Management's Report to Shareholders

The accompanying consolidated financial statements of Orca Exploration Group Inc. are the responsibility of the Directors. The financial and operating information presented in this annual report is consistent with that shown in the consolidated financial statements.

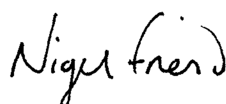
The consolidated financial statements have been prepared by management, on behalf of the Board, in accordance with the accounting policies disclosed in the notes to the consolidated financial statements. Where necessary, management has made informed judgments and estimates in accounting for transactions which were not complete at the balance sheet date. In the opinion of management, the consolidated financial statements have been prepared within acceptable limits of materiality and are in accordance with International Financial Reporting Standards appropriate in the circumstances.

Management, with the participation of the Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures and has concluded that such disclosure controls and procedures are effective.

Management maintains appropriate systems of internal controls. Policies and procedures are designed to give reasonable assurance that transactions are properly authorized, assets are safeguarded and financial records are properly maintained to provide reliable information for the preparation of financial statements. An independent firm of Chartered Accountants, as appointed by the Shareholders, examines the consolidated financial statements in accordance with International Financial Reporting Standards and provides an independent professional opinion.

The Board of Directors carries out its responsibility for the financial reporting and internal controls principally through an Audit Committee. The committee has met with external auditors and Management in order to determine if Management has fulfilled its responsibilities in the preparation of the consolidated financial statements. The consolidated financial statements have been approved by the Board of Directors on the recommendation of the Audit Committee.

P. R. Clutterbuck
President & Chief Executive Officer
28 April 2009



Nigel Friend
Chief Financial Officer
28 April 2009

Auditors' Report

Report on the consolidated financial statements

We have audited the accompanying consolidated financial statements of Orca Exploration Group Inc. and its subsidiaries (the 'Group'), which comprise the consolidated balance sheet as at 31 December 2008 and 31 December 2007 and the consolidated income statements, consolidated statement of cash flows and statements of changes in shareholders' equity for the years then ended, a summary of significant accounting policies and notes to the consolidated financial statements.

Management's responsibility for the financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal controls relevant to the preparation and fair presentation of the financial statements that are free from material misstatements, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditors' responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with the International Standards on Auditing. Those standards require that we comply with the relevant ethical requirements and plan and perform the audit to obtain a reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgement, including the assessments of the risks of material misstatements of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal controls relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting principles used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Opinion

In our opinion, the consolidated financial statements give a true and fair view of the consolidated financial position of the Group as at 31 December 2008 and 31 December 2007, and of its consolidated financial performance and its statement of consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards.

KPMG LLP

Calgary, Canada
28 April 2009

COMMENTS BY AUDITORS FOR CANADIAN READERS ON INTERNATIONAL – CANADIAN REFERENCES

Canadian reporting standards may differ from International Standards on Auditing in the form and content of the auditors' report, depending on the circumstances. However, had this auditors' report been prepared in accordance with Canadian reporting standards, there would be no material differences in the form and content of this auditors' report. Furthermore, an auditors' report prepared in accordance with Canadian standards on the aforementioned consolidated financial statements would not contain a qualification of opinion.

Calgary, Canada
28 April 2009

Consolidated Income Statements

YEARS ENDED 31 DECEMBER *(thousands of US dollars except per share amounts)*	NOTE	2008	2007
Revenue	5	23,782	18,777
Cost of sales			
Production and distribution expenses		(1,477)	(1,193)
Depletion expense	12	(4,716)	(4,476)
Impairment of exploration and evaluation assets	11	(9,520)	-
		8,069	13,108
Administrative expenses		(14,686)	(10,708)
Net financing income/(charge)	7	(439)	1,375
(Loss) /profit before taxation		(7,056)	3,775
Taxation	8	(2,467)	(2,030)
(Loss)/profit after taxation		(9,523)	1,745
(Loss)/profit per share Basic and diluted (US$)	17	(0.32)	0.06

See accompanying notes to the consolidated financial statements.

Consolidated Balance Sheets

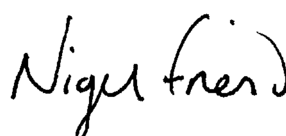
AS AT 31 DECEMBER *(thousands of US dollars)*	NOTE	2008	2007
ASSETS			
Current assets			
Cash and cash equivalents	*9*	10,586	16,515
Trade and other receivables	*10*	13,196	8,236
		23,782	24,751
Exploration and evaluation assets	*11*	648	6,881
Property, plant and equipment	*12*	60,818	61,157
		61,466	68,038
		85,248	92,789
LIABILITIES			
Current liabilities			
Trade and other payables	*13*	14,055	17,452
Non current liabilities			
Deferred income taxes	*8*	5,510	3,205
Deferred additional profits tax		971	588
		20,536	21,245
SHAREHOLDERS' EQUITY			
Capital stock	*15*	66,537	66,538
Capital reserve	*16*	3,715	1,023
Accumulated (loss)/income		(5,540)	3,983
		64,712	71,544
		85,248	92,789

See accompanying notes to the consolidated financial statements.
Contractual obligations and committed capital investment (Note 21)
Post balance sheet events (Note 22)

The consolidated financial statements were approved by the Board of Directors on 28 April 2009.

Director

Director



Consolidated Statements of Cash Flows

YEARS ENDED 31 DECEMBER *(thousands of US dollars)*	2008	2007
CASH FLOWS FROM OPERATING ACTIVITIES		
(Loss)/profit after taxation	(9,523)	1,745
Adjustment for:		
Depletion and depreciation	4,792	4,631
Impairment of exploration and evaluation assets	9,520	–
Stock-based compensation	2,419	1,062
Deferred income taxes	2,305	1,976
Deferred additional profits tax	383	324
Interest income	(145)	(628)
Foreign exchange gain	–	(414)
	9,751	8,696
Increase in trade and other receivables	(4,960)	(3,961)
Increase in trade and other payables	394	6,032
Net cash flows from operating activities	5,185	10,767
CASH FLOWS USED IN INVESTING ACTIVITIES		
Exploration and evaluation expenditures	(3,014)	(6,322)
Property, plant and equipment expenditures	(4,453)	(46,836)
Interest income	145	628
(Decrease)/increase in trade and other payables	(3,791)	6,897
Net cash used in investing activities	(11,113)	(45,633)
CASH FLOWS FROM FINANCING ACTIVITIES		
Normal course issuer bid	(1)	(220)
Shares issued	–	30,366
Foreign exchange gain	–	414
Proceeds from exercise of options	–	143
Net cash flow from financing activities	(1)	30,703
Decrease in cash and cash equivalents	(5,929)	(4,163)
Cash and cash equivalents at the beginning of the year	16,515	20,678
Cash and cash equivalents at the end of the year	10,586	16,515

See accompanying notes to the consolidated financial statements.

Statement of Changes in Shareholders' Equity

(thousands of US dollars)	Capital stock	Capital reserve	Accumulated (loss)/Income	Total
Note	*15*	*16*		
Balance as at 1 January 2007	34,469	1,182	2,238	37,889
Shares issued	31,971	(675)	–	31,296
Options exercised	143	–	–	143
Stock-based compensation	–	691	–	691
Normal course issuer bid	(45)	(175)	–	(220)
Profit for the year	–	–	1,745	1,745
Balance as at 31 December 2007	66,538	1,023	3,983	71,544
Shares issued	–	–	–	–
Options exercised	–	–	–	–
Stock-based compensation	–	2,692	–	2,692
Normal course issuer bid	(1)	–	–	(1)
Loss for the year	–	–	(9,523)	(9,523)
Balance as at 31 December 2008	66,537	3,715	(5,540)	64,712

See accompanying notes to the consolidated financial statements.

Notes to the Consolidated Financial Statements

General Information

Orca Exploration Group Inc. ("Orca Exploration" or the "Company") was incorporated on 28 April 2004 under the laws of the British Virgin Islands. The Company is a participant in a gas-to-electricity project in Tanzania. The Company's operations at the Songo Songo gas field in Tanzania include the operation of six producing wells and two 45 MMscfd dehydration and refrigeration gas processing units on Songo Songo Island on behalf of Songas Limited ("Songas"). Gas produced and sold from the Songo Songo field is classified as either Protected Gas or Additional Gas. Protected Gas is 100% owned by Tanzania Petroleum Development Corporation ("TPDC") and is sold to Songas under a twenty year Gas Agreement primarily for use at the Ubungo power plant and the Wazo Hill cement plant. The Protected Gas is principally used as feedstock for specified turbines and kilns. Gas sales in excess of the Protected Gas users' requirements is classified as Additional Gas. The Company has the exclusive right to explore, develop, produce and market all Additional Gas. Revenues from the sale of Additional Gas, net of transportation tariff, are shared with TPDC in accordance with the terms of the Production Sharing Agreement ("PSA") until October 2026.

Basis of preparation

These consolidated financial statements are measured and presented in US dollars as the main operating cash flows are linked to this currency through the commodity price. Management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the period. Actual results could differ from these estimates.

1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A) STATEMENT OF COMPLIANCE

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board ("IASB") and interpretations issued by the Standing Interpretations Committee of the IASB. These principles differ in certain respects from those in Canada as described in note 18.

B) BASIS OF CONSOLIDATION

i) Subsidiaries

The consolidated financial statements include the accounts of the Company and all its wholly owned subsidiaries (collectively, the "Company"). Subsidiaries are those enterprises controlled by the Company. The following companies have been consolidated within the Orca Exploration financial statements:

Subsidiary	Registered	Holding	functional currency
Orca Exploration Group Inc	British Virgin Islands	Parent Company	US dollar
Orca Exploration Ventures Inc	British Virgin Islands	100%	US dollar
Orca Exploration Uganda (Holdings) Inc	British Virgin Islands	100%	US dollar
Orca Exploration Uganda Inc	British Virgin Islands	100%	US dollar
PAE PanAfrican Energy Corporation	Mauritius	100%	US dollar
PanAfrican Energy Tanzania Limited	Jersey	100%	US dollar

ii) Transactions eliminated upon consolidation

Inter-company balances and transactions, and any unRealized gains arising from inter-company transactions, are eliminated in preparing the consolidated financial statements.

C) FOREIGN CURRENCY

Foreign currency transactions are recorded at the rate of exchange prevailing at the date of the transaction. Monetary assets and liabilities in foreign currencies are translated at period-end rates. Non-monetary items are translated at historic rates, unless such items are carried at market value, in which case they are translated using the exchange rates that existed when the values were determined. Any resulting exchange rate differences are taken to the income statement.

D) EXPLORATION AND EVALUATION ASSETS, PROPERTY, PLANT AND EQUIPMENT

Exploration and evaluation assets

Exploration and evaluation costs are capitalized as intangible assets. Intangible assets includes lease and license acquisition costs, geological and geophysical costs and other direct costs of exploration and evaluation which the directors consider to be unevaluated until reserves are appraised as commercial, at which time they are transferred to property, plant and equipment following an impairment review and depleted accordingly. Where properties are appraised to have no commercial value or are appraised at values less than book values, the associated costs are treated as an impairment loss in the period in which the determination is made.

Property, plant and equipment

Property, plant and equipment comprises the Company's tangible natural gas assets, development wells, together with leasehold improvements, computer equipment, motor vehicles and fixtures and fittings and are carried at cost, less any accumulated depletion, depreciation and accumulated impairment losses. Cost includes purchase price and construction costs for qualifying assets. Depletion of these assets commences when the assets are ready for their intended use. Only costs that are directly related to the discovery and development of specific oil and gas reserves are Capitalized. The cost associated with tangible natural gas assets are amortised on a field by field unit of production method based on commercial proven reserves. The calculation of the unit of production amortisation takes into account the estimated future development cost of the field.

Impairment of exploration and evaluation assets, property, plant and equipment

At each balance sheet date, the Company reviews the carrying amounts of its property, plant and equipment and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. Individual assets are grouped together as a cash generating unit for impairment assessment purposes at the lowest level at which there are identifiable cash flows that are independent from other group assets. In the case of exploration and evaluation assets, this will normally be at the Company's field level. If any such indication of impairment exists, the Company makes an estimate of its recoverable amount. The recoverable amount is the higher of fair value less costs to sell and value in use. Where the carrying amount of a cash generating unit exceeds its recoverable amount, the cash-generating unit is considered impaired and is written down to its recoverable amount. In assessing the value in use, the estimated future cash flows are adjusted for the risks specific to the cash-generating unit and are discounted to their present value with a discount rate that reflects the current market indicators. Where an impairment loss subsequently reverses, the carrying amount of the asset cash-generating unit is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognized for the cash-generating unit in prior years. A reversal of an impairment loss is recognized as income immediately.

E) OPERATORSHIP

The Company operates the gas field, flow lines and gas processing plant on behalf of Songas at cost. The cost of operating and maintaining the wells and flow lines is paid for by Orca Exploration and Songas in proportion to the respective volumes of Protected Gas and Additional Gas sales. The costs of operating and maintaining the wells and flow lines are reflected in the accounts to the extent that the costs were incurred to accomplish Additional Gas sales. The cost of operating the gas processing plant and pipeline to Dar es Salaam is paid by Songas. When there are Additional Gas sales, a transportation tariff is paid to Songas as compensation for using the gas processing plant and pipeline. This transportation tariff is netted off revenue.

F) TRADE AND OTHER RECEIVABLES

Trade and other receivables are stated at their recoverable amount.

G) CASH AND CASH EQUIVALENTS

Cash and cash equivalents include cash on deposit and highly liquid investments with original maturities of three months or less.

H) EMPLOYMENT BENEFITS

i) Pension

The Company does not operate a pension plan, but it does make defined contributions to the statutory pension fund for employees in Tanzania. Obligations for contributions to the statutory pension fund are Authorized as an expense in the income statement as incurred.

ii) Stock options

The share option plan allows Company officers, directors and key personnel to acquire shares at an exercise price determined by the market value at the date of grant. When the options are exercised, equity is increased by the amount of the proceeds received. The fair value of stock options is expensed to the income statement in accordance with the specific vesting periods. The fair value of the options is calculated, on the grant date, using the Black-Scholes option pricing model.

iii) Stock appreciation rights

Stock appreciation rights are issued to certain key managers, officers and employees. The fair value of stock appreciation rights is expensed to the income statement in accordance with the service period. The fair value of the stock appreciation rights is revalued every reporting date with the change in the value expensed to the income statement.

i) Asset retirement obligations

No provision has been made for future site restoration costs since the Company has no legal or contractual obligation under the PSA to restore the fields at the end of their commercial lives.

J) REVENUE RECOGNITION, PRODUCTION SHARING AGREEMENTS AND ROYALTIES

The Company recognizes revenue from natural gas sales when title passes to a customer. The Company conducts operations jointly with the Tanzanian government and "parastatal entities" in accordance with production sharing agreements ("PSA"). Under these agreements, the Company pays both its share and the parastatal's share of operating, administrative and capital costs. The Company recovers all the operating, administrative and capital costs including the parastatal's share of these costs from future revenues over several years ("Cost Gas"). The parastatal's share of operating and administrative costs, are recorded in operating and general and administrative costs when incurred and capital costs are recorded in 'Property, plant and equipment'. All recoveries are recorded as revenue in the year of recovery. The Company is entitled to a share of production in excess of the Cost Gas ("Profit Gas"). Operating revenue represents the Company's share of Cost Gas and Profit Gas during the period, net of the transportation tariff.

K) ADDITIONAL PROFITS TAX

Under the terms of the PSA, in the event that all costs have been recovered with an annual return of 25% plus the percentage change in the United States Industrial Goods Producer Price Index, an additional profits tax ("APT") is payable to the Government of Tanzania. This tax is considered to be a royalty and is netted against revenue. APT is provided for by forecasting the total APT payable as a proportion of the forecast Profit Gas over the term of PSA license.

L) TAXATION

Income tax on the profit for the year comprises current and deferred tax. The Company is liable for Tanzanian income tax, but this is recovered from TPDC through the profit-sharing arrangement. Where current income tax is payable, revenue is adjusted for the tax and the income tax is shown as current tax. Deferred tax is provided using the balance sheet asset and liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount of deferred tax provided is based on the expected manner of realisation or settlement of carrying amounts of assets and liabilities using tax rates substantively enacted at the balance sheet date. A deferred tax asset is recognized only to the extent that it is probable that future taxable profits will be available against which the asset can be utilized. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefits will be realized.

M) SEGMENTAL REPORTING

The Company currently operates only in Tanzania.

O) DEPRECIATION

Depreciation for non-natural gas properties is charged to the income statement on a straight line basis over the estimated useful economic lives of each class of asset. The estimated useful lives are as follows:

Leasehold improvement	Over remaining life of the lease
Computer equipment	3 years
Vehicles	3 years
Fixtures and fittings	3 years

P) NEW ACCOUNTING STANDARDS AND INTERPRETATIONS

Certain new accounting standards and interpretations have been published that are not mandatory for the 31 December 2008 reporting period. The Company's assessment of the impact of these new standards and interpretations which have not been adopted is set out below.

IAS 1 (Amendment), Presentation of Financial Statements: effective for accounting periods commencing on or after 1 January 2009. The revised standard requires the financial statements to clearly identify operating results attributable to owners of the parent and non controlling interests. All of the companies consolidated within the Orca Exploration's financial statements are 100% owned by Orca Exploration. As a result the additional disclosure requirements around non controlling interests, does not apply. The previous version of IAS 1 used the titles "income statement" and "balance sheet" and "cash flow statement". IAS 1 uses "statement of comprehensive income", "statement of financial position" and "statement of cash flow". The change in terminology only applies to the annual statements for the year end 31 December 2009 and not the interim statements for 2009. Management's assessment of IAS1 is that it will only impact the presentation of financial information within the main financial statements.

The following standards are assessed not to have any impact on the Company's financial statements:

- IAS 23 (Amendment), Borrowing Costs: effective for accounting periods commencing on or after 1 January 2009;
- IAS 27 (Amendment), Consolidated and Separate Financial Statements: effective for accounting periods commencing on or after 1 July 2009;
- IFRS 2 (Amendment), Share based payment Vesting Conditions and Cancellations: effective for accounting periods commencing on or after 1 January 2009;
- IFRS 3 (Amendment) Business Combinations: effective for accounting periods commencing on or after 1 July 2009;
- IFRS 8, "Operating segments" (effective from 1 January 2009)

2 CRITICAL ACCOUNTING ESTIMATES

In applying the Company's accounting policies, which are described in note 1, management makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, vary to the actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below:

I) RESERVES

There are numerous uncertainties inherent in estimating quantities of proved and probable reserves and cash flows to be derived therefrom, including many factors beyond the control of Orca Exploration. The reserve and cash flow information contained herein represents estimates only. The reserves and estimated future net cash flow from Orca Exploration's properties have been independently evaluated by McDaniel & Associates Consultants Ltd. These evaluations include a number of assumptions relating to factors such as initial production rates, production decline rates, ultimate recovery of reserves, timing and amount of capital expenditures, marketability of production, crude oil price differentials to benchmarks, future prices of oil and natural gas, operating costs, transportation costs, cost recovery provisions and royalties, TPDC "back-in" methodology and other government levies that may be imposed over the producing life of the reserves. These assumptions were based on price forecasts in use at the date of the relevant evaluations were prepared and many of these assumptions are subject to change and are beyond the control of Orca Exploration.

Reserves are integral to the amount of depletion charged to the income statement.

II) EXPLORATION AND EVALUATION ASSETS

Under the Company's accounting policy expenditures incurred on the exploration for, and evaluation of, reserves are capitalized as intangible assets. These intangibles assets are then assessed for impairment when circumstances suggest that the carrying amount may exceed its recoverable value. Such circumstances include but are not limited to:

- the period for which the Company has the right to explore in the specific area has expired during the period, or will expire in the near future, and is not expected to be renewed;
- no further expenditure on exploration and evaluation is budgeted or planned;
- no reserves have been encountered;
- the evaluation of seismic data indicates that the reserves are unlikely to be of a commercial quantity;
- the quantity of mineral reserves are deemed not to be of commercially viable quantities and the entity has decided to discontinue further activities;
- sufficient data exists to indicate that, although a development in the specific area is likely to proceed, the carrying amount of the exploration and evaluation asset is unlikely to be recovered in full from successful development or by sale.

The assessment for impairment involves estimates as to (i) the likely future commerciality of the asset and when such commerciality should be determined, (ii) future revenues and costs associated with the asset, and (iii) the discount rate to be applied to such revenues and costs for the purpose of deriving a recoverable value.

III) FAIR VALUE OF STOCK BASED COMPENSATION

All stock options issued or stock appreciation rights granted by the Company have to be valued at their fair value. In assessing the fair value of the equity based compensation estimates have to be made as to i) the volatility in share price, ii) risk free rate of interest and iii) the level of forfeiture. In the case of stock options, this fair value is estimated at the date of issue and is not revalued, where as the fair value of stock appreciation rights is recalculated at each reporting period.

3 RISK MANAGEMENT

The Company, by its activities in oil and gas exploration, development and production, is exposed to the risk associated with the unpredictable nature of the financial markets. The Company seeks to manage its exposure to these risks where ever possible.

I) FOREIGN EXCHANGE RISK

Foreign exchange risk arises when transactions and Authorized assets and liabilities of the Company are denominated in a currency that is not the U.S. dollar functional currency.

The Company operates internationally and is exposed to foreign exchange risk arising from currency exposures to U.S. dollars. The main currencies to which the Company has an exposure are: Tanzanian shillings, British pounds sterling and Canadian dollars.

The majority of the expenditure associated with the operation of the gas distribution system is denominated in Tanzanian shillings. The majority of the consultant's contracts are denominated in British pounds sterling. All of the capital stock, equity financing and any associated stock based compensation are denominated in Canadian dollars. All of the operational revenue and the majority of capital expenditure are denominated in US dollars.

There are no forward exchange rate contracts in place.

II) COMMODITY PRICE RISK

The Songo Songo gas field is the first gas field to be developed in East Africa. The Company has therefore been able to negotiate industrial gas sales contracts with gas prices that are at a discount to the lowest cost alternative fuels in Dar es Salaam, namely Heavy Fuel Oil ("HFO"). The price of HFO is exposed to the volatility in the market price of oil.

III) INTEREST RATE RISK

The Company currently does not have any debt or borrowings so is therefore not exposed to any interest rate risk.

IV) CREDIT RISK

All of the Company's production is currently derived in Tanzania. The sales are made to the power sector and the industrial sector. In relation to sales to the power sector, the Company has a short term contract with Songas for the supply of gas to the Ubungo power plant and a contract with TANESCO to supply Wärtsilä power plant. The contracts with Songas and TANESCO accounted for 49% of the Company's operating revenue during 2008 and US$8.9 million of the receivables at the year end. Songas itself is heavily reliant on the payment of capacity and energy charges by TANESCO for its liquidity. TANESCO is dependent on the Government of Tanzania for some of its funding. Whilst some payments have been delayed, the Company has subsequently received all the amounts due from Songas and TANESCO in respect of the amounts due at 31 December 2008. Sales to industrial sector are subject to an internal credit review to minimize the risk of non payment. The Company does not anticipate any default with these customers.

V) LIQUIDITY RISK

Liquidity risk is the risk that the Company will not have sufficient funds to meet its liabilities. Cash forecasts identifying liquidity requirements of the Company are produced on a quarterly basis. These are reviewed on a regular basis to ensure sufficient funds exist to finance the Company's current operational and investment cash flow requirements. The Company has no financial liabilities other than the trade and other payables indentified in note 13 which are all due within 12 months. The Company currently has a short term US$5 million overdraft facility. The Company currently has no bank borrowings and there is scope for utilizing debt funding once the longer term contracts for the supply of gas to the power sector are in place.

VI) CAPITAL RISK MANAGEMENT

The Company's objectives when managing capital are to safeguard the Company's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders and to maintain an optimal capital structure to reduce the cost of capital. The Company currently has no borrowings.

4 SEGMENTAL INFORMATION

The Company has a single class of business which is international exploration, development and production of petroleum and natural gas. The Company currently operates in Tanzania having ceased its operations in Uganda during the year.

(Figures in US$ '000)	External revenue	Segment income/(loss)	Total assets	Total liabilities	Capital additions	Depletion & depreciation
2008						
Tanzania	23,782	(3)	85,248	20,536	5,101	4,792
Uganda	–	(9,520)	–	–	2,639	9,520
	23,782	(9,523)	85,248	20,536	7,740	14,312
2007						
Tanzania	18,777	1,745	85,908	21,245	46,837	4,631
Uganda	–	–	6,881	–	6,881	–
	18,777	1,745	92,789	21,245	53,718	4,631

5 REVENUE

YEARS ENDED 31 DECEMBER *Figures in US$ '000*	2008	2007
Operating revenue	23,916	19,023
Current income tax adjustment	249	78
Deferred additional profits tax	(383)	(324)
Revenue	23,782	18,777

The revenue reported is the Company's proportionate share of revenue as calculated in accordance with the accounting policy 1(j).

The Company's total revenues for the year amounted to US$23,782,000 after adjusting the Company's operating revenue of US$23,916,000 by:

i) US$249,000 for current income tax. The Company is liable for income tax in Tanzania, but the income tax is recoverable out of TPDC's Profit Gas when the tax is payable. To account for this, revenue is adjusted to reflect the current income tax charge or loss.

ii) US$383,000 for the deferred effect of additional profits tax. This tax is considered a royalty and is netted against revenue.

6 PERSONNEL EXPENSES

The average number of employees during the year was 21 (2007: 15). The costs are as follows:

YEARS ENDED 31 DECEMBER *(Figures in US$ '000)*	2008	2007
Wages and salaries	1,434	1,550
Social security costs	288	237
Other statutory costs	385	272
	2,107	2,059

7 NET FINANCING INCOME/(CHARGE)

YEARS ENDED 31 DECEMBER *Figures in US$'000*	2008	2007
Finance income		
Interest income	145	628
Foreign exchange gain	56	832
	201	1,460
Finance charges		
Overdraft charges	(62)	-
Foreign exchange loss	(578)	(85)
	(640)	(85)
Net financing income/(charge)	(439)	1,375

8 TAXATION

Under the terms of the Production Sharing Agreement with TPDC, the Company is liable to pay income tax at the corporate rate of 30% on profits generated in Tanzania. The amount paid is then recovered in full from TPDC by adjusting their share of profit gas.

The tax charge is as follows:

YEARS ENDED 31 DECEMBER *(Figures in US$'000)*	2008	2007
Current tax	162	54
Deferred tax	2,305	1,976
	2,467	2,030

Tax Rate Reconciliation

YEARS ENDED 31 DECEMBER *(Figures in US$'000)*	2008	2007
(Loss)/profit before taxation	(7,056)	3,775
Provision for income tax calculated at the statutory rate of 30%	(2,117)	1,133
Add the tax effect of non-deductible income tax items:		
Administrative and operating expenses	1,187	676
Stock-based compensation	504	450
Other income	(22)	(331)
Impairment of exploration and evaluation assets	2,856	-
Permanent differences	59	102
	2,467	2,030

As at 31 December 2008, there were temporary differences between the carrying value of the assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Accordingly a deferred tax liability has been recognized for the year ended 31 December 2008.

The deferred income tax liability includes the following temporary differences:

AS AT 31 DECEMBER *(Figures in US$ '000)*	2008	2007
Differences between tax base and carrying value of property, plant and equipment	6,338	3,542
Provision for stock option bonuses	(2)	(360)
Income tax recoverable	221	230
Other liabilities	(196)	(31)
Additional profits tax	(291)	(176)
Tax losses	(560)	-
	5,510	3,205

9 CASH AND CASH EQUIVALENTS

AS AT 31 DECEMBER *(Figures in US$ '000)*	2008	2007
Cash and cash equivalents	10,586	16,515

Included in the cash and cash equivalents is US$529,000 advanced from Songas under the terms of the Operatorship Agreement to pay for the costs of operating the wells and gas processing plant. This amount is also included in trade and other payables.

10 TRADE AND OTHER RECEIVABLES

AS AT 31 DECEMBER *(Figures in US$ '000)*	2008	2007
Trade receivables	11,896	7,275
Prepayments	950	801
Other receivables	350	160
	13,196	8,236

The Company's exposure to credit, currency and interest risk related to trade and other receivables is disclosed in note 3.

11 EXPLORATION AND EVALUATION ASSETS

Figures in US'000	Tanzania	Uganda	Total
Costs			
As at 1 January 2008	–	6,881	6,881
Additions	648	2,639	3,287
As at 31 December 2008	648	9,520	10,168
Depletion/Depreciation			
As at 1 January 2008	–	–	–
Impairment	–	(9,520)	(9,520)
As at 31 December 2008	–	(9,520)	(9,520)
Net Book Values			
As at 31 December 2008	648	–	648
As at 31 December 2007	–	6,881	6,881

TANZANIA

The exploration and evaluation asset relates to initial evaluation of the Songo Songo West prospect which is pending the determination of proven and probable reserves.

UGANDA

As a result of the seismic acquired in 2007, it was decided in June 2008 not to progress with the drilling of two exploration wells. Accordingly, the Company did not exercise its option to acquire a 50% working interest in Exploration Area 5 in Uganda. A total cost of US$9.5 million was subsequently recognized as an impairment during the year and written off in full to the income statement. This included US$0.6 million of general administrative expenses (2007: US$1.2 million) that were capitalized in the year in relation to the Ugandan exploration and evaluation asset.

12 PROPERTY, PLANT AND EQUIPMENT

Figures in US'000	Tanzania	Leasehold improvements	Computer equipment	Vehicles	Fixtures & Fittings	Total
Costs						
As at 1 January 2008	68,362	156	164	139	41	68,862
Additions	4,370	29	43	–	11	4,453
Disposals	–	–	–	(17)	–	(17)
As at 31 December 2008	72,732	185	207	122	52	73,298
Depletion/ Depreciation						
As at 1 January 2008	7,356	156	84	68	41	7,705
Charge for period	4,716	–	42	34	–	4,792
Depreciation on disposals	–	–	–	(17)	–	(17)
As at 31 December 2008	12,072	156	126	85	41	12,480
Net Book Values						
As at 31 December 2008	60,660	29	81	37	11	60,818
As at 31 December 2007	61,006	–	79	70	–	61,157

In determining the depletion charge, it is estimated by the independent reserve engineers that future development costs of US$89.1 million (2007: US$128.4 million) will be required to bring the total proved reserves to production.

13 TRADE AND OTHER PAYABLES

AS AT 31 DECEMBER *(Figures in US$'000)*	2008	2007
Trade payables	11,799	12,667
Accrued liabilities	2,256	4,629
Related party *(note 20)*	–	156
	14,055	17,452

The Company's exposure to credit, currency and interest risk related to trade and other payables is disclosed in note 3.

14 BANK FACILITY

The Company currently has a short-term undrawn US$5.0 million overdraft facility which expires in May 2009.

15 CAPITAL STOCK

a) Authorized

50,000,000 Class A Common Shares No par value

50,000,000 Class B Subordinate Voting Shares No par value

The Class A and Class B shares rank pari passu in respect of dividends and repayment of capital in the event of winding-up. Class A shares carry twenty votes per share and Class B shares carry one vote per share. The Class A shares are convertible at the option of the holder at any time into Class B shares on a one-for-one basis. The Class B shares are convertible into Class A shares on a one-for-one basis in the event that a take over bid is made to purchase Class A shares which must, by reason of a stock exchange or legal requirements, be made to all or substantially all of the holders of Class A shares and which is not concurrently made to holders of Class B shares.

b) Changes in the capital stock of the Company were as follows:

Thousands of shares or US$'000	2008			2007		
	Authorized	Issued	Valuation	Authorized	Issued	Valuation
Class A shares						
As at 1 January and 31 December	50,000	1,751	983	50,000	1,751	983
Class B shares						
As at 1 January	50,000	27,863	65,555	50,000	25,023	33,486
Issue of new stock	–	–	–	–	2,700	31,971
Stock options exercised	–	–	–	–	160	143
Normal course issuer bid	–	–	(1)	–	(20)	(45)
As at 31 December	50,000	27,863	65,554	50,000	27,863	65,555
Total Class A & B shares as at 31 December	100,000	29,614	66,537	100,000	29,614	66,538

In April 2007, 0.2 million Class B shares were awarded to a newly appointed officer. These shares are held in escrow and they vest to the officer in three equal installments starting 7 April 2007. At the time the shares were awarded they had a market value of US$1.6 million (Cdn$1.7 million). The shares will be fully vested by 7 April 2009. An expense of US$0.6 million was recorded in 2008 (2007: US$0.9 million).

In July 2007, 2.5 million Class B shares were issued at a price of Cdn$13.80 per share following the conclusion of a private placement, resulting in gross proceeds of Cdn$34.5 million. A total of US$30.4 million net proceeds have been recognized in capital stock. A large proportion of the funds were used for the completion of the SS-10 well in Tanzania and for the funding of the venture in Uganda.

STOCK-BASED COMPENSATION

The stock option plan provides for the granting of stock options to directors, officers and employees. The exercise price of each stock option is determined at the closing market price of the common shares on the day prior to the day of grant. Each stock option granted permits the holder to purchase one common share at the stated exercise price. The Company records a charge to the profit and loss account using the Black-Scholes fair valuation option pricing model. The valuation is dependent on a number of estimates, including the risk free interest rate, the level of stock volatility, together with an estimate of the level of forfeiture. The level of stock volatility is calculated with reference to the historic traded daily closing share price at the date of issue.

Stock Options

Thousands of options or Cdn$	2008		2007	
	Options	Exercise Price	Options	Exercise Price
Outstanding as at 1 January	2,847	1.00 to 13.55	2,022	1.00 to 6.80
Granted	-	-	1,185	8.70 to 13.55
Forfeited	(33)	12.00	(200)	6.80
Exercised	-	-	(160)	1.00
Outstanding as at 31 December	2,814	1.00 to 13.55	2,847	1.00 to 13.55

The weighted average remaining life and weighted average exercise prices of options at 31 December 2008 were as follows:

Exercise Price (Cdn$)	Number Outstanding as at 31 December 2008	Weighted Average Remaining Contractual Life	Number Exercisable as at 31 December 2008	Weighted Average Exercise Price (Cdn$)
1.00	1,662	5.19	1,662	1.00
8.0 to 13.55	1,152	3.37	392	10.91

There were no new stock options issued during the year. A total charge of US$2.0 million has been recognized for the year in relation to the stock options.

Stock Appreciation Rights

Thousands of stock appreciation rights or Cdn$	2008		2007	
	SAR	Exercise Price	SAR	Exercise Price
Outstanding as at 1 January	1,090	4.00 to 13.55	400	4.00
Granted *(i)*	15	5.30	300	8.00
Granted *(i)*	–	–	300	8.70
Granted *(i)*	–	–	90	13.55
Granted *(ii)*	105	11.05	–	–
Exercised *(ii)*	(400)	4.0	–	–
Outstanding as at 31 December	810	8.0 to 13.55	1,090	4.00 to 13.55

(i) These stock appreciation rights have a term of 5 years and vest in three equal annual installments, the first third vesting on the anniversary of the grant date. There is no maximum liability associated with these rights.

(ii) These stock appreciation rights have a liability of Cdn$3.00 per right or Cdn$0.3 million in total with a two year term. The stock appreciation rights exercised in 2008 also had a maximum liability of Cdn$3.0 per right or Cdn$1.2 million in total.

The Company records a charge to the income statement using the Black-Scholes fair valuation option pricing model every reporting period with a resulting liability being recognized in the balance sheet. In the valuation of these stock appreciation rights at the reporting date, the following assumptions have been made: the risk free rate of interest equal to 3.50%, stock volatility 110%, 0% dividend yield and a range of forfeiture from 0% to 33%.

As at 31 December 2008, a total liability of US$0.2 million (2007: US$1.9 million) has been recognized in relation to the stock appreciation rights. A total credit of US$0.6 million has been recorded during 2008, as a result of the decline of the share price during the year (2007: US$1.3 million charge).

16 CAPITAL RESERVE

The capital reserve is used to record two types of transactions:

(i) To recognize the fair value of equity settled stock based compensation expensed in the year. In the case of the treasury shares issued in 2007, the reserve has been used to recognize the unexpensed fair value of the treasury shares, as the full fair value of the treasury stock issued has been recorded as capital stock.

(ii) To account for the difference between the aggregated book value of the shares purchased under the normal course issuer bid and the actual consideration.

17 LOSS PER SHARE

The calculation of basic loss per share is based on the net loss attributable to ordinary shareholders of US$9.5 million (2007: US$1.7 million profit) and a weighted average number of Class A and Class B shares outstanding during the period of 29,614,423 (2007: 28,259,382).

In computing the diluted loss per share, the dilutive effect of the stock options was 1,425,253 (2007: 1,543,358) shares. These are added to the weighted average number of common shares outstanding during the year resulting in a diluted weighted average number of Class A and Class B shares of 31,039,676 for the year ended 31 December, 2008. No adjustments were required to the reported earnings from operations in computing diluted per share amounts.

18 RECONCILIATION OF IFRS TO ACCOUNTING PRINCIPLES GENERALLY ACCEPTED IN CANADA

The consolidated financial statements have been prepared in accordance with IFRS, which differ in some respects from Canadian Generally Accepted Accounting Principles ("GAAP"). Any difference in accounting principles as they pertain to the accompanying consolidated financial statements were immaterial except as described below:

A) TAXATION

On 31 August 2004, the Company was spun off from a predecessor company pursuant to a scheme of arrangement. Under Canadian GAAP, a deferred tax liability has to be recognized for the taxable temporary differences arising from the initial recognition of an asset or liability under any scenario. IFRS does not permit the setting up of a deferred tax liability for all taxable temporary differences arising from the initial recognition of an asset or liability except in a business combination.

B) STOCK-BASED COMPENSATION

There were 810,000 stock appreciation rights outstanding as at 31 December 2008 (see note 15). Under IFRS as these rights are a cash-settled share-based transaction, the fair value of the rights is calculated using a Black-Scholes option pricing model every reporting period. Under Canadian GAAP, the fair value is calculated using the intrinsic value method whereby the rights are valued at the quoted market price less the rights price at each reporting period. Under both IFRS and Canadian GAAP, the fair value is expensed over the service period of the rights.

C) EXPLORATION AND EVALUATION ASSETS

Under IFRS 6 there is a requirement for separate disclosure of costs associated with exploration and evaluation assets. There is no such requirement under Canadian GAAP and the costs are aggregated within property, plant and equipment.

As at 31 December (Figures in US$ '000)	2008		2007	
	IFRS	CDN	IFRS	CDN
Current assets	23,782	23,782	24,751	24,751
Exploration and evaluation assets	648	–	6,881	–
Property, plant and equipment	60,818	63,010	61,157	69,500
	85,248	86,792	92,789	94,251
Current liabilities	14,055	13,899	17,452	17,187
Non current liabilities	6,481	8,226	3,793	5,541
Capital stock	66,537	66,537	66,538	66,538
Reserves	(1,825)	(1,870)	5,006	4,985
	85,248	86,792	92,789	94,251
(Loss)/profit before taxation	(7,056)	(7,140)	3,775	3,886

19 OPERATING LEASES

AS AT 31 DECEMBER *(Figures in US$ '000)*	2008	2007
Less than one year	204	102
Between one and five years	714	394
	918	496

The Company has entered into two five year rental agreements that expire on 30 November 2012 and 30 November 2013, respectively, at a cost of approximately US$0.2 million per annum for the use of offices in Dar es Salaam.

20 RELATED PARTY TRANSACTIONS

One of the non executive Directors is a partner at a law firm. During the year, the Company incurred US$195,000 to this firm for services provided. The transactions with this related party were made at the exchange amount.

21 CONTRACTUAL OBLIGATIONS AND COMMITTED CAPITAL INVESTMENT

CAPITAL INVESTMENT

Re-rating of the Songas processing plant

Orca Exploration is committed to paying Songas US$0.5 million on successful completion and operation of the gas processing facilities at 90 MMscfd together with a further US$0.5 million on the first anniversary of the successful completion of the project. The gas processing plant was re-rated from 70 Mmscfd to 90 MMscfd by Lloyds Register in January 2009. The re-rating was approved by Songas in Q1 2009.

Wazo Hill cement plant

Orca Exploration signed a five year contract with Tanzania Portland Cement Company ("TPCC"), a subsidiary of Heidelberg Cement, for the supply of gas to a new US$100 million kiln at its Wazo Hill plant in Dar es Salaam. In order to honour this contract, Orca Exploration committed to install a pressure reduction station at Wazo Hill at a cost of US$0.7 million.

Compressed natural gas

In Q3 2008, Orca Exploration ordered US$2.5 million of CNG facilities, consisting of a compressor, a vehicle dispenser and two trailer filling facilities to deliver 0.7 MMscfd of CNG to industrial customers in Dar es Salaam. The facilities are expected to be operational during Q2 2009. A total of US$2.3 million had been spent on this project by the end of 2008.

Funding

Management forecasts that the Company will be able to meet its 2009 capital expenditure program through the use of existing cash balances and self-generated cash flows. The Company currently has no bank borrowings and there is scope for utilizing debt funding once the longer term contracts for the supply of gas to the power sector are in place.

CONTRACTUAL OBLIGATIONS

Protected Gas

Under the terms of the original gas agreement for the Songo Songo project ("Gas Agreement"), in the event that there is a shortfall/insufficiency in Protected Gas as a consequence of the sale of Additional Gas, then the Company is liable to pay the difference between the price of Protected Gas (US$0.55/Mmbtu) and the price of an alternative feedstock multiplied by the volumes of Protected Gas up to a maximum of the volume of Additional Gas sold (23.8 Bcf as at 31 December 2008).

The Gas Agreement has been amended by an initialled Amended and Restated Gas Agreement ("ARGA"). The ARGA provides clarification of the Protected Gas volumes and removes all terms dealing with the security of the Protected Gas and the consequences of any insufficiency to a new Insufficiency Agreement ("IA"). The IA specifies terms under which Songas may demand cash security in order to keep them whole in the event of a Protected Gas insufficiency. Once the Insufficiency Agreement is signed, it will govern the basis for determining security. Under the provisional terms of the IA, when it is calculated that funding is required, the Company shall fund an escrow account at a rate of US$2/Mmbtu on all industrial Additional Gas sales out of its and TPDC share of revenue, and TANESCO shall contribute the same amount on Additional Gas sales to the power sector. The funds provide security for Songas in the event of an insufficiency of Protected Gas. The Company is actively monitoring the reservoir and does not anticipate that a liability will occur in this respect.

Back in

TPDC has indicated that they wish to exercise their right to 'back in' to the field development by contributing 20% of the costs of the future wells including SS-10 in return for a 20% increase in the profit share percentage for the production emanating from these wells. The implications and workings of the 'back in' are still to be discussed in detail with TPDC and there may be the need for reserve modifications once these discussions are concluded. For the purpose of the reserves certification, it has been assumed that they will 'back in' for 20% and this is reflected in the Company's net reserve position. However, the financial statements do not take account of any reimbursement for the SS-10 capital expenditure, pending the finalisation of the terms of the 'back in'.

22 POST BALANCE SHEET EVENTS

There are no post balance sheet events.

23 DIRECTORS AND OFFICERS EMOLUMENTS

USD'000 except for number of share options	Year	Base	Bonus	Other	Total	Outstanding Stock options	Outstanding Stock appreciation rights	Outstanding Treasury stock
Directors								
W. David Lyons *(i)*	2008	15	–	–	15	1,000,000	–	–
Chairman	2007	23	–	–	23	1,000,000	–	–
Peter R. Clutterbuck *(i)*	2008	393	135	–	528	490,000	–	–
President and CEO	2007	452	–	–	452	490,000	–	–
Nigel A. Friend *(i)*	2008	353	95	–	448	265,000	90,000	–
Vice President, Executive Officer and CFO	2007	334	–	–	334	265,000	90,000	–
James Smith *(i)*	2008	408	92	–	500	300,000	300,000	66,667
Vice President Exploration	2007	350		–	350	300,000	300,000	133,333
Pierre Raillard	2008	359	125	–	484	325,000	–	–
Vice President Operations	2007	241	–	–	241	325,000	–	–
David W. Ross	2008	–	–	–	–	75,000	–	–
Non Executive Director	2007	–	–	–	–	75,000	–	–
John Patterson *(i)*	2008	67	–	–	67	125,000	–	–
Non Executive Director	2007	49	–	–	49	125,000	–	–

(i) The 'Base compensation' for W.D. Lyons, P.R. Clutterbuck, N. Friend, J. Smith, and J. Patterson are in respect of consultancy fees.

FORWARD LOOKING STATEMENTS

This disclosure contains certain forward-looking estimates that involve substantial known and unknown risks and uncertainties, certain of which are beyond Orca Exploration's control, including the impact of general economic conditions in the areas in which Orca Exploration operates, civil unrest, industry conditions, changes in laws and regulations including the adoption of new environmental laws and regulations and changes in how they are interpreted and enforced, increased competition, the lack of availability of qualified personnel or management, fluctuations in commodity prices, foreign exchange or interest rates, stock market volatility and obtaining required approvals of regulatory authorities. In addition there are risks and uncertainties associated with oil and gas operations, therefore Orca Exploration's actual results, performance or achievement could differ materially from those expressed in, or implied by, these forward-looking estimates and, accordingly, no assurances can be given that any of the events anticipated by the forward-looking estimates will transpire or occur, or if any of them do so, what benefits, including the amounts of proceeds, that Orca Exploration will derive therefrom.

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United Kingdom

NIGEL A. FRIEND
Chief Financial Officer
London
United Kingdom

PIERRE RAILLARD
Vice President Operations
Dar es Salaam
Tanzania

JOHN PATTERSON
Non-Executive Director
Nanoose Bay
Canada

DAVID ROSS
Non-Executive Director
Calgary
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JAMES SMITH
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