

Consolidated Financial Statements of

HIGHPINE OIL & GAS LIMITED

Three months ended March 31, 2005

HIGHPINE OIL & GAS LIMITED

Consolidated Balance Sheets

| | March 31, 2005 (unaudited) | December 31, 2004 (audited) |
|---|----------------------------------|-----------------------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ - | \$ - |
| Accounts receivable | 17,433,982 | 13,366,408 |
| Prepaid expenses and deposits | 647,733 | 658,978 |
| | <u>18,081,715</u> | <u>14,025,386</u> |
| Property, plant and equipment (note 2) | 164,778,770 | 134,282,197 |
| Long-term investment, at cost | 1,000,000 | 1,000,000 |
| Deferred charges (note 3) | 657,812 | - |
| Goodwill | 14,081,000 | 14,081,000 |
| | <u>\$198,599,297</u> | <u>\$163,388,583</u> |
| Liabilities and Shareholders' Equity | | |
| Current liabilities: | | |
| Accounts payable and accrued liabilities | \$ 32,225,685 | \$ 28,840,343 |
| Bank indebtedness (note 4) | 63,967,781 | 34,821,996 |
| | <u>96,193,466</u> | <u>63,662,339</u> |
| Future income taxes | 22,493,464 | 20,419,084 |
| Asset retirement obligations (note 5) | 3,146,230 | 1,973,735 |
| Shareholders' equity: | | |
| Share capital (note 6) | 59,582,480 | 52,829,758 |
| Contributed surplus (note 6) | 789,468 | 511,258 |
| Retained earnings | 16,394,189 | 23,992,409 |
| | <u>76,766,137</u> | <u>77,333,425</u> |
| Subsequent events (notes 4 and 8) | | |
| Contingency (note 9) | | |
| | <u>\$198,599,297</u> | <u>\$163,388,583</u> |

See accompanying notes to consolidated financial statements.

HIGHPINE OIL & GAS LIMITED

Consolidated Statements of Earnings and Retained Earnings
(Unaudited)

Three months ended March 31, 2005 and 2004

| | 2005 | 2004 |
|---|---------------|---------------|
| Revenues: | | |
| Oil and gas revenues | \$ 14,092,937 | \$ 6,274,048 |
| Royalties, net of Alberta royalty tax credits | (3,816,531) | (1,340,736) |
| | 10,276,406 | 4,933,312 |
| Processing and pipeline revenues | 542,200 | 45,800 |
| Interest income | 199 | 32,943 |
| | 10,818,805 | 5,012,055 |
| Expenses: | | |
| Operating costs | 2,158,774 | 1,068,755 |
| General and administrative | 846,099 | 572,823 |
| Depletion, depreciation and accretion | 5,432,733 | 2,305,905 |
| Interest and finance costs | 824,234 | 541,964 |
| Stock based compensation (note 6) | 278,210 | 34,178 |
| | 9,540,050 | 4,523,625 |
| Earnings before taxes | 1,278,755 | 488,430 |
| Taxes: | | |
| Current | 50,000 | 31,250 |
| Future | 460,620 | 205,336 |
| | 510,620 | 236,586 |
| Net earnings | 768,135 | 251,844 |
| Retained earnings, beginning of period | 23,992,409 | 20,815,692 |
| Stock dividend and adjustment (note 6) | (8,366,355) | - |
| Retained earnings, end of period | \$ 16,394,189 | \$ 21,067,536 |
| Net earnings per share (note 6) | | |
| Basic | \$0.04 | \$0.02 |
| Diluted | \$0.04 | \$0.02 |

See accompanying notes to consolidated financial statements.

HIGHPINE OIL & GAS LIMITED

Consolidated Statements of Cash Flows
(Unaudited)

Three months ended March 31, 2005 and 2004

| | 2005 | 2004 |
|---|--------------|--------------|
| Cash provided by (used in): | | |
| Operating Activities: | | |
| Net earnings | \$ 768,135 | \$ 251,844 |
| Items not involving cash: | | |
| Depletion, depreciation and accretion | 5,432,733 | 2,305,905 |
| Future income taxes | 460,620 | 205,336 |
| Stock based compensation | 278,210 | 34,178 |
| Funds from operations | 6,939,698 | 2,797,263 |
| Change in non-cash working capital relating to operations | (5,857,121) | (4,719,538) |
| | 1,082,577 | (1,922,275) |
| Financing Activities: | | |
| Proceeds on conversion of Class B shares | 127 | - |
| Increase in bank indebtedness | 29,145,785 | 45,721,245 |
| Deferred charges | (657,812) | - |
| | 28,488,100 | 45,721,245 |
| Investing Activities: | | |
| Property, plant and equipment additions | (34,756,811) | (8,498,482) |
| Debenture receivable repayment | - | 3,736,697 |
| Long-term investment, at cost | - | (760,000) |
| Net cash paid on business combination | - | (42,089,000) |
| Change in non-cash working capital relating to investing activities | 5,186,134 | 4,598,133 |
| | (29,570,677) | (43,012,652) |
| Increase in cash and cash equivalents | - | 786,318 |
| Cash and cash equivalents, beginning of period | - | 537,682 |
| Cash and cash equivalents, end of period | \$ - | \$ 1,324,000 |
| Cash interest paid | \$407,000 | \$33,000 |
| Cash taxes paid | \$216,000 | \$60,000 |

See accompanying notes to consolidated financial statements.

HIGHPINE OIL & GAS LIMITED

Notes to Consolidated Financial Statements
(Unaudited)

Three months ended March 31, 2005 and 2004

1. Significant accounting policies:

The interim consolidated financial statements of Highpine Oil & Gas Limited (the "Company") have been prepared by management in accordance with Canadian generally accepted accounting principles and follow the same accounting policies as the most recent audited annual consolidated financial statements. Certain disclosures normally required to be included in the notes to the annual consolidated financial statements have been condensed or omitted. The interim consolidated financial statements should be read in conjunction with the audited annual consolidated financial statements and notes thereto for the year ended December 31, 2004.

2. Property, plant and equipment:

At March 31, 2005, approximately \$23,500,000 (December 31, 2004 - \$13,000,000) of unproved properties were excluded from the depletion calculation. Future development costs of \$4,877,000 (December 31, 2004 - \$9,500,000) were included in the depletion calculation. During the first quarter of 2005, general and administrative expenses of \$144,000 (March 31, 2004 - \$57,000) were capitalized.

3. Deferred charges:

During the first quarter of 2005, the Company incurred various costs in connection with its initial public offering which closed on April 5, 2005 (see note 8). The costs have been recorded as deferred charges at March 31, 2005. Concurrent with the closing of the initial public offering, the deferred charges will be recorded as a reduction in share capital.

4. Bank indebtedness:

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 June 30, 2005 unless it is extended for a 364-day period. The amount outstanding on the non-revolving, non-extendible term credit facility was repaid on receipt of the proceeds from the initial public offering and the facility was subsequently cancelled. 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 bear 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.

5. Asset retirement obligations:

At March 31, 2005, the estimated total undiscounted cash flows required to settle asset retirement obligations were \$5,444,000. Expenditures to settle asset retirement obligations will be incurred between 2005 and 2025. Estimated cash flows have been discounted using an annual credit adjusted risk-free interest rate of 8.0 percent per annum and have been inflated using an inflation rate of 2.0 percent per annum.

HIGHPINE OIL & GAS LIMITED

Notes to Consolidated Financial Statements, Page 2
(Unaudited)

Three months ended March 31, 2005 and 2004

Changes to asset retirement obligations were as follows:

| | Three months ended March 31, 2005 | Year ended December 31, 2004 |
|--|--------------------------------------|---------------------------------|
| Asset retirement obligations, beginning of period | \$ 1,973,735 | \$ 377,894 |
| Liabilities acquired | - | 950,000 |
| Liabilities incurred | 1,134,152 | 1,144,110 |
| Liabilities disposed of | - | (600,000) |
| Accretion expense | 38,343 | 101,731 |
| Asset retirement obligations, end of period | \$ 3,146,230 | \$1,973,735 |

6. Share capital:

| | Three months ended March 31, 2005 | | Year ended December 31, 2004 | |
|--|--------------------------------------|---------------------|---------------------------------|----------------------|
| | Number | Amount | Number | Amount |
| Class A common shares: | | | | |
| Balance, beginning of period | 15,207,583 | \$24,247,233 | 13,195,083 | \$ 13,454,933 |
| Issued for cash | - | - | 1,200,000 | 6,000,000 |
| Shares issued for services performed | - | - | 12,500 | 62,500 |
| Conversion of Class B shares | 1,270,833 | 284 | - | - |
| Flow-through shares issued | - | - | 800,000 | 4,800,000 |
| Flow-through shares renounced | - | (1,613,760) | - | - |
| Special warrants exercised | 3,300,000 | 28,582,368 | - | - |
| Stock dividend and adjustment | 929,595 | 8,366,355 | - | - |
| Share issue costs less tax effect (2004 - \$37,800) | - | - | - | (70,200) |
| Balance, end of period | 20,708,011 | \$59,582,480 | 15,207,583 | \$24,247,233 |
| Class B common shares: | | | | |
| Balance, beginning of period | 1,270,833 | \$ 157 | 1,270,833 | \$ 157 |
| Conversion of Class B shares | (1,270,833) | (157) | - | - |
| Balance, end of period | - | \$ - | 1,270,833 | \$ 157 |
| Special Warrants: | | | | |
| Balance, beginning of period | 3,300,000 | \$28,582,368 | - | \$ - |
| Issued for cash | - | - | 3,300,000 | 29,700,000 |
| Exercised | (3,300,000) | (28,582,368) | - | - |
| Share issue costs less tax effect (2004 - \$601,804) | - | - | - | (1,117,632) |
| Balance, end of period | - | \$ - | 3,300,000 | \$ 28,582,368 |
| Total | | \$59,582,480 | | \$52,829,758 |

HIGHPINE OIL & GAS LIMITED

Notes to Consolidated Financial Statements, Page 3
(Unaudited)

Three months ended March 31, 2005 and 2004

6. Share capital (continued):

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 \$6,970,410 which resulted in 0.047 of a class A common share being issued for each issued and outstanding class A common share. In accordance with the terms of the issued and outstanding special warrants of the Company the stock dividend resulted in an additional 155,105 class A common shares being issuable upon exercise of the outstanding special warrants.

On March 31, 2005, 3,455,105 class A common shares were issued upon the exercise of the special warrants.

Per share amounts:

| Weighted average number of common shares outstanding | Three months ended March 31, 2005 | Three months ended March 31, 2004 |
|---|--------------------------------------|--------------------------------------|
| Basic | 20,708,011 | 15,145,815 |
| Dilutive effect of options | 906,920 | 101,060 |
| Diluted | 21,614,931 | 15,246,875 |

Weighted average common shares outstanding have been retroactively restated to give effect to the February 15, 2005 stock dividend.

Stock options:

The Company has a stock option plan pursuant to which options to purchase class A common shares of the Company may be granted to directors, officers, employees and consultants. The outstanding stock options of the Company are exercisable for a period of six years and vest over a period of four years.

HIGHPINE OIL & GAS LIMITED

Notes to Consolidated Financial Statements, Page 4
(Unaudited)

Three months ended March 31, 2005 and 2004

6. Share capital (continued):

A summary of changes is as follows:

| | Three months ended | | Year ended | |
|---|--|--|--|--|
| | March 31, 2005 | | December 31, 2004 | |
| | Class A common shares issuable upon exercise of options | Weighted average exercise price | Class A common shares issuable upon exercise of options | Weighted average exercise price |
| Balance, beginning of period | 1,542,155 | \$ 5.26 | 530,000 | \$ 2.84 |
| Granted | 160,000 | 14.00 | 1,012,155 | 6.53 |
| Adjustment as a result of stock dividend | 72,482 | - | - | - |
| Balance, end of period | 1,774,637 | \$ 6.08 | 1,542,155 | \$ 5.26 |
| Exercisable, end of period | 264,368 | \$ 2.83 | 175,000 | \$ 2.78 |

The fair value of stock options granted is estimated using the Black-Scholes option pricing model. The following assumptions were used for the 2005 grants:

| | Three months ended March 31, 2005 |
|---|--------------------------------------|
| Dividend yield | 0% |
| Expected volatility | 50% |
| Risk free rate of return | 4.5% |
| Expected option life | 4 years |
| Weighted average fair market value per option | \$6.83 |

Contributed surplus:

| | Three months ended March 31, 2005 | Year ended December 31, 2004 |
|----------------------------------|--------------------------------------|---------------------------------|
| Balance, beginning of period | \$ 511,258 | \$ 114,787 |
| Stock based compensation expense | 278,210 | 396,471 |
| Balance, end of period | \$789,468 | \$ 511,258 |

HIGHPINE OIL & GAS LIMITED

Notes to Consolidated Financial Statements, Page 5
(Unaudited)

Three months ended March 31, 2005 and 2004

7. Commodity price risk management:

The following commodity swap agreement was in place at March 31, 2005:

| Commodity | Notional Volumes | Contract Term | Fixed Price |
|-----------|---------------------|--------------------------------------|------------------------|
| 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 at March 31, 2005 of approximately \$4.5 million.

8. Subsequent events:

(a) Initial public offering:

Pursuant to an underwriting agreement dated March 24, 2005 between the Company and a group of underwriters, the Company issued 4,000,000 class A 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, the issued and outstanding class A common shares of the Company were listed and posted for trading on the Toronto Stock Exchange under the symbol "HPX".

(a) Plan of arrangement:

On April 6, 2005, the Company announced that it had 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. Transaction costs in connection with the acquisition of Vaquero are estimated to be \$1.5 million.

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Notes to Consolidated Financial Statements, Page 6
(Unaudited)

Three months ended March 31, 2005 and 2004

9. 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.