

Consolidated Financial Statements of

HIGHPINE OIL & GAS LIMITED

Years ended December 31, 2004 and 2003

MANAGEMENT'S REPORT

Management has prepared the consolidated financial statements in accordance with accounting principles generally accepted in Canada. If alternative accounting methods exist, management has chosen those it deems most appropriate in the circumstances. Financial statements are not precise since they include certain amounts based on estimates and judgments. Management has ensured that the consolidated financial statements are presented fairly in all material respects. Management has also prepared the financial information presented in Management's Discussion and Analysis and ensured that it is consistent with information in the consolidated financial statements.

Highpine Oil & Gas Limited maintains internal accounting and administrative controls designed to provide reasonable assurance that the financial information is relevant, reliable and accurate and that assets are appropriately accounted for and adequately safeguarded.

The Board of Directors is responsible for reviewing and approving the consolidated financial statements and Management's Discussion and Analysis and, primarily through its Audit Committee, ensures that management fulfills its responsibilities for financial reporting.

The Audit Committee is appointed by the Board and is composed of non-management Directors. The Audit Committee has met with management and with the external auditors to discuss internal controls and reporting issues and to satisfy itself that management's responsibilities are properly discharged. It reviews the consolidated financial statements and the external auditors' report. The Audit committee also considers, for review by the Board and approval by shareholders, the engagement or reappointment of external auditors.

KPMG LLP, the external auditors, has audited the consolidated financial statements in accordance with the auditing standards generally accepted in Canada on behalf of the shareholders. KPMG LLP have full and free access to the Audit Committee

(signed) "*A. Gordon Stollery*"
A. Gordon Stollery
President and Chief Executive Officer

(signed) "*Harry D. Cupric*"
Harry D. Cupric
Vice President, Finance and
Chief Financial Officer

Calgary, Canada
April 22, 2005

AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the consolidated balance sheets of Highpine Oil & Gas Limited as at December 31, 2004 and 2003 and the consolidated statements of earnings and retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2004 and 2003 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

(signed) "*KPMG LLP*"
Chartered Accountants

Calgary, Canada
April 22, 2005

HIGHPINE OIL & GAS LIMITED

Consolidated Balance Sheets

December 31, 2004 and 2003

	2004	2003
		(Restated-note 2)
Assets		
Current assets:		
Cash and cash equivalents	\$ -	\$ 537,682
Accounts receivable (note 3)	13,366,408	3,128,001
Debenture receivable (note 5)	-	3,736,697
Prepaid expenses and deposits	658,978	157,835
	<u>14,025,386</u>	<u>7,560,215</u>
Property, plant and equipment (note 4)	134,282,197	36,239,633
Long-term investments, at cost (note 5)	1,000,000	240,000
Goodwill (note 13)	14,081,000	-
	<u>\$163,388,583</u>	<u>\$ 44,039,848</u>

Liabilities and Shareholders' Equity

Current liabilities:		
Accounts payable and accrued liabilities	\$ 28,840,343	\$ 2,302,697
Bank indebtedness (note 8)	34,821,996	-
	<u>63,662,339</u>	<u>2,302,697</u>
Future income taxes (note 6)	20,419,084	6,973,688
Asset retirement obligations (note 9)	1,973,735	377,894
Shareholders' equity:		
Share capital (note 7)	52,829,758	13,455,090
Contributed surplus (note 7)	511,258	114,787
Retained earnings	23,992,409	20,815,692
	<u>77,333,425</u>	<u>34,385,569</u>
Commitments (notes 11 and 12)		
Subsequent events (notes 7 and 14)		
Contingency (note 15)		
	<u>\$163,388,583</u>	<u>\$ 44,039,848</u>

See accompanying notes to consolidated financial statements.

On behalf of the Board:

(signed) "Richard G. Carl" Director

(signed) "Andrew Krusen" Director

HIGHPINE OIL & GAS LIMITED

Consolidated Statements of Earnings and Retained Earnings

Years ended December 31, 2004 and 2003

	2004	2003
		(Restated-note 2)
Revenues:		
Oil and gas revenues	\$ 41,024,339	\$ 16,926,338
Royalties, net of Alberta Royalty Tax Credits	(10,139,791)	(3,108,708)
	30,884,548	13,817,630
Processing and pipeline fees	1,026,236	533,000
	31,910,784	14,350,630
Expenses:		
Operating costs	6,960,424	2,826,287
General and administrative	2,814,796	1,856,417
Depletion, depreciation and accretion	14,887,350	4,876,061
Interest and finance costs	2,296,061	195,152
Stock based compensation (note 7)	396,471	102,450
	27,355,102	9,856,367
Earnings before the undernoted	4,555,682	4,494,263
Other items:		
Interest and dividend income (note 5)	56,191	2,213,688
Gain on sale of investment (note 5)	349,844	17,438,860
	406,035	19,652,548
Earnings before taxes	4,961,717	24,146,811
Taxes (note 6):		
Current	185,000	70,394
Future	1,600,000	4,968,669
	1,785,000	5,039,063
Net earnings	3,176,717	19,107,748
Retained earnings, beginning of year (note 2)	20,815,692	1,707,944
Retained earnings, end of year	\$ 23,992,409	\$ 20,815,692
Net earnings per share (note 7)		
Basic	\$0.20	\$1.32
Diluted	\$0.20	\$1.31

See accompanying notes to consolidated financial statements.

HIGHPINE OIL & GAS LIMITED

Consolidated Statements of Cash Flows

Years ended December 31, 2004 and 2003

	2004	2003
		(Restated-note 2)
Cash provided by (used in):		
Operations:		
Net earnings	\$ 3,176,717	\$ 19,107,748
Items not involving cash:		
Depletion, depreciation and accretion	14,887,350	4,876,061
Gain on sale of investment	(349,844)	(17,438,860)
Future income taxes	1,600,000	4,968,669
Shares issued for services performed	62,500	-
Stock based compensation	396,471	102,450
Funds from operations	19,773,194	11,616,068
Change in non-cash working capital relating to operations (note 10)	(2,940,300)	(2,200,905)
	16,832,894	9,415,163
Financing:		
Common shares issued for cash, net of share issue costs	10,692,000	81,346
Special warrants issued for cash, net of issue costs	27,980,564	-
Increase in bank indebtedness	31,427,996	-
	70,100,560	81,346
Investments:		
Property, plant and equipment additions	(66,106,372)	(24,652,018)
Debenture receivable repayment	3,736,697	-
Proceeds on sale/return of capital on investment	349,844	14,202,163
Long-term investment, at cost	(760,000)	(240,000)
Proceeds on the disposition of property, plant and equipment	4,973,299	1,146,920
Net cash paid on business combination (note 13)	(42,089,000)	-
Change in non-cash working capital relating to investing activities (note 10)	12,424,396	(1,005,837)
	(87,471,136)	(10,548,772)
Decrease in cash and cash equivalents	(537,682)	(1,052,263)
Cash and cash equivalents, beginning of year	537,682	1,589,945
Cash and cash equivalents, end of year	\$ -	\$ 537,682

See accompanying notes to consolidated financial statements.

HIGHPINE OIL & GAS LIMITED

Notes to Consolidated Financial Statements

Years ended December 31, 2004 and 2003

Incorporation:

Highpine Oil & Gas Limited (the "Company") was incorporated under the laws of the Province of Alberta on April 2, 1998. The Company is involved in the exploration, development and production of petroleum and natural gas.

1. Significant accounting policies:

The consolidated financial statements of the Company have been prepared by management in accordance with Canadian generally accepted accounting principles. In the preparation of these financial statements, management has made estimates and assumptions that affect the recorded amounts of certain of the Company's assets, liabilities, revenues and expenses. The most significant estimates relate to the amounts recorded for the depletion and depreciation of property, plant and equipment and the determination of the asset retirement obligations as well as the cost recovery assessment for property, plant and equipment, goodwill and long-term investments. While it is the opinion of management that these consolidated financial statements have been properly prepared within reasonable limits of materiality and within the framework of the significant accounting policies summarized below, actual results could differ from the estimates made.

(a) Basis of presentation:

These consolidated financial statements include the accounts of the Company and its subsidiaries. The Company's investment in Rubicon Energy Corporation, representing a 50% ownership interest, is accounted for as a joint venture and accordingly, the financial statements reflect only the Company's proportionate interest in the assets, liabilities, revenues and expenses of Rubicon Energy Corporation.

Substantially all of the Company's exploration and development activities are conducted jointly with others. Accordingly, the financial statements reflect only the Company's proportionate interest in such activities.

Certain of the comparative figures have been reclassified to conform to the current period's presentation.

(b) Petroleum and natural gas properties:

The Company follows the full cost method of accounting for exploration and development expenditures wherein all costs related to the exploration for and the development of oil and gas reserves are capitalized. These costs include lease acquisition costs, geological and geophysical expenses, carrying charges of unproven properties, costs of drilling and completing wells and oil and gas production equipment. Proceeds received from the disposal of properties are normally credited against accumulated costs unless this would result in a significant change in the depletion rate of in excess of 20%, in which case a gain or loss is computed and reflected in the consolidated statement of earnings.

HIGHPINE OIL & GAS LIMITED

Notes to Consolidated Financial Statements, Page 2

Years ended December 31, 2004 and 2003

1. Significant accounting policies (continued):

(b) Petroleum and natural gas properties (continued):

Depletion of exploration and development costs and depreciation of production equipment are provided on the unit-of-production method based upon estimated proven oil and gas reserves before royalties in each cost centre as determined by independent engineers. For purposes of this calculation, reserves and production of natural gas are converted to common units based on their approximate relative energy content. The cost of acquiring and evaluating unproven properties are initially excluded from the depletion calculation. These properties are assessed periodically for impairment. When proved reserves are assigned or the property is considered to be impaired, the cost of the property or the amount of the impairment is added to the costs subject to depletion.

The Company places a limit on the carrying value of property, plant and equipment and other assets, which may be depleted against revenues of future periods (the "ceiling rest"). The carrying value is assessed to be recoverable when the sum of the undiscounted cash flows expected from the production of proved reserves, the lower of cost and market of unproved properties and the cost of major development projects exceeds the carrying value. When the carrying value is not assessed to be recoverable, an impairment loss is recognized to the extent that the carrying value of assets exceeds the sum of the discounted cash flows expected from the production of proved and probable reserves, the lower of cost and market of unproved properties and the cost of major development projects. The cash flows are estimated using expected future product prices and costs and are discounted using a risk-free interest rate.

(c) Asset retirement obligations:

The Company recognizes the fair value of an Asset Retirement Obligation ("ARO") in the period in which it is incurred when a reasonable estimate of the fair value can be made. The fair value of the estimated ARO is recorded as a liability, with a corresponding increase in the carrying amount of the related asset. The capitalized amount is depleted using the unit-of-production method based on proved reserves. The liability amount is increased each reporting period due to the passage of time and the amount of accretion is expensed to income in the period. Actual costs incurred upon the settlement of the ARO are charged against the ARO.

HIGHPINE OIL & GAS LIMITED

Notes to Consolidated Financial Statements, Page 3

Years ended December 31, 2004 and 2003

1. Significant accounting policies (continued):

(d) Office equipment and computers:

Office equipment and computers are stated at cost. Depreciation is provided for using the declining balance method at 20% per year.

(e) Goodwill:

Goodwill is the residual amount that results when the purchase price of an acquired business exceeds the sum of the amounts allocated to the assets acquired, less liabilities assumed, based on their fair values. Goodwill is not amortized and is tested for impairment annually or more frequently if events or changes in circumstances indicated that the asset might be impaired. The impairment test is carried out in two steps. In the first step, the carrying amount of the segment is compared to its fair value. When the fair value of the segment exceeds its carrying amount, goodwill is considered not to be impaired and the second step of the impairment test is unnecessary. The second step is carried out when the carrying amount of the Company's goodwill exceeds its fair value, in which case the implied fair value of the Company's goodwill is compared with its carrying amount to measure the amount of the impairment loss, if any. The implied fair value of goodwill is determined in the same manner as the value of the goodwill is determined in a business combination using the fair value of the Company as if it were the purchase price. When the carrying amount of the Company's goodwill exceeds the implied fair value of the goodwill, an impairment loss is recognized in an amount equal to the excess.

(f) Long-term investment:

The Company's long-term investment is accounted for by the cost method (see note 5). The net income of this company is reflected in the determination of the net earnings of the Company only to the extent of dividends received.

The carrying value of the Company's long-term investment is periodically reviewed by management to determine if the facts and circumstances suggest that the investment may be impaired. Any impairment identified through this assessment would result in a write-down of the investment and a corresponding charge to earnings.

(g) Revenue recognition:

Revenues associated with sales of crude oil, natural gas and natural gas liquids are recorded when title passes to the customer. Revenues from properties in which the Company has an interest with other producers are recognized on the basis of the Company's net working interest.

HIGHPINE OIL & GAS LIMITED

Notes to Consolidated Financial Statements, Page 4

Years ended December 31, 2004 and 2003

1. Significant accounting policies (continued):

(h) Financial instruments:

The Company may enter into derivative instrument contracts to manage its exposure related to oil and gas prices. The Company does not enter into derivative instrument contracts for trading or speculative purposes. The Company believes that all derivative instruments entered into are effective hedges, both at inception and over the term of the instrument, as the term and notional amount have not and are not expected to exceed the Company's firm commitment or forecasted production. These derivative instrument contracts are recognized in oil and gas revenues and cash flows in the period in which the revenues associated with the hedged transaction are recognized.

(i) Future income taxes:

Income taxes are calculated using the liability method of accounting for income taxes. Under this method, future income tax liabilities and future income tax assets are recorded based on the differences between the carrying amount of assets and liabilities in the consolidated balance sheet and their tax basis using income tax rates substantively enacted at the balance sheet date. The effect of change in rates on future income tax liabilities and assets is recognized in the period in which the change occurs. A valuation allowance is recorded against any future income tax assets if it is more likely than not that the asset will not be realized.

(j) Stock-based compensation:

During the year ended December 31, 2004 the Company retroactively adopted the amended standard with respect to stock-based compensation (see note 2(c)), which requires the use of the fair value method of valuing all stock options granted and other stock-based payments whether they be to employees, directors or non-employees. Under the fair value method, a compensation cost is measured at fair value method for stock options granted at the grant date and expensed over the vesting period with a corresponding increase to contributed surplus. Upon the exercise of the stock options, consideration paid together with the amount previously recognized to contributed surplus is recorded as an increase to share capital.

(k) Flow-through shares:

The tax attributes of expenditures financed by the issuance of flow-through shares are renounced to investors in accordance with income tax legislation. Share capital issued is recorded on the date of issue net of estimated benefits renounced to investors with a corresponding future tax liability for the tax benefits renounced to investors.

(l) Cash equivalents:

The Company considers all highly liquid investments with a maturity of three months or less at the time of purchase to be cash equivalents and therefore classifies them with cash.

HIGHPINE OIL & GAS LIMITED

Notes to Consolidated Financial Statements, Page 5

Years ended December 31, 2004 and 2003

1. Significant accounting policies (continued):

(m) Earnings per share:

Basic net earnings per common share is computed by dividing net earnings from operations by the weighted average number of common shares outstanding for the period. Diluted per share amounts reflect the potential dilution that could occur if securities or other contracts to issue common shares were exercised or converted to common shares. The treasury stock method is used to determine the dilutive effect of stock options and other dilutive instruments. Under the treasury stock method, only options for which the exercise price is less than the market value impact the dilution calculations.

(n) Use of estimates:

The amounts recorded for the depletion and depreciation of petroleum and natural gas properties and for the determination of asset retirement obligations are based on estimates. The ceiling test calculation and the goodwill impairment test are based, in part, on estimates of proved reserves, production rates, oil and natural gas prices, future costs and other relevant assumptions. By their nature, these estimates are subject to measurement uncertainty and the effects of changes in such estimates in future years on financial statements could be significant.

2. Change in accounting policies:

(a) Full cost accounting guideline:

Effective January 1, 2004 the Company adopted the new Canadian accounting guideline for the full cost method of accounting for oil and gas entities. The recoverability of a cost centre is tested by comparing the carrying value of the cost centre to the sum of the undiscounted cash flows expected from the cost centre's use and eventual disposition. If the carrying value is unrecoverable the cost centre is written down to its fair value using the expected present value approach. This approach incorporates risks and uncertainties in the expected future cash flows which are discounted using a risk free rate. The cash flows are estimated using expected future product prices and costs. The adoption of this guideline had no effect on the Company's financial results.

Prior to January 1, 2004, the Company applied a ceiling test to ensure capitalized costs did not exceed the aggregate of the cost of the unproved properties and undiscounted future net revenues of proved reserves at year end commodity prices less future administrative, financing and income tax expenses.

HIGHPINE OIL & GAS LIMITED

Notes to Consolidated Financial Statements, Page 6

Years ended December 31, 2004 and 2003

2. Change in accounting policies (continued):

(b) Asset retirement obligations:

Effective January 1, 2004, the Company retroactively adopted the new standard "Asset Retirement Obligations". This standard requires the recognition of the fair value of obligations associated with the retirement of tangible long-lived assets be recorded in the period the asset is put into use, with a corresponding increase to the carrying amount of the related asset. The obligations recognized are statutory, contractual or legal obligations. The liability is accreted over time and the accretion is included in depletion, depreciation and accretion expense. The costs capitalized to the related assets are amortized to earnings in a manner consistent with the depreciation, depletion and amortization of the underlying asset. Actual costs incurred upon the settlement of asset retirement obligations are charged against the asset retirement obligation. The impact of the adoption on prior periods was as follows:

Consolidated Balance Sheet as at December 31, 2003:

	As Reported	Change	As Restated
Asset:			
Property, plant and equipment	\$35,955,362	\$ 284,271	\$36,239,633
Liabilities and shareholders' equity:			
Future income taxes	6,905,115	68,573	6,973,688
Asset retirement obligations	—	377,894	377,894
Provision for site restoration	274,078	(274,078)	—
Retained earnings	20,703,810	111,882	20,815,692

Consolidated Statement of Earnings and Retained Earnings

	Year ended December 31, 2003		
	As Reported	Change	As Restated
Depletion and depreciation	\$ 4,896,905	\$ (48,836)	\$4,848,069
Accretion	—	27,992	27,992
Depletion, depreciation and accretion	4,896,905	(20,844)	4,876,061
Future income taxes	4,960,748	7,921	4,968,669
Net earnings	19,094,825	12,923	19,107,748

HIGHPINE OIL & GAS LIMITED

Notes to Consolidated Financial Statements, Page 7

Years ended December 31, 2004 and 2003

2. Change in accounting policies (continued):

Prior to January 1, 2004, the Company provided for future site restoration and abandonment costs over the life of the proved reserves on a unit-of-production basis. The charge was recorded in depletion and depreciation expense and the liability was recorded net of actual costs incurred. Had the Company continued to provide for future site restoration and abandonment costs over the life of the proved reserves on a unit-of-production basis, the provision for site restoration for the year ended December 31, 2004 would have been \$301,000, the provision for depletion and depreciation would have been \$15,327,000, future income taxes would have been \$1,646,000 and net earnings would have been \$2,366,000.

(c) Stock-based compensation:

Effective January 1, 2004 the Company retroactively adopted the amended standard with respect to stock-based compensation, which requires the use of the fair value method for valuing all stock options granted whether they be to employees, directors or non-employees. As a result of adopting this amended standard, the Company recognized an expense for all options granted. As such, stock-based compensation expense recorded totalled \$102,450 during the year ended December 31, 2003 with a decrease in net earnings and a corresponding increase in contributed surplus. A decrease in retained earnings of \$12,337 and a corresponding increase in contributed surplus was made relating to compensation expense for the year ended December 31, 2002.

3. Accounts receivable:

As at December 31, 2004 accounts receivable included a loan due from an officer of the Company totalling \$100,000 plus accrued interest of \$17,000 (December 31, 2003 - \$100,000). The loan bears interest at 4.75% compounded annually per annum, is payable on demand and is secured by the pledge of 57,143 Class A common shares of the Company.

HIGHPINE OIL & GAS LIMITED

Notes to Consolidated Financial Statements, Page 8

Years ended December 31, 2004 and 2003

4. Property, plant and equipment:

	Cost	Accumulated depletion and depreciation	Net book value
2004			
Petroleum and natural gas properties	\$ 156,534,374	\$22,438,767	\$ 134,095,607
Office equipment and computers	353,078	166,488	186,590
	\$ 156,887,452	\$22,605,255	\$ 134,282,197
2003			
Petroleum and natural gas properties	\$ 43,816,390	\$ 7,699,398	\$ 36,116,992
Office equipment and computers	242,879	120,238	122,641
	\$ 44,059,269	\$ 7,819,636	\$ 36,239,633

At December 31, 2004, approximately \$13,000,000 (2003 - \$6,400,000) of unproved properties were excluded from the depletion calculation. Future development costs included in the depletion and depreciation calculation totalled \$9,500,000 (2003 - \$3,900,000) at December 31, 2003. During the year ended December 31, 2004 overhead applicable to acquisition, development and exploration activities in the amount of approximately \$295,000 (2003 - \$176,000) was capitalized to petroleum and natural gas properties.

As at December 31, 2004, property, plant and equipment includes \$1,240,000 (December 31, 2003 - \$285,000), net of accumulated depletion related to asset retirement obligations.

The Company performed a ceiling test at December 31, 2004 to assess the recoverable value of property, plant and equipment and other assets. The oil and gas future prices are based on the commodity price forecast of our independent reserve evaluators.

The following table summarizes the benchmark prices used in the ceiling test calculation. The Canadian dollar prices have been adjusted for commodity quality differentials specific to the Company. Based on these assumptions, the undiscounted value of future net revenues from proved reserves exceeded the carrying value of property, plant and equipment at December 31, 2004.

	WTI Oil (\$U.S./bbl)	Foreign exchange rate	Edmonton Light Crude Oil (\$Cdn/bbl)	AECO Gas (\$Cdn/mmbtu)
2005	42.00	0.82	45.72	7.01
2006	40.00	0.82	44.08	6.76
2007	37.50	0.82	41.26	6.46
2008	35.00	0.82	38.45	6.15
2009	33.00	0.82	35.97	5.85
Prices escalate thereafter at approximately 1% to 2% per annum				

HIGHPINE OIL & GAS LIMITED

Notes to Consolidated Financial Statements, Page 9

Years ended December 31, 2004 and 2003

5. Long-term investments:

(a) Investment in In Depth Resources Ltd.:

At December 31, 2004 the Company's long-term investment totalling \$1,000,000 was comprised of 960,000 common shares of In Depth Resources Ltd., a private oil and gas company in which the president of the Company is a director. The investment represents approximately 10% of the outstanding common shares of In Depth Resources Ltd. The Company has a right of first refusal to participate in certain prospects generated by In Depth Resources Ltd. At December 31, 2003 the Company's long-term investment was comprised of 200,000 flow-through common shares of In Depth Resources Ltd., which were acquired during the year ended December 31, 2003 at a cost of \$240,000.

(b) Investment in Monolith Oil Corp.:

During the year ended December 31, 2003, the Company sold its investment in Monolith Oil Corp., a private oil and gas company for a gain totalling \$17,439,000. Consideration received on the disposition of the investment in Monolith Oil Corp. consisted of \$14,202,000 of cash or cash equivalents and a secured debenture totalling \$3,737,000 bearing interest at 9% per annum, payable monthly. The debenture was repaid in its entirety in January 2004. The debenture was secured but subordinate to the purchaser's secured credit facility. During the year ended December 31, 2004, proceeds totalling \$350,000 relating to the sale of its investment in Monolith Oil Corp. resulting from the resolution of various contingent matters was recorded.

During the year ended December 31, 2003, the Company received a dividend of approximately \$2,100,000 from its investment in Monolith Oil Corp.

6. Taxes:

The provision for income taxes differs from the result that would be obtained by applying the combined Canadian Federal and Provincial income tax rate of approximately 38.6% (2003 – 40.6%) to earnings before taxes. The difference results from the following:

	2004	2003
Effective tax rate	38.6%	40.6%
Computed expected income taxes	\$ 1,915,222	\$ 9,808,435
Add (deduct):		
Non-deductible crown payments, net of Alberta Royalty Tax Credits	2,494,261	804,326
Resource allowance	(2,146,359)	(1,053,442)
Non-taxable portion of capital gains	(70,164)	(3,539,029)
Stock-based compensation	153,117	41,000
Capital taxes	185,000	70,394
Change in tax rate	(746,077)	(249,023)
Non-taxable dividend	-	(843,598)

HIGHPINE OIL & GAS LIMITED

Notes to Consolidated Financial Statements, Page 10

Years ended December 31, 2004 and 2003

	\$ 1,785,000	\$ 5,039,063
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HIGHPINE OIL & GAS LIMITED

Notes to Consolidated Financial Statements, Page 11

Years ended December 31, 2004 and 2003

6. Taxes (continued):

The components of the net future income tax liability at December 31, 2004 and 2003 are as follows:

	2004	2003
Future income tax assets:		
Asset retirement obligations	\$ 621,727	\$ 125,000
Attributed royalty income deductible for provincial taxes	234,040	73,283
Share issue and financing costs	648,088	35,000
	<u>1,503,855</u>	<u>233,283</u>
Future income tax liabilities:		
Property, plant and equipment	(21,876,595)	(7,158,227)
Long-term investments	(46,344)	(48,744)
	<u>(21,922,939)</u>	<u>(7,206,971)</u>
Net future income tax liability	<u>\$(20,419,084)</u>	<u>\$(6,973,688)</u>

Corporate tax returns are subject to assessment by Canada Revenue Agency in the normal course of business. The result of any assessments will be accounted for as a charge to net earnings in the period in which they are realized.

7. Share capital:

(a) Authorized:

- (i) an unlimited number of Class A common shares without par value; and
- (ii) an unlimited number of Class B common shares without par value issuable in series. The Class B common shares are non-voting and are not entitled to the receipt of dividends.

HIGHPINE OIL & GAS LIMITED

Notes to Consolidated Financial Statements, Page 12

Years ended December 31, 2004 and 2003

7. Share capital (continued):

(b) Shares issued:

	2004		2003	
	Number	Amount	Number	Amount
Class A common shares:				
Balance, beginning of year	13,195,083	\$13,454,933	11,827,106	\$ 13,365,606
Issued for cash	1,200,000	6,000,000	57,143	100,131
Shares issued for services performed	12,500	62,500	-	-
Conversion of Class B shares	-	-	1,310,834	131
Flow-through shares issued	800,000	4,800,000	-	-
Share issue costs less tax effect of \$37,800	-	(70,200)	-	(10,935)
Balance, end of year	15,207,583	\$24,247,233	13,195,083	\$13,454,933
Class B common shares:				
Balance, beginning of year	1,270,833	157	2,721,667	\$ 288
Issued for cash	-	-	-	-
Conversion of Class B shares	-	-	(1,310,834)	(131)
Cancelled	-	-	(140,000)	-
Balance, end of year	1,270,833	\$ 157	1,270,833	\$ 157
Special Warrants:				
Balance, beginning of year	-	-	-	\$ -
Issued for cash	3,300,000	29,700,000	-	-
Share issue costs less tax effect of \$601,804	-	(1,117,632)	-	-
Balance, end of year	3,300,000	\$28,582,368	-	\$ -
Total		\$52,829,758		\$13,455,090

On February 3, 2005 the Company filed Articles of Amendment to amend the provisions of the series 1 class B shares and as such, the series 1 class B shares were automatically converted into class A common shares on February 4, 2005. On February 15, 2005 the Company declared a stock dividend in the amount of approximately \$6,970,000 which resulted in 0.047 of a class A common share being issued for each issued and outstanding class A common share and each class A common share issuable upon the exercise of each issued and outstanding special warrant. This resulted in the issuance of 774,490 class A common shares at a price of \$9.00 per share.

As at December 31, 2004 the Company had incurred all expenditures required to be committed relating to obligations pursuant to the terms of the flow through shares issued.

HIGHPINE OIL & GAS LIMITED

Notes to Consolidated Financial Statements, Page 13

Years ended December 31, 2004 and 2003

7. Share capital (continued):

On October 20, 2004 the Company issued 3,300,000 special warrants at a price of \$9.00 per special warrant for gross proceeds totalling \$29,700,000. Costs associated with the issuance of the special warrants totalled approximately \$1,719,000 including a commission received by the agent equal to 5.5% of the gross proceeds from the sale of the special warrants for an aggregate fee of approximately \$1,634,000. Each special warrant entitled the holder thereof to acquire 1.047 common shares at no additional cost on that date which is five business days following the date upon which a receipt for the final version of a prospectus is issued by the appropriate securities commissions.

On receipt of the final prospectus 3,455,105 Class A common shares were issued upon the exercise of the special warrants (see note 14).

(c) Per Share Amounts:

Weighted average number of common shares outstanding	2004	2003
Basic	15,994,912	14,465,916
Dilutive effect of options	276,485	97,574
Diluted	16,271,397	14,563,490

(d) Stock options:

The Company has a stock option plan to provide options for directors, officers and employees to purchase Class A common shares of the Company. The stock options are exercisable over six years, with a vesting period over four years.

The following summarizes the options outstanding at December 31, 2004 and 2003:

	2004		2003	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Balance, beginning of year	530,000	\$ 2.84	170,000	\$ 2.60
Granted	1,012,155	6.53	360,000	2.94
Balance, end of year	1,542,155	\$ 5.26	530,000	\$ 2.84
Exercisable, end of year	175,000	\$ 2.78	42,500	\$ 2.60

HIGHPINE OIL & GAS LIMITED

Notes to Consolidated Financial Statements, Page 14

Years ended December 31, 2004 and 2003

7. Share capital (continued):

Range of exercise price	Options outstanding			Options Exercisable	
	Number outstanding December 31, 2004	Weighted average remaining contractual life (years)	Weighted average exercise price	Number exercisable December 31, 2004	Weighted average exercise price
\$ 2.60	345,000	3.8	\$ 2.60	128,750	\$ 2.60
\$ 3.25 - \$3.50	235,000	4.6	3.34	46,250	3.29
\$ 4.50 - \$5.00	535,000	5.4	4.98	-	-
\$ 8.10 - \$9.00	427,155	5.9	8.82	-	-
	1,542,155	5.1	\$ 5.26	175,000	\$ 2.78

The fair value of stock options granted during the year ended December 31, 2004 and December 31, 2003 was estimated using the Black-Scholes option pricing model with the following assumptions:

	2004	2003
Dividend yield	0%	0%
Expected volatility	50%	25%
Risk free rate of return	4.5%	4.5%
Expected option life	4 years	4 years
Weighted average fair market value per option	\$3.48	\$1.00

(e) Contributed surplus:

	2004	2003
Balance, beginning of year	\$ 114,787	\$ 12,337
Stock based compensation expense	396,471	102,450
Balance, end of year	\$ 511,258	\$ 114,787

HIGHPINE OIL & GAS LIMITED

Notes to Consolidated Financial Statements, Page 15

Years ended December 31, 2004 and 2003

8. Bank indebtedness:

At December 31, 2004 the Company had available a revolving demand facility to a maximum of \$35,000,000 (December 31, 2003 - \$12,000,000) and non-revolving demand facility to a maximum of \$11,400,000 (December 31, 2003 - \$nil) with a Chartered Canadian bank. The revolving facility bears interest at the bank's prime rate plus 0.25% per annum and the non-revolving demand facility bears interest at the bank's prime rate plus 3.75% per annum. Any balance outstanding on the non-revolving demand facility is to be repaid by March 31, 2005. As at December 31, 2004, \$23,422,000 (December 31, 2003 - \$nil) was outstanding under the revolving demand facility payable at an interest rate of 4.04% per annum and \$11,400,000 (December 31, 2003 - \$nil) was outstanding under the non-revolving demand facility payable at an interest rate of 5.57% per annum.

The facility is secured by a general security agreement with a floating charge covering land registered in Alberta, British Columbia and Saskatchewan.

9. Asset retirement obligations:

At December 31, 2004, the estimated total undiscounted amount required to settle asset retirement obligations was \$3,100,000 which will be incurred between 2005 and 2025. This amount has been discounted using an annual credit adjusted risk-free interest rate of 8.0 percent per annum and an inflation rate of 2.0 per cent per annum.

Charges to asset retirement obligations were as follows:

	2004	2003
Asset retirement obligations, beginning of year	\$ 377,894	\$ 129,530
Liabilities acquired	950,000	–
Liabilities incurred	1,144,110	220,372
Liabilities disposed of	(600,000)	–
Accretion	101,731	27,992
Asset retirement obligations, end of year	\$ 1,973,735	\$ 377,894

HIGHPINE OIL & GAS LIMITED

Notes to Consolidated Financial Statements, Page 16

Years ended December 31, 2004 and 2003

10. Changes in non-cash working capital:

(a) Changes in non-cash working capital balances:

	2004	2003
Changes in non-cash working capital:		
Accounts receivable	\$ (7,852,799)	\$ 953,482
Prepaid expenses and deposits	(330,017)	5,413
Accounts payable and accrued liabilities	17,666,912	(4,165,637)
	9,484,096	(3,206,742)
Changes in non-cash working capital relating to investing	(12,424,396)	1,005,837
Changes in non-cash working capital relating to operations	\$ (2,940,300)	\$(2,200,905)

(b) Cash payments:

The following cash payments were received (paid):

	2004	2003
Dividends received	\$ -	\$ 2,076,084
Interest received (paid)	(1,651,300)	137,176
Taxes paid	(60,000)	(28,000)

11. Financial Instruments:

(a) Commodity price risk management:

The Company entered into commodity swap agreements during the year ended December 31, 2004. The details of these agreements are as follows:

Commodity	Notional Volumes	Contract Term	Fixed Price
Crude Oil	500 barrels per day	July 1, 2004 to December 31, 2004	CDN \$44.00 per barrel
Crude Oil	700 barrels per day	January 1, 2005 to December 31, 2005	CDN \$47.20 per barrel

The 700 barrel per day crude oil swap agreement had an unrealized loss as at December 31, 2004 of approximately \$1.0 million.

HIGHPINE OIL & GAS LIMITED

Notes to Consolidated Financial Statements, Page 17

Years ended December 31, 2004 and 2003

11. Financial Instruments (continued):

(b) Credit risk:

The Company's accounts receivable are with customers and joint venture partners in the petroleum and natural gas industry and are subject to normal industry credit risks. Purchasers of the Company's natural gas, crude oil and natural gas liquids are subject to an internal credit review to minimize the risk of non-payment. During the year ended December 31, 2004, approximately 85% (December 31, 2003 – 90%) of the Company's oil and gas revenues were sold to three customers.

(c) Fair values:

The carrying values of the Company's financial assets and liabilities, with the exception of the Company's long-term investments (see note 5), approximated their fair values as at December 31, 2004 and 2003. The fair value of the Company's long-term investments was considered undeterminable due to the inability to apply a valuation method or obtain market prices. As noted in note 5, during the year ended December 31, 2003 the Company sold its investment in Monolith for a gain of approximately \$17,439,000.

12. Commitment:

The Company is committed to a lease for office space annually as follows:

2005	\$ 329,000
2006	330,000
2007	340,000
2008	345,000
2009	175,000

13. Acquisition of Rubicon Energy assets:

In March 2004, the Company acquired 50% of the issued and outstanding shares of Rubicon Energy Corporation ("Rubicon"), an oil and gas company. The acquisition was accounted for by the purchase method of accounting with the results of operations included from the date of acquisition. The allocation to the fair value of the assets and liabilities was as follows:

HIGHPINE OIL & GAS LIMITED

Notes to Consolidated Financial Statements, Page 18

Years ended December 31, 2004 and 2003

13. Acquisition of Rubicon Energy assets (continued):

Net assets acquired and liabilities assumed:

Property, plant and equipment	\$ 51,151,000
Goodwill	14,081,000
Working capital deficiency	(6,314,000)
Bank indebtedness	(3,394,000)
Asset retirement obligations	(950,000)
Future income taxes	(12,485,000)
	<hr/>
	\$ 42,089,000

Consideration was comprised of:

Purchase of Rubicon common shares for cash	\$ 41,810,000
Transaction costs	279,000
	<hr/>
	\$ 42,089,000

14. Subsequent events:

(a) Credit facility:

In February 2005 a new banking arrangement was entered into by the Company with Canadian financial institutions. The facilities consisted of a \$45 million revolving term credit facility, a \$10 million demand operating credit facility and a \$25 million non-revolving, non-extendible term credit facility. The \$45 million revolving term facility revolves until May 31, 2005 unless it is extended for a 364-day period. The \$25 million non-revolving, non-extendible term credit facility shall be repaid no later than May 31, 2005. The revolving term credit facility bears interest at the lenders' prime rate plus 0.25% per annum. The non-revolving, non-extendible term credit facility and the demand operating credit facility bears interest at the lenders' prime rate plus 1.75% per annum. The facilities are secured by a general security agreement and a first floating charge over all of the Company's assets.

HIGHPINE OIL & GAS LIMITED

Notes to Consolidated Financial Statements, Page 19

Years ended December 31, 2004 and 2003

14. Subsequent events (continued):

(b) Initial public offering:

Pursuant to an underwriting agreement dated March 24, 2005 between the Company and certain underwriters, the Company sold to the underwriters 4,000,000 common shares at a price of \$18.00 per share for gross proceeds totalling \$72,000,000. Costs associated with the issuance of the common shares are estimated to be approximately \$4,342,200 including the underwriters' fee of \$3,742,200 and other expenses.

On April 5, 2005, common shares distributed pursuant to an initial public offering and the common shares issuable upon exercise of the outstanding special warrants were listed on the Toronto Stock Exchange.

(c) Plan of Arrangement:

On April 6, 2005, the Company announced that it entered into a merger agreement with Vaquero Energy Ltd. ("Vaquero") whereby the Company would acquire all of the issued and outstanding shares of Vaquero pursuant to a Plan of Arrangement to be approved by the Vaquero shareholders no later than June 30, 2005.

Under the Plan of Arrangement, shareholders of Vaquero will receive 0.391 Class A common shares of the Company for each common share of Vaquero held. It is anticipated that on closing the Company will be required to issue approximately 19.5 million shares to the Vaquero shareholders. On April 5, 2005, the last trading day prior to the announcement of the proposed arrangement, the closing prices of the Vaquero shares and the Highpine shares on the Toronto Stock Exchange were \$7.84 and \$19.50 respectively. Transaction costs on the Company's acquisition are estimated to be approximately \$1.5 million. The acquisition will be accounted for using the purchase method of accounting whereby the net assets and liabilities acquired will be recorded at their fair values and the results of operations will be recorded from the date of closing of the transaction.

15. Contingency:

On December 14, 2004 the Company was granted a license from the Alberta Energy and Utilities Board (the "AEUB") relating to the expansion of an existing facility. On December 15, 2004 a notice of objection was filed with the AEUB by a corporation which is a joint lease owner where the facility is being constructed. To date, the AEUB has not ruled on the merits of the notice of objection. Although management of the Company is of the view that the objection submitted by the corporation is without merit and will continue to defend the interests of the Company in the facility, it is possible that the AEUB may render a decision in this matter which would have an adverse effect on the Company and its processing capabilities in an area which is significant to the Company.