \$131,000 or 6%. During the third 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. Subsequent to the third quarter the Company has drilled 3 (3.0 net) wells in Judy Creek and 3 (3.0) net wells in Battle Creek all of which will be tested and on production by the end of the fourth quarter.

For the nine month period ended September 30, 2009 and 2008, aggregate lease operating costs increased by 31% from the comparable period of 2008. On a boe basis, lease operating costs were consistent with that experienced in 2008.

### Transportation

(\$000s, except per boe)	Three months ended September 30, %			Nine months ended September 30, %		
	2009	2008	Change	2009	2008	Change
Transportation	<b>98</b>	90	9	<b>303</b>	221	37
Per boe (\$) <sup>(1)</sup>	<b>1.08</b>	1.05	3	<b>1.13</b>	1.09	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 have remained at a consistent level on a per boe basis with both the third quarter and year to date amounts as compared with the previous periods.

### Operating Netback

(\$/boe)	Three months ended September 30, %			Nine months ended September 30, %		
	2009	2008	Change	2009	2008	Change
Petroleum and natural gas sales	<b>43.99</b>	83.82	(48)	<b>41.48</b>	83.41	(50)
Royalties	<b>(3.75)</b>	(10.54)	(64)	<b>(4.08)</b>	(10.71)	(62)
Lease operating costs	<b>(24.42)</b>	(30.13)	(19)	<b>(24.38)</b>	(24.51)	(1)
Transportation	<b>(1.08)</b>	(1.05)	3	<b>(1.13)</b>	(1.09)	4
Operating netback <sup>(1)</sup>	<b>14.74</b>	42.10	(65)	<b>11.89</b>	47.10	(75)

<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 both the three and nine months ended September 30, 2009, when compared to the prior year period, due mainly to the decrease in commodity prices.

## General and Administrative (“G&A”)

(\$000s, except per boe)	Three months ended September 30, %			Nine Months ended September 30, %		
	2009	2008	Change	2009	2008	Change
G&A expenses	<b>649</b>	954	(32)	<b>2,165</b>	2,480	(13)
Capitalized G&A expenses	<b>(149)</b>	(128)	16	<b>(469)</b>	(363)	29
Net G&A expenses	<b>500</b>	826	(40)	<b>1,686</b>	2,117	(20)
Per boe (\$) <sup>(1)</sup>	<b>5.49</b>	8.30	(34)	<b>6.28</b>	10.43	(40)

(1) 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 \$500,000 from \$826,000 in the same period last year. Aggregate G&A costs decreased 32% 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 34% lower in the comparative quarter due mainly to the increase in production volumes. The decrease in G&A costs on an absolute and per unit basis was a result of the Company being able to successfully optimization its cost structure in 2009.

General and administrative expenses of \$149,000 were capitalized during the third quarter of 2009 (2008 – \$128,000).

For the nine months ended September 30, 2009, general and administrative expenses, net of capitalized G&A, decreased 20% from those of the comparative period last year, however on a per boe basis the decrease was 40%.

## Stock-Based Compensation

Stock-based compensation expense, net of capitalized stock-based compensation, for the three months ended September 30, 2009 was \$256,000, as compared to \$504,000 in the comparative period of 2008. The decrease in stock-based compensation expense is mainly due to the timing of stock option grants. Stock-based compensation expenses of \$112,000 were capitalized during the quarter (2008 – \$187,000).

For the nine months ended September 30, 2009 and 2008, stock-based compensation expense, net of capitalized stock-based compensation, was \$880,000 and \$950,000 respectively. Stock-based compensation expenses of \$249,000 were capitalized during the nine months ended September 30, 2009 (2008 – \$404,000). 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

(\$000s, except per boe)	Three months ended September 30, %			Nine months ended September 30, %		
	2009	2008	Change	2009	2008	Change
Interest on current portion of debt	<b>258</b>	94	174	<b>700</b>	213	229
Interest on convertible debenture	<b>81</b>	-	-	<b>81</b>	31	161
Interest on long term portion of debt	-	154	-	<b>152</b>	234	(35)
Total financing expenses	<b>339</b>	248	37	<b>933</b>	479	95
Per boe (\$)	<b>3.72</b>	2.89	29	<b>3.48</b>	2.36	47

Financing expenses increased by 37% from \$248,000 in 2008 to \$339,000 in the third 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, Company borrowing costs increased significantly in 2009. Although the bank’s prime lending rate is currently 2.25%, 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 in combination with the equity raised subsequent to September 30, 2009 is expected to reduce finance charges with the senior lender for the remainder of the year.

For the nine months ended September 30, 2009, financing expenses increased by 95% to \$933,000 as compared with \$479,000 in 2008.

### Depletion, Depreciation and Accretion

(\$000s, except per boe)	Three months ended			Nine months ended		
	2009	2008	Change	2009	2008	Change
			%			%
Depletion	<b>2,504</b>	1,569	60	<b>6,768</b>	4,053	67
Depreciation	<b>4</b>	5	(20)	<b>11</b>	13	(15)
Accretion of asset retirement obligations	<b>142</b>	119	19	<b>375</b>	245	53
Total	<b>2,650</b>	1,693	57	<b>7,154</b>	4,311	66
Per boe <sup>1</sup> (\$)	<b>29.10</b>	19.72	48	<b>26.66</b>	21.24	26

(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 48% in the third quarter of 2009 to \$2,650,000 from \$1,693,000 in the same period of 2008. This increase in absolute dollar amount is a result of acquisitions and expenditures incurred from Second Wave's exploration and development program.

Depletion, depreciation and accretion expense increased 26% in the nine month period ended September 30, 2009 to \$7,154,000 from \$4,311,000 in the same period of 2008.

### Accretion of Convertible Debenture

Accretion of convertible debenture was \$18,000 during the nine months ended September 30, 2009 and \$13,000 during the comparative period in 2008.

### Income Taxes

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

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

During the fourth quarter of 2009, Second Wave renounced \$3,980,000 of qualifying expenditures to its flow-through subscribers from its February 2009 flow through equity raise. As a result of this renouncement the Company expects to record an income tax recovery of approximately \$1,150,000 in the fourth quarter of 2009. Further, expected renouncements of qualifying expenditures of \$9,000,000 in the first quarter of 2010 should result in additional income tax recoveries of approximately \$2,600,000 in the first quarter of 2010.

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 September 30, 2009, \$3,846,000 (2008 - \$8,920,000), and for the nine months ended September 30, 2009, \$10,741,000 (2008 - \$14,400,000) was expended on capital additions as summarized below:

Capital Expenditures (\$000s)	Three months ended September 30, %			Nine months ended September 30, %		
	2009	2008	Change	2009	2008	Change
Land and acquisitions	68	3,273	(98)	388	3,880	(90)
Geological and geophysical	51	86	(41)	91	214	(57)
Drilling and completion	3,430	3,311	4	7,476	6,868	9
Facilities and equipment	148	2,120	(930)	2,489	3,068	(19)
Dispositions	-	-	-	(182)	-	-
Other	-	2	-	-	7	-
Capitalized G&A	149	128	16	479	363	32
Total cash portion	3,846	8,920	(57)	10,741	14,400	25
Non-cash portion						
Capitalized stock-based compensation	112	187	40	249	404	(38)
Asset retirement obligations additions from drilling and acquisitions	388	62	526	453	62	631
Asset retirement obligations reductions from property sales	-	-	-	(52)	-	-
Total non-cash	500	249	101	649	466	39
Total capital expenditures	4,346	9,169	(53)	11,390	14,866	23

Drilling results	Three months ended September 30, 2009			Nine months ended September 30, 2009		
	Gross	Net	Working interest %	Gross	Net	Working interest %
Crude oil wells	1	1	100	4	4	100
Natural gas wells	-	-	-	-	-	-
Dry and abandoned	-	-	-	-	-	-
Total wells	1	1	100	4	4	100

Drilling results	Three months ended September 30, 2008,			Nine months ended September 30, 2008		
	Gross	Net	Working interest %	Gross	Net	Working interest %
Crude oil wells	3	3	100	5	5	100
Natural gas wells	-	-	-	-	-	100
Dry and abandoned	1	1	100	3	2.65	82.5
Total wells	4	4	100	8	7.65	91

The decrease in capital expenditures in the three months ended September 30, 2009 was the result of a more significant drilling program in 2008 which including the drilling of 4 gross wells (4 net) of which included 1 (1 net) gas well, 1 (1 net) oil well and 1 (1 net) D&A well for a 67% success rate, as compared to drilling only 1 (1 net) well in the 2009 comparative quarter.

For the nine months ended September 30, 2009, Second Wave has drilled 4 gross wells (4 net), which included 4 gross (4 net) oil wells for a 100% success rate, as compared with 8 gross (7.65 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. Second Wave may continue to access future capital in order to continue the exploration and development of its emerging Judy Creek oil resource play. To continue to fund the development of this prospect, the Company may raise further funds and/or dispose of certain non-core assets.

As at September 30, 2009, the Company had a working capital deficiency of \$2,621,047, had drawn \$15,452,330 of the then available \$21,500,000 on all of its debt facilities, and incurred a net loss in the nine months then ended of \$7,911,611. Effective September 30, 2009 the senior lender re-determined the borrowing base and increased the Company's senior debt facilities from \$18,000,000 to \$20,000,000. The increase in the revolving facility was from \$12,500,000 to \$15,000,000, and the \$5,500,000 senior term loan that was due on September 30, 2009, was replaced with a \$5,000,000 revolving development line. The Company 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 for the next twelve months.

On October 20, 2009, the Company closed an equity financing for gross proceeds of \$18,002,340. The Company issued 10,715,600 common shares at a price of \$1.40 per share and 1,765,000 common shares issued on a flow-through basis at a price of \$1.70 per share. The proceeds of the financing were used to fund ongoing exploration and development programs and to repay a term loan of \$3,500,000 to the Company's major shareholder. Under terms of the subscription agreement the Company is required to incur and renounce \$3,000,500 of Canadian Exploration Expenditures to the flow through subscribers on or before December 31, 2010 and February 28, 2010 respectively.

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 September 30, 2009, the Company has incurred the entire amount of its \$180,289 and \$3,800,000 commitment on qualifying Canadian Exploration Expenditures, and qualifying Canadian Development Expenditures respectively.

### Quarterly Financial Summary

(\$000's except per boe and per share amounts)	2009			2008				2007
	Q3	Q2	Q1	Q4	Q3	Q2	Q1	Q4
Average production (boe/d)	990	987	972	1,042	933	783	504	451
Petroleum and natural gas sales	4,006	3,799	3,325	4,688	7,197	6,326	3,407	2,494
Royalties	(342)	(346)	(408)	(560)	(905)	(871)	(466)	(338)
Operating expenses	(2,224)	(2,356)	(1,962)	(2,468)	(2,588)	(1,558)	(829)	(1,047)
Transportation expenses	(98)	(107)	(98)	(163)	(90)	(77)	(54)	(50)
Operating netback	1,342	990	857	1,497	3,614	3,820	2,058	1,059
Operating netback (per boe) <sup>(1)</sup>	14.74	11.02	9.81	15.61	42.10	54.58	44.87	25.51
Cash flow from operating activities	(547)	916	324	2,445	2,545	(651)	1,440	(935)
Per share - basic	(0.01)	0.03	0.01	0.08	0.05	(0.02)	0.06	(0.07)
Per share - diluted	(0.01)	0.03	0.01	0.08	0.04	(0.02)	0.06	(0.06)
Funds from operations <sup>(2)</sup>	333	(64)	(27)	1,069	2,249	2,596	1,617	(345)
Per share - basic	0.01	-	-	0.03	0.07	0.09	0.07	(0.03)
Per share - diluted	0.01	-	-	0.03	0.07	0.09	0.07	(0.02)
Net income (loss)	(1,645)	(4,138)	(2,128)	(1,587)	665	296	380	(1,640)
Per share - basic	(0.03)	(0.11)	(0.06)	(0.05)	0.02	0.01	0.01	(0.13)
Per share - diluted	(0.03)	(0.11)	(0.06)	(0.05)	0.02	0.01	0.01	(0.11)
Capital expenditures								
Cash	3,846	1,992	4,903	7,256	8,920	3,953	1,527	12,627
Non-cash	500	171	(21)	334	3,830	22,801	100	80
Total	4,346	2,163	4,882	7,590	12,750	26,754	1,627	12,707

<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.

Interim Financial Statements of  
Second Wave Petroleum Inc.

As at and for the Three and Nine Months Ended September 30, 2009

Second Wave Petroleum Inc.  
Balance Sheets  
(unaudited)

	As at September 30, 2009	As at December 31, 2008
<b>ASSETS</b>		
Current assets:		
Accounts receivable	\$ 1,781,394	\$ 2,341,161
Prepaid expenses	273,666	626,775
	<b>2,055,060</b>	<b>2,967,936</b>
Property and equipment (note 5)	<b>75,293,256</b>	70,680,994
	<b>\$ 77,348,316</b>	<b>\$ 73,648,930</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 4,676,107	\$ 5,278,977
Loans payable (note 6)	15,452,330	15,675,606
Financial derivatives contracts (note 13)	533,789	-
	<b>20,662,226</b>	<b>20,954,583</b>
Loans payable (note 6)	-	7,365,205
Convertible debenture (note 7)	3,807,089	-
Asset retirement obligation (note 8)	6,895,084	6,156,862
	<b>31,364,399</b>	<b>34,476,650</b>
Shareholders' equity		
Share capital (note 9)	45,480,675	32,043,284
Warrants (note 9e)	2,931,553	3,199,698
Contributed surplus (note 9f)	5,588,418	4,175,145
Equity component of convertible debenture (note 7)	140,729	-
Deficit	(8,157,458)	(245,847)
	<b>45,983,917</b>	<b>39,172,280</b>
Contingencies and commitments (note 10)		
Subsequent event (note 15)		
	<b>\$ 77,348,316</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 nine months ended September 30, 2009 and 2008

(unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2009	2008	2009	2008
<b>Revenues</b>				
Petroleum and natural gas sales	\$ 4,005,839	\$ 7,196,886	\$ 11,129,654	\$ 16,929,503
Royalties	(341,973)	(905,441)	(1,096,159)	(2,174,450)
Realized loss on financial derivatives	(170,165)	(162,029)	(290,396)	(373,381)
Unrealized gain (loss) on financial derivatives (note 13)	945,453	471,235	(533,789)	(22,309)
	<b>4,439,154</b>	6,600,651	<b>9,209,310</b>	14,359,363
<b>Expenses</b>				
Lease operating	2,224,058	2,587,657	6,541,608	4,975,291
Transportation	97,651	89,894	302,524	221,087
General and administrative	499,969	825,546	1,686,084	2,117,218
Depletion, depreciation and accretion	2,649,896	1,692,677	7,153,532	4,310,665
Stock-based compensation	256,255	504,094	880,071	950,062
Financing	338,859	248,861	932,866	478,714
Accretion of convertible debenture	17,736	-	17,736	12,683
	<b>6,084,424</b>	5,948,729	<b>17,514,421</b>	13,065,720
<b>Income (loss) before income taxes</b>	<b>(1,645,270)</b>	651,922	<b>(8,305,111)</b>	1,293,643
Future income tax recovery	-	-	393,500	-
<b>Income (loss) before non-controlling interest</b>	<b>(1,645,270)</b>	651,922	<b>(7,911,611)</b>	1,293,643
Non-controlling interest	-	12,918	-	47,400
<b>Net income (loss) and comprehensive income (loss)</b>	<b>(1,645,270)</b>	664,840	<b>(7,911,611)</b>	1,341,043
Retained earnings (deficit) – beginning of period	(6,512,188)	676,203	(245,847)	(33,003,382)
Elimination of deficit (note 9i)	-	-	-	33,003,382
<b>Retained earnings (deficit) – end of period</b>	<b>\$ (8,157,458)</b>	\$ 1,341,043	<b>\$ (8,157,458)</b>	\$ 1,341,043
<b>Net income (loss) and comprehensive income (loss) per share:</b>				
Basic	\$ (0.03)	\$ 0.02	\$ (0.20)	\$ 0.05
Diluted	\$ (0.03)	\$ 0.02	\$ (0.20)	\$ 0.05
Average number of shares outstanding:				
Basic	47,807,340	31,126,595	39,583,416	27,706,757
Diluted	47,807,340	32,450,686	39,583,416	29,552,555

See accompanying notes to financial statements.

## Second Wave Petroleum Inc.

### Statements of Cash Flow

For the three and nine months ended September 30, 2009 and 2008

(unaudited)

	Three months ended September 30, 2009		Nine months ended September 30, 2008	
<b>Cash flow from operating activities:</b>				
Net income (loss)	\$ (1,645,270)	\$ 664,840	\$ (7,911,611)	\$ 1,341,043
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:				
Depletion, depreciation and accretion	2,649,896	1,692,677	7,153,532	4,310,665
Stock-based compensation	256,255	504,094	880,071	950,062
Unrealized loss (gain) on financial derivatives	(945,453)	(471,235)	533,789	22,309
Non-controlling interest	-	(12,918)	-	(47,400)
Accretion of convertible debenture	17,736	-	17,736	12,683
Abandonment costs incurred	-	(127,615)	(37,672)	(127,615)
Future income tax recovery	-	-	(393,500)	-
	333,164	2,249,843	242,345	6,461,747
Changes in non-cash working capital (note 12)	(879,953)	295,105	450,436	(3,127,792)
	(546,789)	2,544,948	692,781	3,333,955
<b>Cash flow used in investing activities:</b>				
Expenditures on property and equipment	(3,846,033)	(8,920,394)	(10,923,354)	(14,399,976)
Dispositions of property and equipment	-	-	182,280	-
Corporate acquisitions (note 4)	-	(152,266)	-	(639,511)
Changes in non-cash working capital (note 12)	473,443	1,484,396	(139,831)	4,610,903
	(3,372,590)	(7,588,264)	(10,880,905)	(10,428,584)
<b>Cash flow from financing activities:</b>				
Issuance of shares and warrants	-	44,332	14,624,289	16,019,944
Share and warrant issue costs	(2,452)	-	(756,374)	(297,084)
Exercise of stock options	-	-	-	12,337
Loan and convertible debenture advances	4,023,581	4,628,805	-	7,500,000
Loan repayments	-	-	(3,658,399)	(15,913,126)
Repurchase and cancellation of shares	-	-	(20,793)	-
Changes in non-cash working capital (note 12)	(101,750)	370,179	(599)	(227,442)
	3,919,379	5,043,316	10,188,124	7,094,629
Change in cash and cash equivalents	-	-	-	-
Cash and cash equivalents - beginning of period	-	-	-	-
<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	\$ 282,733	\$ 193,566	\$ 933,060	\$ 608,624

See accompanying notes to financial statements.

# Second Wave Petroleum Inc.

## Notes to the Financial Statements

For the three and nine months ended September 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 nine months ended September 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 Company valued the share consideration given at the average three day trading price surrounding the announcement date, and valued the warrant consideration at its Black Scholes value using a one year term and 75% volatility. 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 nine months ended September 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
	\$	2,514,294
<hr/>		
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)
	\$	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 with the results of the Company subsequent to May 8, 2008 which is the date that it acquired control of Milagro.

#### 5. Property and equipment

September 30, 2009			
	Cost	Accumulated Depletion, Depreciation and Amortization	Net Book Value
Petroleum and natural gas properties	\$123,974,672	\$48,720,884	\$ 75,253,788
Office equipment	131,128	91,660	39,468
	\$124,105,800	\$48,812,544	\$ 75,293,256

  

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
	\$ 112,715,738	\$ 42,034,744	\$ 70,680,994

## Second Wave Petroleum Inc.

### Notes to the Financial Statements

For the three and nine months ended September 30, 2009 and 2008

(unaudited)

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

As at September 30, 2009, \$8,207,664 (December 31, 2008 - \$8,055,232) of undeveloped land costs and \$1,165,000 (December 31, 2008 - \$Nil) of deposits on asset acquisitions have been excluded from the depletion base. Future development costs of \$8,804,000 (December 31, 2008 - \$7,484,000) were included in the calculation of depletion. In the three and nine month periods ended September 30, 2009, \$149,339 and \$478,665 (2008 - \$128,345 and \$363,201) of general and administrative costs and \$112,195 and \$248,825 (2008 - \$187,431 and \$404,236) of stock based compensation have been capitalized.

#### 6. Loans payable

	September 30, 2009	December 31, 2008
Cheques issued in excess of bank balance	\$ 1,118,800	\$ 2,475,606
Revolving operating loan facility (note 6a)	5,361,530	13,200,000
Term loan payable (note 6a)	5,500,000	-
Term loan payable (note 6b)	3,472,000	7,365,205
<b>Balance, end of period</b>	<b>\$ 15,452,330</b>	<b>\$ 23,040,811</b>
Current portion	15,452,330	15,675,606
Long term portion	-	7,365,205
	<b>\$ 15,452,330</b>	<b>\$ 23,040,811</b>

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

On May 7, 2009, the Company entered into an \$18,000,000 facility with its senior lender consisting 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 term loan bore interest at the lender's prime rate plus 5%. The debt facilities have the first security charge on all of the assets of the Company. Unamortized loan service fees amounting to \$38,470 were offset against the \$5,400,000 principal amount of the revolving loan outstanding.

In connection with the September 30, 2009 borrowing base re-determination, on November 4, 2009, the Company entered into a new facility with its senior lender for a total borrowing base of \$20,000,000 that consists of a \$15,000,000 demand revolving operating line and a \$5,000,000 demand revolving development line. The operating line bears interest at the lender's prime rate plus 1.5% while the development line bears interest at the lender's prime rate plus 1.75%. The debt facilities continue to have the first security charge on all of the assets of the Company.

## Second Wave Petroleum Inc.

### Notes to the Financial Statements

For the three and nine months ended September 30, 2009 and 2008

(unaudited)

#### 6. Loans payable (continued)

Consistent with terms under Second Wave's previous senior credit facility, Second Wave is required to meet certain covenants including providing certain financial information on a timely basis. The Company is also required to maintain a working capital ratio of not less than 1:1 as defined in the agreement. As at September 30, 2009 the Company was in compliance with its financial debt covenants.

##### (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 \$28,000 was offset against the \$3,500,000 principal amount of the loan outstanding.

In connection with the equity financing that closed on October 20, 2009, the \$3,500,000 term loan was repaid.

#### 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	September 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	-	4,000,000	-	-
Equity portion	140,729	(140,729)	-	-
Unamortized issue costs	-	(69,918)	-	-
Accretion of non-cash interest expense	-	17,736	-	12,683
<b>Balance, end of period</b>	<b>\$ 140,729</b>	<b>\$ 3,807,089</b>	<b>\$ -</b>	<b>\$ -</b>

## Second Wave Petroleum Inc.

### Notes to the Financial Statements

For the three and nine months ended September 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 Company does not have the right to repay the debenture prior to its maturity, however it can force the early conversion into 3,333,333 common shares if the share price exceeds \$1.80 per share for a thirty day period with a minimum share trading volume. Should the Company force early conversion, it would be required to pay interest to the maturity date of the debenture. The convertible debenture is subordinate to the Company's senior lender and 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 \$8,661,000 (2008 – \$8,209,000) are required to settle the obligation at estimated dates in the future ranging from 2009 to 2025.

	September 30, 2009	December 31, 2008
Balance, beginning of period	\$ 6,156,862	\$ 2,374,826
Liabilities incurred	72,611	101,238
Liability dispositions	(52,390)	-
Accretion	375,732	398,583
Acquired on asset acquisitions	-	57,589
Acquired on business acquisitions	-	3,456,964
Changes in accounting estimates	379,941	(19,796)
Abandonments	(37,672)	(212,542)
<b>Balance, end of period</b>	<b>\$ 6,895,084</b>	<b>\$ 6,156,862</b>

## Second Wave Petroleum Inc.

### Notes to the Financial Statements

For the three and nine months ended September 30, 2009 and 2008

(unaudited)

#### 9. Share capital

(a) Authorized

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

(b) Issued and outstanding

	September 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	-	(756,374)
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>\$ 45,480,675</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 for 4,445,000 common shares representing 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. As at September 30, 2009, all of these expenditures have been incurred.

## Second Wave Petroleum Inc.

### Notes to the Financial Statements

For the three and nine months ended September 30, 2009 and 2008

(unaudited)

#### 9. Share capital (continued)

##### (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.

	September 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	2,418,000	0.76	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>4,118,000</b>	<b>\$ 1.56</b>	<b>2,507,500</b>	<b>\$ 2.64</b>
<b>Exercisable – end of period</b>	<b>726,671</b>	<b>\$ 3.04</b>	<b>380,000</b>	<b>\$ 2.84</b>

September 30, 2009	Options outstanding		Options exercisable	
	Number	Weighted Average Remaining Life (years)	Number	Weighted Average Remaining Life (years)
Exercise Price				
\$0.46	80,000	4.46	-	-
\$0.70	1,507,000	4.39	-	-
\$0.90	831,000	4.81	-	-
\$2.00	660,000	2.94	353,335	2.69
\$2.40	265,000	3.29	88,334	3.29
\$2.60	190,000	3.41	63,333	3.41
\$2.80	200,000	3.67	66,667	3.67
\$3.33	345,000	3.79	115,002	3.79
\$10.00	40,000	1.76	40,000	1.76
	4,118,000		726,671	

The weighted average price per option granted in 2009 was \$0.76 (2008 - \$2.81).

## Second Wave Petroleum Inc.

### Notes to the Financial Statements

For the three and nine months ended September 30, 2009 and 2008

(unaudited)

#### 9. Share capital (continued)

The fair value of options granted during the nine month period ended September 30, 2009 was \$852,684 (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 nine months ended September 30, 2009 \$112,195 and \$248,825 (2008 – \$187,431 and \$404,236) of stock based compensation has been capitalized.

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 which will be expensed over the three year term of the modified stock options.

#### (e) Warrants

	September 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, 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 nine months ended September 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 September 30, 2009 and December 31, 2008 is as follows:

	<b>September 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>1,128,896</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>\$ 5,588,418</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 nine month periods ended September 30, 2009 was 47,807,340, and 39,583,416 (2008 – 31,126,595 and 27,706,757) respectively.

Diluted weighted average number of shares outstanding during the three and nine month periods ended September 30, 2009 was 47,807,340, and 39,583,416 (2008 – 32,450,686 and 29,592,555) respectively. During the periods ended September 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.

## Second Wave Petroleum Inc.

### Notes to the Financial Statements

For the three and nine months ended September 30, 2009 and 2008

(unaudited)

#### 9. Share capital (continued)

- (i) Elimination of deficit

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.

#### 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.

The Plaintiffs applied for a Motion of Leave to appeal the decision to the Supreme Court of Canada, and on November 19, 2009, the Supreme Court denied this application. As a result, this contingency has been eliminated.

- (b) In connection with an asset acquisition, the Company has committed to acquire certain oil and natural gas assets in 2009 for approximately \$1,315,000. As of September 30, 2009 the Company has a deposit of \$1,165,000 recorded in property and equipment with a remaining balance of \$150,000 to be paid prior to October 31, 2009. This acquisition was closed on October 31, 2009.
- (c) In connection with equity offerings closed to date in 2009, the Company is committed to incur \$8,996,000 on qualifying flow through Canadian Exploration Expenditures prior to December 31, 2010.
- (d) 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 nine months ended September 30, 2009 and 2008

(unaudited)

#### 11. Related party transactions

- (a) During the three and nine month periods ended September 30, 2009, the Company incurred \$132,300 and \$884,500 (2008 – \$127,600 and \$709,000) for financing expenses and commitment fees paid to the Company’s major shareholder. As at September 30 2009 and December 31, 2008 no amounts were payable to the Company’s major shareholder.
- (b) During the three and nine month periods ended September 30, 2009, the Company incurred \$545,400 and \$1,309,700 (2008 – \$222,000 and \$350,700) for drilling and well services from companies who are under common control and significant influence by Second Wave’s major shareholder. As at September 30, 2009 and December 31, 2008, amounts payable for related party drilling and well servicing was \$407,700 and \$87,700, respectively.

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 September 30,		Nine months ended September 30,	
	2009	2008	2009	2008
Decrease (increase) in non-cash working capital				
Accounts receivable	\$ 81,858	\$ 621,704	\$ 559,767	\$ (318,625)
Prepaid expenses	15,700	272,194	353,109	(9,253)
Accounts payable and accrued liabilities	(605,818)	1,255,782	(602,870)	1,583,547
Net change in non-cash working capital	\$ (508,260)	\$2,149,680	\$ 310,006	\$1,255,669
Relating to:				
Operating	\$ (879,953)	295,105	\$ 450,436	(3,127,792)
Investing	473,443	1,484,396	(139,831)	4,610,903
Financing	(101,750)	370,179	(599)	(227,442)
	\$ (508,260)	\$2,149,680	\$ 310,006	\$1,255,669

#### 13. Financial risk management

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

- Credit risk
- Liquidity risk
- Market risk

## Second Wave Petroleum Inc.

### Notes to the Financial Statements

For the three and nine months ended September 30, 2009 and 2008

(unaudited)

#### **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 September 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 occurred as at September 30, 2009, with the next review expected to occur prior to May 31, 2010. The Company also has a \$3,500,000 term loan payable to its major shareholder that matures on May 8, 2010. With the completion of the equity financing subsequent to September 30, 2009 (note 16), the Company repaid substantially all of its third party loans at that time and the \$3,500,000 term loan to its major shareholder.

##### 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 nine month periods ended September 30, 2009 would have been \$74,957 and \$220,783 lower respectively, due to higher revenues.

## Second Wave Petroleum Inc.

### Notes to the Financial Statements

For the three and nine months ended September 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 September 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	\$ (333,189)
300	January 1, 2010 – March 31, 2010	CDN\$71.85	(151,101)
<b>Gas (GJs)</b>		Fixed per GJ (AECO Monthly)	
1,200	June 1, 2009 – October 31, 2009	CDN\$3.38	23,260
1,200	November 1, 2009 – March 31, 2010	CDN\$5.16	(47,449)
600	April 1, 2010 – October 31, 2010	CDN\$5.42	(25,310)
		Total	\$ (533,789)

#### 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 September 30, 2009 totaled \$68,398,172 (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.

#### 15. Subsequent event

On October 20, 2009, the Company closed an equity financing for gross proceeds of \$18,002,340. The Company issued 10,715,600 common shares at a price of \$1.40 per share and 1,765,000 common shares issued on a flow-through basis at a price of \$1.70 per share.