



Annual Report  
2004

<b>HIGHLIGHTS</b>			
	<b>Year ended December 31, 2004</b>	Six months ended December 31, 2003	Year ended June 30, 2003
<b>Production:</b>			
Gas (thousand cubic feet per day)	<b>68</b>	69	–
Oil and NGLs (barrels per day)	<b>12</b>	12	–
Boe (barrels oil equivalent per day)	<b>23</b>	24	–
<b>Revenue (\$)</b>	<b>389,524</b>	160,413	–
<b>Cash flow from operations (\$)</b>	<b>130,281</b>	42,889	(143,253)
<b>Net income (loss) (\$)</b>	<b>3,684</b>	(4,975)	(144,305)
<b>Per diluted share amounts:</b>			
Cash flow from operations (\$/share)	<b>\$0.01</b>	–	(\$0.03)
Net income (loss) (\$/share)	–	–	(\$0.03)
<b>Weighted average number of shares outstanding</b>	<b>8,871,558</b>	8,871,558	5,700,298

## **MANAGEMENT DISCUSSION AND ANALYSIS**

Management discussion and analysis of the financial condition and results of operations of the Company should be read in conjunction with the Company's audited financial statements and related notes for the year ended December 31, 2004, the six months ended December 31, 2003, and the year ended June 30, 2003. The calculation of barrels of oil equivalent ("boe") is based on a relative energy content conversion ratio of six thousand cubic feet ("mcf") of natural gas to one barrel of oil. Production volumes reported are the Company's interest before royalties.

### Non-GAAP Measures

The financial data presented has been prepared in accordance with Canadian generally accepted accounting principles (GAAP) except for the term "cash flow from operations". Cash flow from operations has been presented for information purposes only and should not be considered an alternative to, or more meaningful than cash flow from operating activities as determined in accordance with GAAP. The determination of the Company's cash flow from operations may not be comparable to the same reported by other companies. The reconciliation of net income and cash flow from operations can be found in the Statements of Cash Flows in the financial statements. The Company calculates cash flow from operations prior to the change in non-cash operating working capital related to operating activities and abandonment costs incurred. Cash flow from operations per share was calculated using the same weighted average shares outstanding used in calculating net income per share.

## Business Environment

World and Canadian crude oil prices and Canadian natural gas prices strengthened significantly in 2004 over 2003 levels. Both commodities are at historically high price levels.

	Q4 2004	Q3 2004	Q2 2004	Q1 2004	Q4 2003	Q3 2003
West Texas Intermediate for crude oil (US\$/bbl)	\$48.35	\$43.93	\$38.74	\$35.12	\$31.12	\$30.41
Edmonton posted reference for crude oil (C\$/bbl)	58.52	56.04	50.85	45.67	40.03	43.82
AECO-C for natural gas (C\$/mcf)	6.73	6.22	7.00	6.43	5.83	5.90

## Operations

The Company produces petroleum and natural gas from Boundary Lake and Lochend in Alberta. The Company acquired all of its producing oil and gas interests on June 27, 2003 and began accounting for production of petroleum and natural gas in the third quarter of 2003.

	Q4 2004	Q3 2004	Q2 2004	Q1 2004	Q4 2003	Q3 2003
<b>Crude oil and natural gas liquids</b>						
Production (barrels)	992	1,182	1,147	983	1,005	1,186
Price per barrel	\$54.00	\$53.25	\$45.08	\$45.26	\$33.55	\$39.37
Revenue	\$53,567	\$62,938	\$51,711	\$44,489	\$33,722	\$46,694
<b>Natural gas</b>						
Production (mcf)	6,097	7,036	5,363	6,445	6,635	6,055
Price per mcf	\$7.05	\$7.11	\$7.03	\$7.15	\$5.99	\$6.65
Revenue	\$43,006	\$50,051	\$37,685	\$46,077	\$39,752	\$40,245
<b>Barrels of oil equivalent</b>						
Production (boe)	2,008	2,355	2,041	2,057	2,111	2,195
Price per boe	\$48.09	\$47.98	\$43.82	\$44.02	\$34.81	\$39.60
Revenue	\$96,573	\$112,989	\$89,396	\$90,566	\$73,474	\$86,939
Royalties	(22,078)	(22,662)	(23,458)	(24,492)	(27,374)	(12,719)
Operating expense	(15,643)	(19,291)	(12,334)	(14,661)	(8,249)	(12,205)
Operating netback	\$58,852	\$71,036	\$53,604	\$51,413	\$37,851	\$62,015
Average royalty rate	22.9%	20.1%	26.2%	27.0%	37.3%	14.6%
Operating costs per boe	\$7.79	\$8.19	\$6.04	\$7.13	\$3.91	\$5.56

The Company recorded strong operating netbacks throughout 2004. The Company recorded an operating netback of \$234,905 for its first full year of operations. Royalties during the year were incurred at an average rate of 23.8% for the year ended December 31, 2004 compared to 25.0% for the six months ended December 31, 2004. Operating costs averaged \$7.32 per barrel of oil equivalent compared to \$4.75 per barrel of oil equivalent in 2003, reflecting increased field efforts to increase production in the current robust commodity market.

## Overhead Costs

	2004				2003			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
General and administration	\$34,668	\$24,008	\$47,382	\$44,146	\$35,001	\$21,976	\$31,966	\$32,801
Interest	-	-	-	-	-	-	27,487	19

The Company incurred \$150,204 in general and administration expenses, an increase of 23% over 2003. In addition and included in the general and administration, a amortization of the non-cash compensation cost relating to the granting of stock options pursuant to the Company's stock option plan amounted to \$41,074 in 2004 versus \$nil in 2003. Excluding stock option compensation, the Company's general and administration decreased 11% from 2003 to 2004. Although operations have commenced, the Company has not experienced a significant degree of administration cost increments since production began in the third quarter of 2003. Since June 27, 2003, the Company had no outstanding debt or interest-bearing payables, and as a result no interest expense was recorded in the year ended December 31, 2004 or in the six months ended December 31, 2003.

The Company, under an administration agreement, is charged fees from a company related by virtue of common management for the performance of administration activities.

## Depletion, depreciation and amortization

	2004				2003			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Depletion and depreciation	\$10,790	\$23,608	\$18,900	\$20,800	\$23,442	\$21,591	\$265	\$262
Site restoration	1,534	2,942	3,117	3,832	1,655	1,175	-	-
	\$12,324	\$26,550	\$22,017	\$24,632	\$25,097	\$22,766	\$265	\$262
Depletion and depreciation rate per boe	\$5.37	\$10.02	\$9.26	\$10.11	\$11.10	\$9.84	-	-

The Company began to record depletion, depreciation and site restoration expense following the acquisition of the producing properties on June 27, 2003. The Company's depletion and depreciation rate per barrel of oil equivalent declined in 2004 to \$8.76 per boe versus \$10.46 per boe in 2003. The most significant portion of this declining depletion rate results from the increase in proven reserves attributed to the Company's Boundary Lake property.

## Taxation

The Company has non-capital losses and unused resource tax pools available for deduction in calculating taxable income in future periods. Although in aggregate these balances amount to approximately \$1.6 million, the Company has not recognized an asset in the financial statements. Approximately \$730,000 of the amount available for future deduction relate to non-capital losses which expire in the years 2005 through 2009.

## Net Income

	2004				2003			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Net income	\$13,452	\$21,529	\$(14,989)	\$(16,308)	\$32,758	\$26,646	\$(31,297)	\$(33,082)
Net income per share								
Basic	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ (0.01)
Diluted	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ (0.01)
Weighted average outstanding								
Shares (000s)	8,872	8,872	8,872	8,872	8,872	8,872	6,689	5,381

## Liquidity and Capital Resources

The Company has recorded positive cash flow from operations since the acquisition of producing properties on June 27, 2003, and currently has sufficient working capital to meet its obligations as they come due. Cash flow in the current quarter has risen from the previous quarter due to higher prices, lower royalty and overhead costs, partially offset by higher operating expenses.

	2004				2003			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Working capital	\$391,095	\$358,734	\$298,827	\$279,971	\$261,653	\$258,802	\$218,764	\$69,143
Cash flow	\$33,200	\$59,907	\$18,856	\$18,318	\$2,851	\$40,038	\$(59,453)	\$(32,820)

## Petroleum and Natural Gas Reserves

	Year Ended December 31, 2004			Six Months Ended December 31, 2003		
	Oil & Liquids (mmbbls)	Natural Gas (mmcf)	Barrels Equivalent (mboe)	Oil & Liquids (mmbbls)	Natural Gas (mmcf)	Barrels Equivalent (mboe)
Proven reserves						
Opening balance	22	122	42	-	-	-
Acquisitions	-	-	-	24	135	46
Production	(4)	(25)	(8)	(2)	(13)	(4)
Revisions	12	94	28	-	-	-
Closing balance	30	191	62	22	122	42
Probable reserves						
Opening balance	6	35	12	-	-	-
Acquisitions	-	-	-	6	35	12
Revisions	1	19	4	-	-	-
Closing balance	7	54	16	6	35	12
Proven plus probable reserves						
Opening balance	28	157	54	-	-	-
Acquisitions	-	-	-	30	170	58
Production	(4)	(25)	(8)	(2)	(13)	(4)
Revisions	13	113	32	-	-	-
Closing balance	37	245	78	28	157	54

Production on the Company's properties at Boundary Lake and to a lesser extent Lochend, both acquired by the Company in June 2003, were positively revised in the Company's external reserve evaluation performed by Gilbert Laustsen Jung Associates Ltd., effective December 31, 2004.

## Present Value Continuity of Petroleum and Natural Gas Reserves

The Company's estimates of future cash flows were also positively impacted by the positive revision in production estimates from both properties and to a lesser extent by increased estimates of petroleum and natural gas prices anticipated in future periods.

The value of the Company's petroleum and natural gas estimates from the Company's external reserve evaluation performed by Gilbert, Laustsen Jung Associates Ltd., effective December 31, 2004 and as measured by the estimates of future cash flows of proved reserves and discounted by 10%, was measured at \$815,000, up from \$494,000 at December 31, 2003. Technical revisions raised this measure by 89% and accounted for \$440,000 of the increase with price revisions of a positive 14% adding an additional \$67,000. Cash flow earned from the properties and changes in present value account for the balance.

The value of the Company's petroleum and natural gas estimates from the Company's measuring the estimates of future cash flows of proved plus probable reserves and discounted by 10%, was measured at \$946,000, up from \$592,000 at December 31, 2003. Technical revisions as noted above had the most significant impact on this total, improving this measure by 79% or \$468,000 of the increase. Price revisions of a positive 10% added an additional \$62,000. Cash flow earned from the properties and changes in present value make up the remaining balances.

	Year ended December 31, 2004		Six Months Ended December 31, 2003	
	PV 0% (\$000s)	PV 10% (\$000s)	PV 0% (\$000s)	PV 10% (\$000s)
<b>Proven reserves</b>				
Opening balance	668	494	-	-
Acquisitions	-	-	768	566
Cash flow	(235)	(235)	(100)	(100)
Changes in present value	-	49	-	28
Price revisions	168	67	-	-
Technical revisions	605	440	-	-
Closing balance	1,206	815	668	494
<b>Probable reserves</b>				
Opening balance	203	98	-	-
Acquisitions	-	-	203	93
Changes in present value	-	10	-	5
Price revisions	48	(5)	-	-
Technical revisions	102	28	-	-
Closing balance	353	131	203	98
<b>Proven plus probable reserves</b>				
Opening balance	871	592	-	-
Acquisitions	-	-	170	58
Cash flow	(235)	(235)	(100)	(100)
Changes in present value	-	59	-	33
Price revisions	216	62	-	-
Technical revisions	707	468	-	-
Closing balance	1,559	946	157	54

## Auditors' Report

To: The Shareholders of  
**Ironhorse Oil & Gas Inc.**

We have audited the balance sheets of **Ironhorse Oil & Gas Inc.** as at **December 31, 2004 and 2003** and the statements of operations and deficit and cash flows for the year ended December 31, 2004 and the six month period ended December 31, 2003. 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 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 year ended December 31, 2004 and six month period ended December 31, 2003 in accordance with Canadian generally accepted accounting principles.

Calgary, Alberta  
March 16, 2005

(Signed) Kenway Mack Slusarchuk Stewart LLP  
Chartered Accountants

# IRONHORSE OIL & GAS INC.

## Balance Sheets

	December 31, 2004	December 31, 2003	June 30, 2003
<b>ASSETS</b>			
Current Assets			
Cash	\$ 396,871	\$ 243,296	\$ 195,511
Accounts receivable	34,541	40,355	25,304
Prepaid expenses	4,969	-	4,768
	<b>436,381</b>	283,651	225,583
Property and equipment (note 5)	<b>332,249</b>	406,347	451,381
	<b>\$ 768,630</b>	\$ 689,998	\$ 676,964
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
Current Liabilities			
Accounts payable and accrued liabilities	\$ 45,286	\$ 21,998	\$ 6,819
Future site restoration (note 6)	<b>109,151</b>	98,565	95,735
	<b>154,437</b>	120,563	102,554
Shareholders' equity			
Share capital (note 8)	4,170,174	4,170,174	4,170,174
Contributed surplus (note 8)	41,074	-	-
Deficit	<b>(3,597,055)</b>	(3,600,739)	(3,595,764)
	<b>614,193</b>	569,435	574,410
	<b>\$ 768,630</b>	\$ 689,998	\$ 676,964

See accompanying notes to the financial statements.

Approved on behalf of the board:

*(signed) "Larry J. Parks"*  
Director

*(signed) "James K. Wilson"*  
Director

# IRONHORSE OIL & GAS INC.

## Statements of Operations and Deficit

	Year ended December 31 2004	Six months ended December 31 2003	Year ended June 30 2003
Revenue	\$ 389,524	\$ 160,413	\$ -
Royalties	(92,690)	(40,093)	-
	296,834	120,320	-
Other income	4,506	-	-
	301,340	120,320	-
Expenses			
Operations	61,929	20,454	-
General and administration	150,204	56,977	115,702
Interest	-	-	27,551
Depletion, depreciation and amortization	85,523	47,864	1,052
	297,656	125,295	144,305
Income (loss) for the period	3,684	(4,975)	(144,305)
Deficit, beginning of period	(3,600,739)	(3,595,764)	(3,451,459)
Deficit, end of period	<u>\$ (3,597,055)</u>	<u>\$ (3,600,739)</u>	<u>\$ (3,595,764)</u>
Basic and diluted income (loss) per share (note 9)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (0.03)</u>

See accompanying notes to the financial statements.

# IRONHORSE OIL & GAS INC.

## Statements of Cash Flows

	Year ended December 31 2004	Six months ended December 31 2003	Year ended June 30 2003
Cash flows from (used in) operating activities			
Income (loss) for the period	\$ 3,684	\$ (4,975)	\$ (144,305)
Add items not affecting cash			
Depletion, depreciation and amortization	85,523	47,864	1,052
Stock option compensation	41,074	-	-
Cash flow from operations	130,281	42,889	(143,253)
Abandonment costs incurred	(839)	-	-
Changes in non-cash operating working capital (note 12)	24,133	4,896	(46,769)
	153,575	47,785	(190,022)
Cash flows from investing activities			
Purchase price adjustment on acquisition of petroleum and natural gas properties (note 3)	-	-	207,407
Cash flows from financing activities			
Issuance of common shares	-	-	169,400
Increase in cash during the period	153,575	47,785	186,785
Cash, beginning of period	243,296	195,511	8,726
Cash, end of period	\$ 396,871	\$ 243,296	\$ 195,511

See accompanying notes to the financial statements.

# **IRONHORSE OIL & GAS INC.**

## **Notes to the Financial Statements**

**For the Year Ended December 31, 2004, the Six Month Period Ended December 31, 2003 and for the Year Ended June 30, 2003**

---

### **1. NATURE OF OPERATIONS**

The Company was incorporated on September 18, 1972 in the Province of British Columbia and was continued under the Alberta Business Corporations Act on November 26, 2002. Immediately prior to the acquisition described in Note 3 to these financial statements, the Company did not have any active operations. Following the acquisition, the Company is in the business of exploration for and production of petroleum and natural gas properties.

### **2. BASIS OF PRESENTATION**

The company changed its fiscal year end to December 31, commencing in the six month fiscal period ended December 31, 2003.

### **3. ACQUISITION**

On June 27, 2003, the Company acquired certain petroleum and natural gas properties in the Boundary Lake and Lochend areas of Alberta for consideration of \$560,000. The consideration was satisfied by the issuance of 2,240,000 common shares of the Company at a deemed price of \$0.25 per share. In conjunction with the acquisition, purchase price adjustments on the net property revenues amounted to a net reduction to the cost of the purchase in the amount of \$218,990 and this amount was settled in cash. The Company also incurred additional costs related to the acquisition amounting to \$11,583.

### **4. SIGNIFICANT ACCOUNTING POLICIES**

#### **(a) Petroleum and natural gas properties**

##### **Capitalized costs**

The Company follows the full cost method of accounting, whereby all costs associated with the exploration for and development of petroleum and natural gas reserves are capitalized in a single Canadian cost centre. Such amounts include land acquisition costs, geological and geophysical expenditures, carrying charges of non-producing properties, costs of drilling productive and non-productive wells, site restoration and abandonment costs and administrative costs related to exploration and development activities.

Proceeds from the sale of properties are applied against capitalized costs and gains or losses are not recognized in the statement of operations unless the depletion and depreciation rate would be changed by 20% or more.

# IRONHORSE OIL & GAS INC.

## Notes to the Financial Statements

For the Year Ended December 31, 2004, the Six Month Period Ended December 31, 2003 and for the Year Ended June 30, 2003

---

#### 4. SIGNIFICANT ACCOUNTING POLICIES (continued)

##### Impairment test

Effective January 1, 2004, the Company retroactively adopted the Canadian Institute of Chartered Accountants Accounting Guideline AcG-16 on full cost accounting for oil and gas companies. The Company calculates a ceiling test whereby the carrying value of its property and equipment is compared at each reporting period end to an estimate of undiscounted future net cash flow from the production of gross proved reserves plus the cost of unproven properties and major development projects excluded from depletion. Net cash flow is estimated using forecasted prices, less estimated costs directly associated with the development, production and sale of reserves. Should the ceiling test result in a calculation in excess of carrying value, the Company would then measure the amount of impairment by comparing the carrying amounts of property and equipment to an amount equal to the estimated net present value of future cash flows from proved plus probable reserves and the sale of unproved properties. A risk-free interest rate is used to arrive at the net present value of the future cash flows. Any excess is recorded as a permanent impairment.

##### Depletion, depreciation and amortization

The capitalized costs of petroleum and natural gas properties are depleted and amortized using the unit-of-production method based on the Company's interest in proved reserves of petroleum and natural gas calculated before royalties. Estimated proved reserves are based on reports prepared by independent engineering consultants. Petroleum substances are converted to volumes of energy equivalent barrels of oil at a conversion rate of six thousand cubic feet ("mcf") of natural gas to one barrel of crude oil.

Costs associated with the acquisition and evaluation of significant unproved properties where there is no commercial production are excluded from amounts subject to depletion until such time as the properties are proved or become impaired.

##### (b) Site restoration and abandonment costs

The Company recognizes and measures the liabilities for obligations associated with the retirement of petroleum and natural gas properties when those obligations result from the acquisition, construction, development or normal operation of the asset. The obligation is measured at fair value and the related costs recorded as part of the carrying value of the related asset. In subsequent periods, the liability is adjusted for the change in present value and any changes in the amount or timing of the underlying future cash flows required for settlement of the obligation. The asset retirement costs included in petroleum and natural gas costs are depleted or amortized into income in accordance with the Company's policies pertaining to those assets.

##### (c) Interests in joint ventures

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

# IRONHORSE OIL & GAS INC.

## Notes to the Financial Statements

For the Year Ended December 31, 2004, the Six Month Period Ended December 31, 2003 and for the Year Ended June 30, 2003

---

#### 4. SIGNIFICANT ACCOUNTING POLICIES (continued)

(d) Future income taxes

The Company uses the liability method for accounting for future income taxes. Under the liability method, future income tax assets and liabilities are determined based on "temporary differences" (differences between the accounting basis and the tax basis of the assets and liabilities), and are measured using the currently enacted tax rates and laws expected to apply when those differences reverse. 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.

(e) Stock based compensation

The Company uses the fair value method using the Black-Scholes option pricing model to account for stock options granted under its stock option plan. For options granted in respect of future services, compensation expense is recorded over the vesting period.

(f) Revenue recognition

Revenue from the production of petroleum and natural gas is recognized when deliveries of products are made to third parties.

(g) Use of estimates

Management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reported period. The amounts recorded for depletion and amortization of petroleum and natural gas properties and the provision for site restoration and abandonment and the ceiling test are based on estimates of proved reserves, production rates, oil and gas prices, future costs and other relevant assumptions. The fair value of stock options and the related stock-based compensation expense is based on estimates using the Black-Scholes option pricing model. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future periods could be significant.

(h) Income (loss) per share

Diluted per share amounts are calculated using the treasury stock method. Diluted calculations reflect the weighted average incremental common shares that would be issued upon exercise of dilutive options, warrants and equivalents assuming the proceeds would be used to repurchase shares at average market prices for the period. Anti-dilutive items are not included in the calculation.

# IRONHORSE OIL & GAS INC.

## Notes to the Financial Statements

For the Year Ended December 31, 2004, the Six Month Period Ended December 31, 2003 and for the Year Ended June 30, 2003

### 5. PROPERTY & EQUIPMENT

	December 31, 2004		
	Cost	Accumulated Depletion and Amortization	Net
Petroleum and natural gas properties	\$ 448,328	\$ 116,079	\$ 332,249
	December 31, 2003		
	Cost	Accumulated Depletion and Amortization	Net
Petroleum and natural gas properties	\$ 448,328	\$ 41,981	\$ 406,347
	June 30, 2003		
	Cost	Accumulated Depletion and Amortization	Net
Petroleum and natural gas properties	\$ 448,328	\$ -	\$ 448,328
Computer, furniture and equipment	6,371	3,318	3,053
	\$ 454,699	\$ 3,318	\$ 451,381

In conducting the ceiling test as at December 31, 2004, the Company's estimated future cash flows exceeded the carrying value of the related petroleum and natural gas properties using the following assumptions pertaining to future commodity prices for crude oil refinery postings at Edmonton and for spot natural gas postings at AECO-C storage hub consistent with the Company's December 31, 2004 reserve report as provided by Gilbert Laustsen Jung Associates Ltd.:

	Oil (\$/barrel)	Gas (\$/mcf)
2005	\$ 50.25	\$ 6.60
2006	47.75	6.35
2007	45.50	6.15
2008	43.25	6.00
2009	40.75	6.00
Thereafter	39.50 – 41.25	6.00 – 6.30

During the year ended December 31, 2004, the Company has capitalized no interest (December 31, 2003 – nil; June 30, 2003 – nil) and no general and administrative costs (December 31, 2003 – nil; June 30, 2003 – nil).

The cost of unproved properties excluded from depletion in the year ended December 31, 2004 was nil (six months ended December 31, 2003 – nil; year ended June 30, 2003 – nil).

# IRONHORSE OIL & GAS INC.

## Notes to the Financial Statements

For the Year Ended December 31, 2004, the Six Month Period Ended December 31, 2003 and for the Year Ended June 30, 2003

### 6. FUTURE SITE RESTORATION

	Year ended December 31 2004	Six months ended December 31 2003	Year ended June 30 2003
Future site restoration, beginning of period	\$ 98,565	\$ 95,735	\$ -
Incurred in the period	-	-	95,735
Expenditures made on asset retirements	(839)	-	-
Change in present value during period	11,425	2,830	-
<u>Future site restoration, end of period</u>	<u>\$ 109,151</u>	<u>\$ 98,565</u>	<u>\$ 95,735</u>

The total undiscounted amount of cash flows required to settle the obligations as measured at December 31, 2004 is estimated at \$160,310 (December 31, 2003 - \$131,768). These obligations are expected to be settled at various times over the 14 years subsequent to December 31, 2004. The credit-adjusted risk free rate at which the estimated cash flows were discounted was 8% during the period ended December 31, 2004 (December 31, 2003 - 6%) and the estimated inflation rate used to project future costs was 1.5% (December 31, 2003 - nil).

### 7. INCOME TAXES

	Year ended December 31 2004	Six months ended December 31 2003	Year ended June 30 2003
Statutory tax rate	37.87%	40.58%	40.58%
Anticipated tax expense (recovery)	\$ 1,395	\$ (2,019)	\$ (58,559)
Increase (decrease) resulting from:			
Non-deductible crown royalties	23,539	13,242	-
Non-deductible stock compensation	15,555	-	-
Resource allowance	(10,428)	(7,222)	-
Non-capital loss expiry	-	64,761	73,781
Tax rate changes	40,333	-	26,107
Valuation allowance applied	(70,394)	(68,762)	(41,329)
<u>Future tax expense (recovery)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

# IRONHORSE OIL & GAS INC.

## Notes to the Financial Statements

For the Year Ended December 31, 2004, the Six Month Period Ended December 31, 2003 and for the Year Ended June 30, 2003

### 7. INCOME TAXES (continued)

The components of the net future tax liability are as follows:

	<b>December 31 2004</b>	December 31 2003	June 30 2003
Future income tax assets related to:			
Non-capital losses	\$ 276,708	\$ 363,086	\$ 448,686
Property and equipment	215,515	200,869	185,179
Future site restoration	41,335	39,998	38,849
Total future income tax assets	533,558	603,952	672,714
Valuation allowance	(533,558)	(603,952)	(672,714)
Future income tax asset (liability)	\$ —	\$ —	\$ —

The Company has non-capital losses available to reduce future taxable income as follows:

<u>Year of expiry</u>	<u>Amount</u>
2005	\$ 130,135
2006	177,576
2007	74,775
2008	204,939
Thereafter	143,253
Total	\$ 730,696

In addition, the Company has other petroleum and natural gas property tax pools available to reduce future taxable income as follows:

<u>Expenditure Class</u>	<u>Amount</u>
Canadian exploration expense	\$ 130,725
Canadian development expense	418,023
Canadian oil & gas property expense	282,074
Undepreciated capital cost	70,519
Total	\$ 901,341

# IRONHORSE OIL & GAS INC.

## Notes to the Financial Statements

For the Year Ended December 31, 2004, the Six Month Period Ended December 31, 2003 and for the Year Ended June 30, 2003

### 8. SHARE CAPITAL

The Company has authorized unlimited common shares and unlimited first preferred shares. The outstanding share capital is as follows:

#### (a) Common Shares

	Year ended December 31, 2004	
	Number	Amount
Balance, opening	8,871,558	\$4,170,174
Issued during the year	—	—
<u>Balance, closing</u>	<u>8,871,558</u>	<u>\$4,170,174</u>

	Six months ended December 31, 2003	
	Number	Amount
Balance, opening	8,871,558	\$ 4,170,174
Issued during the period	—	—
<u>Balance, closing</u>	<u>8,871,558</u>	<u>\$ 4,170,174</u>

	Year ended June 30, 2003	
	Number	Amount
Balance, opening	4,937,558	\$ 3,440,774
Issued on the exercise of share purchase warrants	1,694,000	169,400
Issued on the acquisition of property and equipment	2,240,000	560,000
<u>Balance, closing</u>	<u>8,871,558</u>	<u>\$ 4,170,174</u>

The Company is holding 1,351,049 common shares in escrow (December 31, 2003 – 2,023,049 shares) arising from two escrow agreements of 1,344,000 and 7,049 shares (December 31, 2003 – 2,016,000 and 7,049 shares). The former agreement provided for the escrow of the 2,240,000 shares issued pursuant to an asset purchase and sale closed June 27, 2003. The terms of the escrow agreement include a release of the shares from escrow over a three year period ending August 5, 2006. The latter agreement provides for the escrow of 7,049 shares subject to release upon approval by regulatory authorities.

# IRONHORSE OIL & GAS INC.

## Notes to the Financial Statements

For the Year Ended December 31, 2004, the Six Month Period Ended December 31, 2003 and for the Year Ended June 30, 2003

### 8. SHARE CAPITAL (continued)

#### (b) Stock Options

Under the Company's stock option plan, common share purchase options may be granted to directors, officers, staff and consultants. The Company may grant options to purchase common shares up to a maximum of 10% of the number of issued and outstanding common shares. The granted common share purchase options are subject to vesting requirements as determined upon granting and are subject to expiry five years following the date granted.

	Year ended December 31, 2004		
	Number Vested	Number Outstanding	Weighted Avg Price Per Share
Balance, opening	—	460,000	\$ 0.225
Granted during the year	—	200,000	0.370
Vested during the year	126,667	—	0.225
Cancelled during the year	—	(80,000)	0.225
<u>Balance, closing</u>	<u>126,667</u>	<u>580,000</u>	<u>\$ 0.275</u>

	Six months ended December 31, 2003		
	Number Vested	Number Outstanding	Weighted Avg Price Per Share
Balance, opening	—	—	\$ —
Granted during the year	—	460,000	0.225
<u>Balance, closing</u>	<u>—</u>	<u>460,000</u>	<u>\$ 0.225</u>

During the year ended December 31, 2004, the Company granted 200,000 options to purchase common shares at a price of \$0.37 per common share. These options vest over a three year period and expire on January 31, 2009. The weighted-average fair value for these options is \$0.18 per option or an aggregate of \$36,000 using assumptions of a risk-free interest rate of 5.0%, an expected life of 5 years, volatility of 48% and no anticipated dividends.

During the six months ended December 31, 2003, the Company granted 460,000 options to purchase common shares at a price of \$0.225 per common share. The Company has cancelled 80,000 of these options during the year ended December 31, 2004. Also vesting over a three year period, these options expire on December 23, 2008. The weighted-average fair value of the options granted during the year was \$0.09 per option, an aggregate of \$41,400 using assumptions of a risk-free interest rate of 4.0%, an expected life of 5 years, volatility of 35% and no anticipated dividends.

# IRONHORSE OIL & GAS INC.

## Notes to the Financial Statements

For the Year Ended December 31, 2004, the Six Month Period Ended December 31, 2003 and for the Year Ended June 30, 2003

---

### 8. SHARE CAPITAL (continued)

There were no options granted or outstanding during the year ended June 30, 2003.

The compensation amount attributed to contributed surplus and charged to general and administration costs for stock-based compensation awards in the year ended December 31, 2004 was \$41,074 (December 31, 2003 – nil; June 30, 2003 - nil).

### 9. PER SHARE AMOUNTS

Basic per share amounts are calculated using the weighted average number of common shares outstanding during the year ended December 31, 2004 of 8,871,558 (six months ended December 31, 2003 – 8,871,558; year ended June 30, 2003 – 5,700,298).

Options to purchase 580,000 common shares were outstanding at December 31, 2004 (460,000 – December 31, 2003; nil – June 30, 2003), 380,000 of which were dilutive (six months ended December 31, 2003 – 460,000; year ended June 30, 2003 – nil).

The following table sets forth the details of the denominator used for the computation of basic and diluted earnings per share:

	Year ended December 31 2004	Six months ended December 31 2003	Year ended June 30 2003
Weighted average number of common shares	8,871,558	8,871,558	5,700,298
Net effect of dilutive securities:			
Employee stock options	68,184	76,383	–
Diluted number of common shares	8,939,742	8,947,941	5,700,298

### 10. RELATED PARTY TRANSACTIONS

The petroleum and natural gas properties described in Note 3 to these financial statements were acquired from Archean Oil & Gas Ltd. In conjunction with the completion of this acquisition, certain principals of that Company, who are members of management of Archean Oil and Gas Ltd., acquired the 2,240,000 common shares of the Company that were issued as consideration for the acquisition.

The transaction is not in the normal course of operations and is recorded at the exchange amount which is the amount of consideration established and agreed to by the related parties.

# IRONHORSE OIL & GAS INC.

## Notes to the Financial Statements

For the Year Ended December 31, 2004, the Six Month Period Ended December 31, 2003 and for the Year Ended June 30, 2003

### 10. RELATED PARTY TRANSACTIONS (continued)

The Company is subject to an administrative services contract with Grizzly Resources Ltd. and prior to September 1, 2004 with Archean Oil and Gas Ltd., companies related by virtue of common management. In the year ended June 30, 2003, the Company paid consulting fees to a company controlled by a former director.

	Year ended December 31 2004	Six months ended December 31 2003	Year ended June 30 2003
Administrative services contract	\$ 15,291	\$ 7,534	\$ -
Consulting fees	-	-	30,500
	<u>\$ 15,291</u>	<u>\$ 7,534</u>	<u>\$ 30,500</u>

These transactions are in the normal course of business and are recorded at the exchange amount which is the amount of consideration established and agreed to by the related parties.

### 11. FINANCIAL INSTRUMENTS

#### Fair value

The Company's carrying values of cash, accounts receivable and accounts payable and accrued liabilities approximates their fair values due to the immediate or short-term maturity of these instruments.

#### Credit risk

The majority of the accounts receivable are in respect of oil and natural gas operations. The Company generally extends unsecured credit to these customers, and therefore, the collection of accounts receivables may be affected by changes in economic or other conditions. Management believes the risk is mitigated by the size and reputation of the companies to which they extend credit. The Company has not experienced any credit loss in the collection of receivables to date.

#### Interest rate risk

The Company does not have any bank indebtedness or other long-term debt and is currently not exposed to the risk of interest rate fluctuations.

#### Commodity prices and exchange rate risk

The nature of the company's operations results in exposure to fluctuation in commodity prices and exchange rates. The Company does not currently hedge these risks.

# IRONHORSE OIL & GAS INC.

## Notes to the Financial Statements

For the Year Ended December 31, 2004, the Six Month Period Ended December 31, 2003 and for the Year Ended June 30, 2003

---

### 12. SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

	Year ended December 31 2004	Six months ended December 31 2003	Year ended June 30 2003
Changes in non-cash working capital from operations:			
Accounts receivable	\$ 5,814	\$ (15,051)	\$ (9,322)
Prepaid expenses	(4,969)	4,768	(4,768)
Accounts payable	23,288	15,179	(32,679)
	<u>\$ 24,133</u>	<u>\$ 4,896</u>	<u>\$ (46,769)</u>

### 13. COMPARATIVE FIGURES

The balance sheet as at June 30, 2003 and the statement of operations and deficit and the statement of cash flows for the year then ended were reported on by another firm of chartered accountants, who issued an unqualified opinion in their report dated August 5, 2003.

---

## BOARD AND MANAGEMENT

### Directors

Larry J. Parks, Chairman  
Blaine C. Favel  
Jeff Lawson  
Gerry C. Quinn  
James K. Wilson

### Officers

Larry J. Parks, President & Chief Executive Officer  
Alan G. Withey, VP Finance & CFO  
D. Craig Boland, VP Exploration  
William G. Manley, VP Engineering & Operations  
James K. Wilson, Corporate Secretary