



**GALLEON ENERGY**

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2008

*Annual Report*



## NOTICE OF ANNUAL MEETING

The Annual Meeting of Galleon Energy Inc. will be held at 11 am on May 14, 2009 at the Livingston Place, South Tower, Mezzanine Level in Conference Rooms A and B (222 – Third Avenue SW) Calgary, Alberta. Shareholders are encouraged to attend the meeting. Shareholders who are unable to attend are urged to complete, sign and return their form of proxy and the accompanying information Circular — Proxy Statement.

# Management's Discussion and Analysis

This Management's Discussion & Analysis ("MD&A") is intended to assist in the understanding of the trends and significant changes in the financial condition and results of operations of Galleon Energy Inc. ("Galleon" or the "Corporation") for the year ended December 31, 2008 with comparisons to the year ended December 31, 2007. The MD&A has been prepared by management in accordance with Canadian generally accepted accounting principles ("GAAP") and should be read in conjunction with the audited financial statements for the year ended December 31, 2008.

Petroleum and natural gas reserves and volumes are converted to a common unit of measure on a basis of six thousand cubic feet (Mcf) of gas to one barrel (Bbl) of oil. BOEs may be misleading, particularly if used in isolation. The forgoing conversion ratio is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.

Amounts are shown in Canadian dollars unless otherwise stated. All production volumes disclosed herein are sales volumes.

This MD&A is based on information available as of, and is dated, March 11, 2009.

## NON-GAAP MEASUREMENTS

The MD&A contains terms commonly used in the oil and gas industry, such as funds from operations, funds from operations per share, and operating netback. These terms are not defined by GAAP and should not be considered an alternative to, or more meaningful than, cash provided by operating activities or net earnings as determined in accordance with Canadian GAAP as an indicator of Galleon's performance. Management believes that in addition to net earnings, funds from operations is a useful financial measurement which assists in demonstrating the Corporation's ability to fund capital expenditures necessary for future growth or to repay debt. Galleon's determination of funds from operations may not be comparable to that reported by other companies. All references to funds from operations throughout this report are based on cash flow from operating activities before changes in non-cash working capital and abandonment expenditures. The Corporation calculates funds from operations per share by dividing funds from operations by the weighted average number of Class A shares outstanding.

Galleon uses the term net debt in the MD&A and presents a table showing how it has been determined. This measure does not have any standardized meaning prescribed by Canadian GAAP and therefore may not be comparable to similar measures presented by other companies.

## FORWARD-LOOKING STATEMENTS

Statements that are not historical facts may be considered forward looking statements including management's assessment of future plans and operations, growth expectations within the Corporation, expected production and production increases, length of drilling program in the Montney, expected general and administration, operating and transportation expenses in 2009, expected royalty rates in 2009 and the impact of the New Alberta Royalty Framework and the transitional royalties and incentives provided in connection therewith, expected levels of cash flow and earnings in 2009, drilling and completion plans and the timing thereof, facilities to be constructed or expanded and the timing thereof, capital expenditures, the timing thereof and the method of funding thereof. These forward-looking statements sometimes include words to the effect that management believes or expects a stated condition or result. All estimates and statements that describe the Corporation's objectives, goals or future plans are forward-looking statements. Since forward-looking statements address future events and conditions, by their very nature they involve inherent risks and uncertainties including, without limitation, risks associated with oil and gas exploration, development, exploitation, production, marketing and transportation, loss of markets, volatility of commodity prices, currency fluctuations, imprecision of reserve estimates, environmental risks, competition from other producers, inability to retain drilling rigs and other services, incorrect assessment of the value of acquisitions, failure to realize the anticipated benefits of acquisitions, delays resulting from or inability to obtain required regulatory approvals and ability to access sufficient capital from internal and external sources. As a consequence, Galleon's actual results may differ materially from those expressed in, or implied by, the forward-looking statements.

Forward-looking statements or information are based on a number of factors and assumptions which have been used to develop such statements and information but which may prove to be incorrect. Although the Corporation believes that the expectations reflected in such forward-looking statements or information are reasonable, undue reliance should not be placed on forward-looking statements because the Corporation can give no assurance that such expectations will prove to be correct.

In addition to other factors and assumptions which may be identified in this document, assumptions have been made regarding, among other things: the impact of increasing competition; the general stability of the economic and political environment in which the Corporation operates; the timely receipt of any required regulatory approvals; the ability of the Corporation to obtain qualified staff, equipment and services in a timely and cost efficient manner; drilling results; the ability of the operator of the projects which the Corporation has an interest in to operate the field in a safe, efficient and effective manor; the ability of the Corporation to obtain financing on acceptable terms; field production rates and decline rates; the ability to replace and expand oil and natural gas reserves through acquisition, development and exploration; the timing and costs of pipeline, storage and facility construction and expansion and the ability of the Corporation to secure adequate product transportation; future oil and natural gas prices; currency, exchange and interest rates; the regulatory framework regarding royalties, taxes and environmental matters in the jurisdictions in which the Corporation operates; and the ability of the Corporation to successfully market its oil and natural gas products.

Readers are cautioned that the foregoing list of all factors and assumptions is not exhaustive. Additional information on these and other factors that could affect Galleon's operations and financial results are included elsewhere herein and in reports on file with Canadian securities regulatory authorities and may be accessed through the SEDAR website ([www.sedar.com](http://www.sedar.com)), or at Galleon's website ([www.galleonenergy.com](http://www.galleonenergy.com)). Furthermore, the forward-looking statements contained herein are made as at the date hereof and Galleon does not undertake any obligation to update publicly or to revise any of the included forward-looking statements, whether as a result of new information, future events or otherwise, except as may be required by applicable securities laws.

## 2008 PERFORMANCE

One of the key highlights in 2008 was the successful capture and development of the Eastern and Central Montney resource projects. Horizontal drilling and multi-stage fracture technology has advanced the development of the Eastern Montney project and one of the Central Montney projects. These resource projects are expected to deliver predictable, sustainable growth throughout the multi- year drilling program.

- Net present value of estimated future net revenue before tax from gross proved plus probable reserves based on forecast prices and costs discounted at 10% reached \$1,226 million, a 10% increase over December 31, 2007;
- Gross proved plus probable reserves grew to 80.4 million BOE, an increase of 35% over December 31, 2007;
- Gross proved reserves grew to 49.3 million BOE, an increase of 45% over December 31, 2007;
- Gross proved producing reserves grew to 23.6 million BOE, an increase of 53% over December 31, 2007;
- Gross proved plus probable reserve life index was 11.9 years based on average Q4 2008 production;
- Production on a gross proved plus probable basis was replaced 4.3 times.

## 2008 FINANCIAL HIGHLIGHTS

- Revenues reached \$418.2 million, an increase of 71% compared to 2007;
- Funds from operations of \$241.3 million (\$3.39 per basic share) were generated, an increase of 84% from 2007;
- Earnings of \$79.3 million (\$1.11 per basic share) were recorded;
- Daily production averaged 17,216 BOE: natural gas – 59 Mmcf and crude oil and NGLs – 7,385 Bbl, an increase of 28% from 2007;
- Investment in exploration and development activities was \$273.6 million;
- The drilling success rate was 89%: drilled 107 gross wells resulting in 56 (53.2 net) natural gas wells, 35 (32 net) light oil wells, three (3 net) heavy oil wells and one (1 net) water injection well.

## ANNUAL INFORMATION

(\$000s)	2008	2007	2006
Revenues	418,233	245,203	157,931
Funds from operations <sup>1</sup>	241,298	131,052	85,151
Per share, basic <sup>1</sup>	3.39	2.18	1.60
Per share, diluted <sup>1</sup>	3.35	2.12	1.52
Net earnings	79,264	8,286	13,826
Per share, basic	1.11	0.14	0.26
Per share, diluted	1.10	0.13	0.25
Total assets	1,181,003	799,359	614,565
Net debt	282,446	193,557	151,213
Bank debt	249,015	163,378	122,996
Total long-term financial liabilities	–	–	–

<sup>1</sup> Funds from operations and funds from operations per share is not a standard measure under GAAP and may not be comparable to similar measures presented by other companies. Management believes that funds flow per share is a useful supplementary measure that may assist investors in assessing the underlying per share value of the Corporation.

On January 16, 2008, the Corporation acquired all of the outstanding common shares of ExAlta Energy Inc. ("ExAlta"). The ExAlta acquisition was accounted for by the purchase method and shares were acquired for an aggregate of \$62.5 million by the issuance of 4,334,856 Class A shares of Galleon at a value of \$14.42 per share plus the assumption of \$48.5 million of net debt including capital leases.

On May 9, 2008 the Corporation acquired all of the outstanding common shares of Adamant Energy Inc. ("Adamant"). The Adamant acquisition was accounted for by the purchase method and shares were acquired for an aggregate of \$65.2 million by the issuance of 4,193,288 Class A shares of Galleon at a value of \$15.55 per share. Cash of \$2.4 million was acquired and positive working capital of \$5.9 million was assumed in the acquisition.

The increase in revenues, funds from operations and net earnings in 2008 compared to 2007 was due to strong commodity prices in the majority of 2008 and to an increase in production volumes throughout 2008. Total assets and net debt increased in 2008 due to the capital expenditure program and the acquisitions of ExAlta and Adamant.

On February 1, 2007, the Corporation closed a transaction resulting in an acquisition of an interest in a partnership and the minority partnership's holdings resulting in a 100% consolidated interest. The partnership held oil and gas assets within Galleon's core area of Dawson, Alberta. The total consideration of \$28.7 million was paid in cash. The acquisition of the partnership increased funds from operations and total assets compared to 2006. The decrease in net income in 2007 compared to 2006 is due to the fair value of financial derivatives recorded based on quoted market prices. At December 31, 2007 the fair value was an unrealized loss of \$9.3 million.

## RESULTS OF OPERATIONS

<i>Year ended December 31</i>	<i>2008</i>		<i>2007</i>	
<i>(\$000s)</i>	<i>6,300,970 BOE</i>		<i>4,901,518 BOE</i>	
	<i>\$/BOE</i>		<i>\$/BOE</i>	
Revenues	418,233	66.38	245,203	50.03
Other income	438	0.07	-	-
Royalties	(86,717)	(13.76)	(51,586)	(10.52)
GCA <sup>1</sup>	15,595	2.48	10,033	2.05
Transportation costs	(8,537)	(1.35)	(6,024)	(1.23)
Operating costs	(75,807)	(12.03)	(44,759)	(9.13)
	263,205	41.79	152,867	31.20
G&A	(13,326)	(2.11)	(7,281)	(1.49)
Interest costs	(11,138)	(1.77)	(10,110)	(2.06)
Gain (loss) on financial derivative	3,621	0.57	(3,545)	(0.72)
Capital and other taxes	(1,064)	(0.17)	(879)	(0.18)
<b>Funds from operations<sup>2</sup></b>	<b>241,298</b>	<b>38.31</b>	<b>131,052</b>	<b>26.75</b>

<sup>1</sup> GCA means Gas Cost Allowance

<sup>2</sup> See "Non-GAAP Measurements"

## PETROLEUM AND NATURAL GAS REVENUES

<i>Year ended December 31</i>	<i>2008</i>		<i>2007</i>	
<i>(\$000s)</i>		<i>%</i>		<i>%</i>
Light oil	189,435	45	98,564	40
Heavy oil	41,503	10	27,776	11
NGLs	11,434	3	5,736	3
Natural gas (net of physical gas contracts)	175,122	42	112,299	46
Royalty income	739	–	828	–
<b>Total</b>	<b>418,233</b>	<b>100</b>	<b>245,203</b>	<b>100</b>

Revenues for the year ended December 31, 2008 increased by 71% to \$418.2 million from \$245.2 million in the prior year due to a 28% increase in average production volumes. As well overall revenues increased by 33% to \$66.38/BOE from \$50.03/BOE in 2007 as a result of higher commodity prices. A portion of Galleon's petroleum products are sold at either spot reference prices or prices subject to commodity contracts based on U.S. dollars for crude oil and AECO for natural gas. The Corporation also enters into fixed price and costless collar commodity contracts on a portion of its petroleum products. Refer to "Commodity Pricing and Marketing" section.

## PRODUCTION

<i>Year ended December 31</i>	<i>2008</i>		<i>2007</i>	
	<i>BOE/d</i>	<i>%</i>	<i>BOE/d</i>	<i>%</i>
Light oil (Bbls/d)	5,187	30	3,562	26
Heavy oil (Bbls/d)	1,686	10	2,005	15
NGLs (Bbls/d)	512	3	246	2
Natural gas (Mcf/d)	58,986	57	45,697	57
<b>BOE/d (6:1)</b>	<b>17,216</b>	<b>100</b>	<b>13,429</b>	<b>100</b>

Average production volumes for 2008 of 17,216 BOE/d increased by 28% compared to 13,429 BOE/d in 2007. By product, light oil volumes increased by 46%, natural gas volumes increased by 29% and heavy oil volumes decreased by 16%. Light oil production increased in 2008 as a result of drilling success at Puskwa, Eaglesham, Culp/Kimiwan and McLeans Creek. Natural gas volumes increased in 2008 as a result of the significant resource gas brought on production in the Central Montney project as well as the production additions realized from horizontal drilling and multi-stage fracture technology in the Eastern Montney project. Heavy oil production suffered a set back in Q2 2008 with a number of wells not recovering their oil production rates after being shut in during spring breakup. Current heavy oil production levels remain stable, but at lower levels.

## COMMODITY PRICING AND MARKETING

Petroleum products are sold to major Canadian marketers at either spot reference prices or prices subject to commodity contracts based on US WTI for crude oil and AECO for natural gas. As a means of managing the risk of commodity price volatility in 2008, Galleon entered into one term natural gas contract and six crude oil financial contracts. The natural gas contract for 10,000 GJ/day was put in place on January 8, 2008 and had a term from February 1 to December 31, 2008 with pricing subject to a costless collar of \$6.00/GJ and \$8.00/GJ Canadian.

An additional natural gas contract was acquired with Adamant. This second contract was for 8,500 GJ/day and was put in place from January 1, 2008 through December 31, 2008 with pricing subject to a costless collar of \$6.00/GJ to \$7.00/GJ Canadian. At the date of acquisition, this contract represented a \$5.3 million liability which has been fully amortized into income in 2008 and recorded as a realized non cash gain of \$5.3 million. For the year ended December 31, 2008, realized losses of \$2.7 million were recorded from these contracts.

In 2008, Galleon had the following crude oil costless collar contracts in place:

January 1, 2008 – December 31, 2008	2,000 Bbl/d	WTI CDN \$70.00 – \$80.75/Bbl
January 1, 2008 – December 31, 2008	1,000 Bbl/d	WTI USD \$75.00 – \$100.00/Bbl
July 1, 2008 – December 31, 2008	1,000 Bbl/d	WTI CDN \$110.00 – \$177.30/Bbl
October 1, 2008 – December 31, 2008	1,000 Bbl/d	WTI USD \$100.00 – \$120.00/Bbl
October 1, 2008 – December 31, 2008	1,000 Bbl/d	WTI USD \$100.00 – \$120.00/Bbl
January 1, 2009 – June 30, 2009	1,000 Bbl/d	WTI USD \$100.00 – \$115.00/Bbl

For the year ended December 31, 2008, the crude oil contracts resulted in realized gains of \$3.6 million. The 2009 contract was unwound in two separate transactions in December 2008 which resulted in a realized gain of \$10.8 million.

In the last two months of 2008, the Corporation entered into the following natural gas financial fixed price contracts:

January 1, 2009 – June 30, 2009	5,000 GJ/d	CDN \$6.00/GJ
January 1, 2009 – June 30, 2009	5,000 GJ/d	CDN \$6.00/GJ
April 1, 2009 – October 31, 2009	5,000 GJ/d	CDN \$7.40/GJ

Unrealized gains of \$1.2 million were recorded as an asset based on the mark to market value at December 31, 2008 of these natural gas financial contracts.

Subsequent to December 31, 2008 the Corporation has entered into the following financial price contracts:

#### Natural Gas

March 1, 2009 – March 31, 2010	5,000 GJ/d	CDN \$5.96/GJ
March 1, 2009 – March 31, 2010	5,000 GJ/d	CDN \$6.01/GJ

#### Crude Oil

March 1, 2009 – December 31, 2009	1,000 Bbl/d	WTI CDN \$68.25/Bbl
February 1, 2009 – December 31, 2009	500 Bbl/d	WTI CDN \$63.30/Bbl
February 1, 2009 – December 31, 2009	500 Bbl/d	WTI CDN \$63.85/Bbl
March 1, 2009 – December 31, 2009	500 Bbl/d	WTI CDN \$60.00 – \$70.00/Bbl

### PRICES (NET OF TRANSPORTATION)

<i>Year ended December 31</i>	<b>2008</b>	<b>2007</b>
Light oil (\$/Bbl)	<b>96.94</b>	74.77
Heavy oil (\$/Bbl)	<b>71.77</b>	37.39
Total oil including financial derivative contract (\$/Bbl)	<b>92.20</b>	59.56
Total oil with out financial derivative contract (\$/Bbl)	<b>90.76</b>	61.31
Natural gas (\$/Mcf)	<b>7.87</b>	6.54
NGLs (\$/Bbl)	<b>61.06</b>	63.94

The average light oil price (excluding the financial derivative contract) received for 2008 was \$96.94/Bbl, an increase of 30% compared to \$74.77/Bbl in the prior year. The average heavy oil price was \$71.77/Bbl, an increase of 92% compared to \$37.39/Bbl in the prior year. The 2009 budget is based on an average price of \$65 WTI USD and a foreign exchange rate of \$0.85 USD to \$1.00 CAD. This budget has been modified to reflect current and future prices.

The average natural gas price received for 2008 was \$7.87/Mcf, an increase of 20% compared to \$6.54/Mcf in the prior year. The 2009 budget is based on an average AECO price of \$7.00/Mcf CAD. This budget has been modified to reflect current and future prices.

## PERFORMANCE BY PROPERTY

	2008			2007			2008
	Year ended December 31	Average Production BOE/d	Operating netbacks/BOE <sup>1</sup> %	Average Production BOE/d	Operating netbacks/BOE <sup>1</sup> %	Funds from operations <sup>2</sup> %	
East Montney	3,818	22	33.60	3,668	27	25.63	19
Eaglesham	3,066	18	42.15	1,975	15	28.07	19
Puskwa	2,573	15	57.71	2,129	16	52.08	22
North Peace River Arch	1,318	8	26.59	–	–	–	5
Alexis / St. Anne	1,198	7	35.45	–	–	–	6
Edam	1,174	7	24.73	1,856	14	8.38	4
Culp / Kimiwan	803	5	59.91	804	6	37.14	7
McLeans Creek	618	4	80.25	154	1	68.25	7
Kakut	549	3	30.08	273	2	22.87	2
Western Montney	278	1	30.52	212	2	26.07	1
Other	1,821	10	26.28	2,358	17	22.21	8
<b>Total</b>	<b>17,216</b>	<b>100</b>	<b>39.65</b>	<b>13,429</b>	<b>100</b>	<b>29.15</b>	<b>100</b>

<sup>1</sup> Operating netbacks/BOE exclude GCA and crude oil and gas hedging gains or losses, and are calculated by subtracting royalties and operating costs from revenues and dividing the result by average production for the period.

<sup>2</sup> See "Non-GAAP Measurements".

Daily production for the year averaged 17,216 BOE/d, an increase of 28% compared to 13,429 BOE/d in 2007. Volume growth in 2008 was primarily driven by Galleon's light oil drilling in the first half of the 2008, Montney resource gas drilling in the second half of the year and production from the ExAlta and Adamant acquisitions. Light oil volumes increased due to the drilling of more oil wells in response to higher oil prices in the first part of 2008. Natural gas volumes increased in 2008 compared to 2007 as a result of the success of the significant Eastern Montney gas horizontal drilling program. Twenty of the 24 horizontal wells drilled in 2008 were brought on production during the second half of 2008. Drilling in the Central Montney project commenced in the second half of the year. The drilling focus shifted between the first half and the second half of 2008. The Corporation moved from conventional plays with smaller size and high initial declines toward resource projects that have repeatability, predictability and comparably larger in size.

The Eastern Montney natural gas project represents a significant resource to Galleon and is currently the largest producing area contributing 19% to total funds from operating activities in 2008 based on 22% of production volumes. The operating netback of \$33.60/BOE has improved by 31% from the prior year as a result of stronger 2008 natural gas prices. Production averaged 3,818 BOE/d (91% natural gas and 9% oil and liquids) during 2008 compared to 3,668 BOE/d in 2007.

Galleon's first Montney horizontal well was drilled in Q1 2008 and commenced production in the latter part of June 2008. In 2008, twenty-four (23.6 net) Eastern Montney horizontal wells were drilled and completed with multi-staged fractures and twenty wells are currently producing approximately 3,600 BOE/d net (20 Mmcf/d and 267 BOE/d of oil and liquids). The production data suggests that horizontal wells have a higher production profile (2 to 3 times better) and lower initial production decline rates than the vertical wells. To date, the economics of the horizontal wells have proven to be better than the vertical wells on a rate of return and reserve optimization basis. On stream costs (including drilling, completion, tie-in and facility costs) on average for the project are less than \$10,000 per producing BOE. Galleon has delineated a gas charged fairway with vertical well control that is 35 miles long by 12 miles wide.

Production at Eaglesham averaged 3,066 BOE/d making it Galleon's second largest producing property in 2008. Production is comprised of 71% natural gas and 29% oil and liquids. Average production was 55% higher in 2008 compared to 1,975 BOE/d in the prior year. This increase has come from success in Wabamun light oil and Montney resource gas drilling. Eaglesham contributed 19% of the 2008 funds from operations from 18% of production volumes. The operating netback of \$42.15/BOE has improved 50% from the prior year as result of stronger commodity prices in 2008. The Wabamun has been a traditional target in this area. The Montney is a new and unique project in that it has seven gas charged Montney sands. To date, four sands have been tested of which two of these are contributing to current production. The remaining two sands are not on production as the sulphur content exceeds the plant specifications. This project has been delineated in 2008 and current Montney production from this project is over 4 Mmcf/d net from three wells. Galleon plans to drill one vertical and one horizontal well targeting the Montney in first quarter 2009.

Puskwa production averaged 2,573 BOE/d in 2008 an increase of 21% compared to 2007. The operating netback was \$57.71/BOE, an improvement of 11% from 2007. These strong operating netbacks were driven by average light oil prices (net of transportation) in 2008 of \$100.02/Bbl. During 2008, Puskwa contributed 22% of funds from operations from 15% of the production volumes. Average production volumes at Puskwa during 2008 were comprised of 80% oil and 20% associated gas.

The Puskwa project has moved into the development stage with the implementation of two enhanced recovery schemes. Approval for down spacing to two wells per quarter section has been received on six sections. The focus has been on increasing water injection capacity to maintain a one to one injection to production ratio. One well was drilled for this purpose in Q3 2008. Wells such as this provide a low risk method of increasing production by allowing an incremental increase of oil production for every barrel of water injected. In Q3 2008 the gas plant and oil battery were modified to increase liquids recovery from the natural gas produced and to make the waterflood operation more efficient.

Galleon continued its exploration in the greater Puskwa area by drilling two successful exploration wells in 2008. Galleon drilled a Montney horizontal well that further proved the viability of a significant resource play in the area, although further delineation will be required. In 2008 a deep Granite Wash well was drilled and tested at highly restricted rates. Galleon will continue to pursue optimization at Puskwa in 2009. Work is continuing on applications for an expanded water flood and additional down spacing through the regulatory process. Galleon plans to drill one Beaverhill Lake well in Q1 2009. Additional activity will be dictated by commodity prices.

Production from Galleon's North Peace River Arch area averaged 1,318/BOE/d in 2008. This area was purchased in the first half of 2008 through two corporate acquisitions: ExAlta and Adamant. This area represented 5% of funds from operations in 2008 based on 8% of production. In 2008, activities included re-entering existing wellbores and fracturing Montney wells that had previously only been perforated. A similar program is planned for 2009.

The Alexis and St. Anne properties were acquired in the ExAlta and Adamant acquisitions and generated 6% of funds from operations from 7% of total production for the year. A key focus in 2009 in this area will be optimization with the primary goal of increasing the volume of injected water into the Alexis pool which is anticipated to enhance the existing waterflood. The level of drilling activity will be dictated by commodity prices.

Galleon's Edam area average production of 1,174 BOE/d decreased by 37% in 2008. The heavy oil wells located at Edam, Saskatchewan generated 4% of funds from operations from 7% of total production. Operating netbacks of \$24.73/BOE increased by 195% due to the increase in heavy oil prices in the 2008. Edam production suffered a set back in Q2 2008 with a number of wells not recovering their oil production rates after being shut-in during spring breakup. Current production levels remain stable but at significantly lower levels.

Culp/Kimiwan light oil has contributed 7% of funds from operations year-to-date 2008 based on 5% of production volumes. The strong operating netbacks of \$59.91/BOE realized in 2008 are a result of high oil prices.

McLeans Creek has grown significantly in 2008. Increased drilling prompted by high oil prices prior to Q4 2008 resulted in production growth which increased by 301% compared to 2007. High netbacks and a strong drilling success rate have bolstered this project. Drilling success was a result of picking locations from an extensive 290 sq. kms of 3D seismic data covering this area. An additional 275 sq. kms of 3D seismic was shot in late 2008. Access to this 3D seismic will fuel drilling activity for many years. The level of drilling activity in 2009 will be dictated by commodity prices. McLeans Creek contributed 7% of funds from operations based on 4% of the production volumes. The high netback of \$80.25/BOE in 2008 is attributable to high oil prices received and a royalty holiday period. This deep oil property commenced production in December 2007.

Kakut production increased by 101% during 2008 compared to 2007. The operating netback was \$30.08/BOE in 2008, an improvement of 32% from 2007. This area is characterized primarily by multi-zone gas potential.

## ROYALTIES

<i>Year ended December 31</i>	<i>2008</i>	<i>2007</i>
<i>(\$000s, except as indicated)</i>		
Crown	79,072	47,524
Freehold	1,600	1,149
GORR and other	6,045	2,913
<b>Gross royalties</b>	<b>86,717</b>	<b>51,586</b>
GCA	(15,595)	(10,033)
<b>Net royalties</b>	<b>71,122</b>	<b>41,553</b>
% of revenue	20.7	21.0
% of revenue net of GCA	17.0	16.9

Gross royalties were 20.7% of revenues for the year ended December 31, 2008 compared to 21.0% for the same period in 2007.

By product, for the year ended December 31, 2008, gross royalties were 16.8% for light oil, 23.7% for natural gas, 22.6% for heavy oil, and 29.6% for liquids. For the year ended December 31, 2007, gross royalties were 18.8% for light oil, 23.8% for natural gas, 20.6% for heavy oil, and 26.5% for liquids.

## OPERATING COSTS

<i>Year ended December 31</i>	<i>2008</i>			<i>2007</i>		
	<i>Production %</i>	<i>Operating Costs %</i>	<i>\$/BOE</i>	<i>Production %</i>	<i>Operating Costs %</i>	<i>\$/BOE</i>
East Montney	22	12	6.48	27	14	4.78
Eaglesham	18	10	6.92	15	10	6.00
Puskwa	15	10	8.08	16	8	4.61
North Peace River Arch	8	7	10.32	–	–	–
Alexis / St. Anne	7	6	10.47	–	–	–
Edam	7	16	28.72	14	31	20.71
Culp / Kimiwan	5	9	24.23	6	12	18.43
McLeans Creek	4	4	14.04	1	1	8.09
Kakut	3	3	10.98	2	2	7.34
Western Montney	1	2	15.51	2	2	10.50
Other	10	21	22.91	17	20	10.47
<b>Total</b>	<b>100</b>	<b>100</b>	<b>12.03</b>	<b>100</b>	<b>100</b>	<b>9.13</b>

Operating costs increased by 32% to \$12.03/BOE for 2008 compared to \$9.13/BOE for 2007. Galleon's operating costs per barrel of oil equivalent excluding operating costs from the heavy oil properties were \$10.32/BOE for 2008.

Galleon has experienced higher operating costs overall in 2008 due to the increased demand for services and labour in the oil and gas industry which was fueled by the period of high commodity prices. As well Galleon's operating costs have increased with operating more crude oil wells compared to the costs of operating natural gas wells. Some of the more significant operating costs for crude oil wells include trucking, artificial lift and maintenance costs.

In the Eastern Montney natural gas project, operating costs were \$6.48/BOE in 2008 compared to \$4.78/BOE in the prior year. Operating cost increases in 2008 were related to emulsion trucking and equipment rentals associated with the increased emulsion storage requirements. As well additional compressor maintenance was incurred in 2008 compared to 2007 relating to the rebuild of one of the units. Operating costs are expected to continue to average between \$6.00/BOE and \$7.00/BOE in 2009.

Eaglesham operating costs for 2008 were \$6.92/BOE compared to \$6.00/BOE in 2007, mainly due to an increase in the number of pumping oil wells on production and the fuel and equipment rental costs required to operate these wells. These costs are expected to be mitigated in 2009, with installation of electricity at the plant and the well sites.

Operating costs at Puskwa were \$8.08/BOE in 2008 compared to \$4.61/BOE in 2007. Operating costs were higher due to an expansion of the waterflood operations in 2008 which resulted in an increase in utilities as well as temporary water trucking and pump equipment rental costs. Due to a greater percentage of pumping oil wells in 2008 compared to flowing wells in 2007, well servicing and equipment maintenance costs were higher in 2008. Operating costs for 2009 are expected to average below \$8.00/BOE at Puskwa.

Operating costs at Kakut were \$10.98/BOE in 2008 compared to \$7.34/BOE in the prior year. This increase is mainly due to the facility turnaround at the oil battery in Q4 2008, rental costs for the sweetening units required prior to the completion of our plant construction, as well as chemicals required for the sweetening units. Operating costs are expected to be significantly lower due to increased volumes with the plant construction and expansion being completed in 2009.

## GENERAL AND ADMINISTRATION EXPENSES

<i>Year ended December 31</i>	<i>2008</i>		<i>2007</i>	
<i>(\$000s)</i>		<i>\$/BOE</i>		<i>\$/BOE</i>
Gross	19,838	3.15	12,155	2.48
Capitalized overhead	(4,792)	(0.76)	(3,775)	(0.77)
Overhead recoveries	(1,720)	(0.27)	(1,099)	(0.22)
	13,326	2.12	7,281	1.49

Gross general and administrative expenses ("G&A") have increased to \$2.12/BOE in 2008 compared to \$1.49/BOE in 2007. This increase is primarily due to an increase in staffing levels required to manage the growth of the Corporation. Also, in April 2008, Galleon relocated to new and larger office space in order to accommodate the addition of employees and consultants. The office space was 150% greater in area with a rate increase of approximately 30% per square foot. The rate increase reflects current market rates compared to the previous lease put in place in 2005.

In 2008, gross G&A has increased by \$0.67/BOE and net G&A has increased by \$0.63/BOE compared to the same periods in 2007. Galleon expects that net G&A will average approximately \$2.00/BOE in 2009.

### G&A by Category

<i>Year ended December 31</i>	<i>2008</i>	<i>2007</i>
	<i>%</i>	<i>%</i>
Salary and employee	48	54
Office	24	17
Consulting	9	7
Computer	6	6
Investor relations and communications	2	2
Audit, engineering and legal	8	8
Other	3	6
	100	100

## INTEREST

Interest expense of \$11.1 million for the year ended December 31, 2008 was slightly higher than \$10.1 million in the prior year due to increased average debt levels. The effective interest rate was 4.81% (2007 – 6.16%). As at December 31, 2008 an amount of \$249 million was drawn against the Corporation's credit facility of \$310 million.

## STOCK BASED COMPENSATION

Stock based compensation was a non-cash expense of \$7.7 million for the year compared to \$8.5 million in the prior year. The decrease was due to a lower fair value of new options granted in the current year compared with 2007. During the year 3,306,000 stock options were granted at an average exercise price of \$10.87 and had fair values of between \$1.52 and \$5.12 per option.

At December 31, 2008 7,037,651 stock options were outstanding at an average exercise price of \$11.87.

## DEPLETION, DEPRECIATION AND ACCRETION

Depletion and depreciation ("D&D") charges were \$137.2 million or \$21.77/BOE for the year ended December 31, 2008 compared to \$100.3 million or \$20.47/BOE in the prior year. Reserve additions for 2008 were estimated by an independent third party qualified reserves evaluator. Gross proved reserves increased by 45% year-over-year.

Capital expenditures of \$108.4 million (\$105.8 million – December 31, 2007) related to undeveloped land, seismic, and equipment under construction have been excluded from the depletion and depreciation calculation and \$173.1 million (\$110.8 million – December 31, 2007) of future development costs have been added.

Accretion expense on the Corporation's asset retirement obligation was \$2.3 million for the year compared to \$1.9 million in the prior year. The increase related to a greater asset retirement obligation which is driven by the number of wells and facilities in which Galleon has an interest.

## CAPITAL AND FUTURE TAXES

The current tax provision of \$1.1 million for the year was comprised of Saskatchewan capital and resource taxes (2007 – \$0.9 million). The provision for future income taxes was \$30.6 million for the year ended December 31, 2008 compared to \$2.7 million for the prior year. The increase in future taxes was a result of higher net earnings during the year and the tax effect of the flow-through share renunciations in January 2008. Galleon has estimated tax pools of approximately \$659.6 million as at December 31, 2008.

## CAPITAL EXPENDITURES

	<i>(\$000s)</i>
Property & equipment balance at December 31, 2007	739,643
Additions to property and equipment	273,598
Acquisition of property and equipment	16,551
Acquisition of ExAlta	92,345
Acquisition of Adamant	71,668
Asset retirement obligation acquired	7,834
Asset retirement obligation additions	6,668
Depletion and depreciation	(137,157)
<b>Property &amp; equipment balance at December 31, 2008</b>	<b>1,071,150</b>

Galleon acquired ExAlta on January 16, 2008 and Adamant on May 9, 2008.

<i>Year ended December 31</i>	<b>2008</b>		<b>2007</b>	
<i>(\$000s)</i>		%		%
Land	13,688	5	10,789	5
Geological and geophysical	11,827	4	16,808	8
Drilling and completion	177,123	65	140,015	67
Plant and facilities	69,764	26	40,378	20
Other assets	1,196	–	354	–
<b>Exploration and Development Expenditures</b>	<b>273,598</b>	<b>100</b>	<b>208,344</b>	<b>100</b>

Exploration and development expenditures during 2008 were \$273.6 million which included the drilling of 107 gross wells and the completion of 95 gross (89.2 net) wells.

Facilities expenditures of \$69.8 million were incurred in 2008. Land and seismic expenditures totaled \$13.7 million and \$11.8 million, respectively, in 2008. In November 2008, management had established an exploration and development capital budget of between \$170 and \$190 million for 2009. Due to decreases in commodity prices to date in 2009, the capital expenditure program has been modified to a level which is expected to match funds from operations. The Corporation does not plan to fund the capital program with incremental bank debt.

## LIQUIDITY AND CAPITAL RESOURCES

<i>December 31</i>	<i>2008</i>	<i>2007</i>
<i>(\$000s)</i>		
Bank debt	249,015	163,378
Capital leases – non current	1,541	–
Working capital deficiency	31,890	30,179
<b>Total net debt</b>	<b>282,446</b>	<b>193,557</b>

## FUNDING OF CAPITAL PROGRAM, INVENTORY AND CASH PORTION OF ACQUISITIONS

<i>Year ended December 31</i>	<i>2008</i>	<i>2007</i>
<i>(\$000s)</i>		
Issuance of shares, net of costs	11,644	88,332
Funds from operations	241,298	131,052
Change in bank debt	85,637	40,382
Change in debt and working capital from acquisitions	(36,658)	–
Change in capital leases	(2,034)	–
Change in working capital and other	(675)	(210)
	<b>299,212</b>	<b>259,556</b>

At December 31, 2008, the Corporation has extendible revolving term credit facilities of \$310 million in place with a bank syndicate. The facilities bear interest at rates ranging from the bank's prime rate to prime plus 0.75% per annum on \$290 million and at rates ranging from the bank's prime rate plus 0.95% to prime plus 1.75% on \$20 million based on the Corporation's debt to cash flow ratio. The Corporation may also borrow at the prevailing Banker's Acceptance rate. Collateral for the facilities consists of a demand debenture for \$500 million collateralized by a first floating charge over all of the property and equipment of the Corporation. At December 31, 2008, an amount of \$249.0 million was drawn against the credit facilities (December 31, 2007 – \$163.4 million).

The credit facilities were reconfirmed at November 30, 2008. An annual review is scheduled to occur on or before May 31, 2009. The level of the borrowing base will be determined by the bank syndicate based on their review of, among other things, a review of the Corporation's reserves and the value thereof utilizing commodity prices determined by the bank syndicate, which will be different than that utilized by the Corporation's independent reserve evaluator.

The Corporation has entered into a fixed rate contract for a two year period commencing on January 20, 2009. The Corporation will pay a fixed rate of 1.1% on \$100 million and receive a three month CDOR floating rate from the counterparty to the contract.

## SENSITIVITY ANALYSIS

The following table shows sensitivities to funds from operations as a result of fluctuations to product prices, production volumes and other market factors. The table is based on budgeted 2009 prices and average production volumes.

<i>Change to annual funds from operations</i>	<i>Change</i>	<i>\$000s</i>	<i>\$/share<sup>2</sup></i>
Price per barrel of oil (US\$ WTI) <sup>1</sup>	\$1.00	2,090	0.03
Price per Mcf of natural gas (C\$ AECO) <sup>1</sup>	\$0.25	5,137	0.07
Oil production volumes	100 Bbl/d	1,465	0.02
Gas production volumes	1 Mmcf/d	1,088	0.01
Exchange rate (US/Canadian)	\$0.01	1,617	0.02
Interest rate on debt (\$250 Million)	1%	2,500	0.03

<sup>1</sup> After adjustment for estimated royalties.

<sup>2</sup> Based on basic shares outstanding at December 31, 2008.

## COMMITMENTS

### Drilling Rig

The Corporation has entered into a Master Daywork Contract whereby it is entitled to the use of a drilling rig for a two year period which commenced November 15, 2007. Future minimum payments under this contract are as follows:

<i>Year</i>	<i>Amount (\$000s)</i>
2009	1,791

### Minimum Lease Payments

At December 31, 2008 the Corporation has committed to future minimum payments under operating leases that cover office space as follows:

<i>Year</i>	<i>Amount (\$000s)</i>
2009	2,518
2010	1,801

The above commitment includes an estimate of the Corporation's share of operating expenses, utilities and taxes for the duration of the office lease.

### Vehicle and equipment

At December 31, 2008 the Corporation committed to future minimum payments under leases for vehicles and compressors, under operating leases, as follows:

<i>Year</i>	<i>Amount (\$000s)</i>
2009	678

The Corporation has entered into a series of equipment lease financing arrangements. Under these arrangements, the Corporation is committed to annual minimum lease payments as follows:

<i>Year</i>	<i>Amount (\$000s)</i>
2009	2,274
2010	1,605
Total minimum lease payments	3,879
Less interest included in payments	(228)
Principal portion of minimum lease payments	3,651
Less current portion	(2,110)
<b>Capital lease obligation at December 31, 2008</b>	<b>1,541</b>

### Flow-through Shares

In connection with the Corporation's flow-through share offerings in 2007, Galleon was obligated to spend \$60.0 million on qualifying exploration expenses prior to December 31, 2008. As at December 31, 2008, all of the required qualifying expenditures have been incurred.

### FINANCIAL INSTRUMENTS

Refer to the "Commodity Pricing and Marketing" section.

### FOURTH QUARTER RESULTS

<i>Three months ended December 31</i>	<i>2008</i>		<i>2007</i>	
<i>(\$000s)</i>	<i>\$</i>	<i>1,697,711 BOE \$/BOE</i>	<i>\$</i>	<i>1,351,986 BOE \$/BOE</i>
Revenues	80,280	47.29	71,339	52.77
Other revenue	105	0.06	–	–
Royalties	(14,409)	(10.68)	(14,353)	(10.62)
GCA <sup>1</sup>	3,364	4.17	2,807	2.07
Transportation costs	(2,366)	(1.39)	(1,600)	(1.18)
Operating costs	(20,704)	(12.20)	(14,227)	(10.52)
	46,270	27.25	43,966	32.52
G&A	(4,019)	(2.37)	(2,712)	(2.00)
Interest costs	(2,599)	(1.53)	(2,476)	(1.83)
Realized gain (loss) on financial derivative	26,796	15.78	(3,367)	(2.49)
Capital and other taxes	(83)	(0.05)	72	0.05
<b>Funds from operations</b> <sup>2</sup>	<b>66,365</b>	<b>39.08</b>	<b>35,483</b>	<b>26.25</b>

<sup>1</sup> GCA means Gas Cost Allowance

<sup>2</sup> See "Non-GAAP Measurements"

For the three months ended December 31, 2008 production increased by 26% to 18,453 BOE/d compared to 14,695 BOE/d in the same period of the prior year. Revenues were 13% higher as a result of greater production volumes. Average natural gas prices of \$6.72/Mcf were 9% higher than \$6.16/Mcf in Q4 2007. Average oil prices were \$100.43/Bbl including oil financial derivative contracts. Excluding the oil financial derivative contracts, average oil prices were \$55.88/Bbl or 21% lower than \$70.34/Bbl realized in Q4 2007.

The average light oil price received for Q4 2008 was \$61.80/Bbl a decrease of 26% compared to \$83.38/Bbl in the prior year. The average heavy oil price in Q4 2008 of \$24.75/Bbl decreased by 34% compared to \$37.32/Bbl in the prior year.

Average production volumes for Q4 2008 were: light oil – 5,491 Bbl/d; heavy oil – 1,046 Bbl/d; natural gas – 67,875 Mcf/d; and NGLs – 604 Bbl/d.

Operating costs were \$20.7 million or \$12.20/BOE for Q4 2008 compared to \$14.2 million or \$10.52/BOE for the prior year. Galleon's operating costs per barrel of oil equivalent excluding heavy oil operating costs were \$10.97/BOE for Q4 2008 and \$8.29/BOE in Q4 2007.

G&A expenses of \$4.0 million in Q4 2008 were 48% higher than Q4 2007. In Q4 2008 G&A expenses were \$2.37/BOE, an increase of 19% compared to \$2.00/BOE in Q4 2007.

## PERFORMANCE BY PROPERTY

	2008		2007		2008 Funds from operations %		
	Average Production		Average Production				
	BOE/d	%	BOE/d	%			
East Montney	4,467	24	26.95	3,919	27	25.49	26
Eaglesham	3,538	19	28.17	2,509	17	26.78	22
Puskwa	2,806	15	36.63	2,781	19	52.63	22
North Peace River Arch	1,608	9	20.80	–	–	–	7
Alexis / St. Anne	1,154	6	18.38	–	–	–	5
Edam	650	4	(6.03)	1,630	11	2.26	–
Culp / Kimiwan	818	4	28.56	785	5	42.70	5
McLeans Creek	621	3	48.20	417	3	79.42	6
Kakut	895	5	24.36	489	3	21.32	5
Western Montney	320	1	13.85	207	1	27.78	1
Other	1,576	10	6.48	1,958	14	21.03	1
	18,453	100	25.09	14,695	100	30.02	100

<sup>1</sup> Operating netbacks/BOE exclude GCA and hedging gains or losses, and are calculated by subtracting royalties and operating costs from revenues divided by average production for the quarter.

<sup>2</sup> See "Non-GAAP Measurements"

Production grew in Q4 2008 as a result of significant Montney resource gas brought on production through horizontal multi-fracture technology in Eastern Montney as well as Central Montney drilling done in the second half of the year. Operating netbacks of \$25.09/BOE in Q4 2008 decreased by 16% compared to Q4 2007 primarily due to lower commodity prices.

Operating costs in Galleon's key areas of Eastern Montney, Eaglesham, Puskwa and Central Montney remain low and below the corporate average for 2008 due to control of the facilities in those areas and increased production.

## BUSINESS RISKS

### General

Galleon is engaged in the exploration, development and production of crude oil and natural gas. The oil and gas business is inherently risky and there is no assurance that hydrocarbon reserves will be discovered and economically produced. Operational risks include competition, reservoir performance uncertainties, environmental factors, and regulatory, environment and safety concerns. Financial risks associated with the petroleum industry include fluctuations in commodity prices, interest rates, currency exchange rates and the cost of goods and services.

Galleon employs highly qualified people, uses sound operating and business practices, and evaluates all potential and existing wells using the latest applicable technology. Galleon complies with government regulations and has in place an up-to-date emergency response program. Environment and safety policies and standards are adhered to. Asset retirement obligations are recognized upon acquisition, construction, development and/or normal use of the assets. Galleon maintains property and liability insurance coverage. The coverage provides a reasonable amount of protection from risk of loss; however, not all risks are foreseeable or insurable.

### Global Financial Crisis

Recent market events and conditions, including disruptions in the international credit markets and other financial systems and the deterioration of global economic conditions, have caused significant volatility to commodity prices. These conditions worsened in 2008 and are continuing in 2009, causing a loss of confidence in the broader U.S. and global credit and financial markets and resulting in the collapse of, and government intervention in, major banks, financial institutions and insurers and creating a climate of greater volatility, less liquidity, widening of credit spreads, a lack of price transparency, increased credit losses and tighter credit conditions. Notwithstanding various actions by governments, concerns about the general condition of the capital markets, financial instruments, banks, investment banks, insurers and other financial institutions caused the broader credit markets to further deteriorate and stock markets to decline substantially. These factors have negatively impacted company valuations and will impact the performance of the global economy going forward.

Petroleum prices are expected to remain volatile for the near future as a result of market uncertainties over the supply and demand of these commodities due to the current state of the world economies, OPEC actions and the ongoing global credit and liquidity concerns.

### Capital Requirements

The Corporation anticipates making substantial capital expenditures for the acquisition, exploration, development and production of oil and natural gas reserves in the future. As the Corporation's revenues may decline as a result of decreased commodity pricing, it may be required to reduce capital expenditures. In addition, uncertain levels of near term industry activity coupled with the present global credit crisis exposes the Corporation to additional access to capital risk. There can be no assurance that debt or equity financing, or cash generated by operations will be available or sufficient to meet these requirements or for other corporate purposes or, if debt or equity financing is available, that it will be on terms acceptable to the Corporation. The inability of the Corporation to access sufficient capital for its operations could have a material adverse effect on the Corporation's business financial condition, results of operations and prospects.

### Financial Risks

Financial risks include fluctuations in commodity prices, interest rates and the Canadian/US dollar exchange rate, and the cost of goods and services. The Corporation currently has financial contracts with Canadian chartered banks (see "Commodity Pricing and Marketing" for details). The Corporation also manages these risks by maintaining a balance sheet with prudent levels of debt measured by debt to funds from operations and debt coverage ratios. This allows for sufficient financial capacity to maintain exploration and development activities in any downturn in commodity prices.

### Third Party Credit Risk

An additional risk is credit risk for failure of performance by counter-parties. This risk is controlled by an evaluation of the credit risk before contract initiation and ensuring product sales and delivery contracts are made with well-known and financially strong crude oil and natural gas marketers.

The Corporation may be exposed to third party credit risk through its contractual arrangements with its current or future joint venture partners and other parties. In the event such entities fail to meet their contractual obligations to the Corporation, such failures may have a material adverse effect on the Corporation's business, financial condition, results of operations and prospects. In addition, poor credit conditions in the industry and of joint venture partners may impact a joint venture partner's willingness to participate in the Corporation's ongoing capital program, potentially delaying the program and the results of such program until the Corporation finds a suitable alternative partner.

## Environmental

All phases of the oil and natural gas business present environmental risks and hazards and are subject to environmental regulation pursuant to a variety of federal, provincial and local laws and regulations. Compliance with such legislation can require significant expenditures and a breach may result in the imposition of fines and penalties, some of which may be material. Environmental legislation is evolving in a manner expected to result in stricter standards and enforcement, larger fines and liability and potentially increased capital expenditures and operating costs. In 2002, the Government of Canada ratified the Kyoto Protocol (the "Protocol"), which calls for Canada to reduce its greenhouse gas emissions to specified levels. There has been much public debate with respect to Canada's ability to meet these targets and the Government's strategy or alternative strategies with respect to climate change and the control of greenhouse gases. Implementation of strategies for reducing greenhouse gases whether to meet the limits required by the Protocol or as otherwise determined could have a material impact on the nature of oil and natural gas operations, including those of the Corporation. Given the evolving nature of the debate related to climate change and the control of greenhouse gases and resulting requirements, it is not possible to predict either the nature of those requirements or the impact on the Corporation and its operations and financial condition.

## CRITICAL ACCOUNTING ESTIMATES

There are a number of critical estimates underlying the accounting policies employed in preparing the Financial Statements.

### Oil and Gas Accounting

Galleon follows the full cost method of accounting for exploration and development activities. In accordance with this method of accounting, all costs associated with exploration and development are capitalized whether successful or not. The aggregate of net capitalized costs and estimated future development costs less estimated salvage values is amortized using the unit-of-production method based on estimated proved oil and gas reserves.

### Proved Reserves

Full cost accounting relies on the estimated proved reserves believed to be recoverable from the oil and gas properties. Determination of reserves is a complex process involving judgments, estimates and decisions based on available geological, engineering/production and other relevant economic data. These estimates are subject to change as economic conditions change and ongoing production and development activities provide new information. The Corporation's reserves are evaluated annually by an independent firm and by the Corporation on a quarterly basis. Reserve estimates are critical to the following accounting estimates:

- Calculation of unit of production depletion. Proved reserve estimates are used to determine the depletion and depreciation rate applied to each unit of production.
- Ceiling test calculation, measurement and impairment of oil and gas assets. Estimated future undiscounted cash flows are determined using the estimate of proved reserves.

An increase in estimated proved oil and gas reserves would result in a corresponding reduction in depletion expense. A decrease in estimated future development costs would result in a corresponding reduction in depletion expense.

The calculation of proved reserves is affected by events, including the following:

- Changes to commodity prices
- Production performance of wells
- Changes to reservoir performance/pressures

- New geological and geophysical data
- Competitor production practices
- Changes to government regulations

As circumstances change and additional data becomes available, revisions are made to these estimates.

### Unproved Properties

Certain costs related to unproved properties may be excluded from costs subject to depletion until proved reserves have been determined or their value is impaired. These properties are reviewed quarterly and any impairment is transferred to the costs being depleted. The costs related to unproved properties are also excluded from the book value subject to the ceiling test measurement and are assessed for impairment separately.

### Full Cost Accounting Ceiling Test

The Corporation is required to review the carrying value of all property, plant and equipment, including the carrying value of oil and gas assets, for potential impairment. Impairment is indicated if the carrying value of the long-lived asset or oil and gas cost centre is not recoverable by the future undiscounted cash flows. If impairment is indicated, the amount by which the carrying value exceeds the estimated fair value of the long-lived asset is charged to earnings.

The ceiling test is based on estimates of reserves, production rate, petroleum and natural gas prices, future costs and other relevant assumptions. By their nature, these estimates are subject to measurement uncertainty and the impact on the financial statements could be material.

### Asset Retirement Obligation

The Corporation is required to provide for future abandonment and site restoration costs. The Corporation must estimate these costs in accordance with existing laws, contracts or other policies. These estimated costs are charged to property, plant and equipment and the appropriate liability account over the expected service life of the asset. The estimate of future removal and site restoration costs involves a number of estimates related to timing of abandonment, determination of economic life of the asset, costs associated with abandonment and site restoration, and review of potential abandonment methods.

### Income Tax Accounting

The determination of the Corporation's income and other tax liabilities requires interpretation of complex laws and regulations often involving multiple jurisdictions. All tax filings are subject to audit and potential reassessment subsequent to the financial statement reporting period. Accordingly, the actual income tax liability may differ significantly from that estimated and recorded by management.

### Goodwill

The Company recognizes goodwill on corporate acquisitions when the total purchase price exceeds the fair value of net identifiable assets and liabilities of the acquired entity. Goodwill is tested annually at year-end for impairment or as events occur that could result in impairment. Impairment is recognized based on the fair value of the Corporation compared to the book value of the Corporation. If the fair value of the Corporation is less than the book value, impairment is measured allocating the fair value to the identifiable assets and liabilities as if the Corporation had been acquired in a business combination for its fair value. The excess of the fair value over the amounts assigned to the identifiable assets and liabilities is the fair value of the goodwill. Any excess of the book value over this implied fair value of goodwill is the impairment amount. Impairment is charged to earnings in the period which it occurs. Goodwill is stated at cost less impairment and is not amortized.

## CHANGES IN ACCOUNTING POLICIES

As of January 1, 2008, Galleon adopted several new CICA standards, section 1400 "General Standards of Financial Statement Presentation", section 1535 "Capital Disclosures", section 3031 "Inventories", section 3862 "Financial Instruments – Disclosures" and Section 3863 "Financial Instruments – Presentation".

CICA 1400, was amended to include requirements to assess and disclose an entity's ability to continue as a going concern. The new requirements are effective for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2008. The adoption of this standard did not have an impact on the Corporation's financial statements.

Section 1535 establishes standards for disclosing information regarding the capital of the entity and how it is managed. The section specifies the disclosure of i) objectives, policies, and processes for managing capital by the entity; ii) quantitative data about what the entity regards as capital; iii) whether the entity has complied with any capital requirements; and iv) if it has not complied, the consequences of such non-compliance.

CICA 3031 replaces CICA 3030 and establishes standards for measurement and disclosure of inventories. This standard provides guidance on the determination of cost and subsequent recognition as an expense, including any write-down to net realizable value and the reversal of previous write-downs when there is a subsequent increase in the value of inventories. It also provides guidance on the cost formulas that are used to assign costs. The adoption of this standard did not have an impact on the Corporation's financial statements.

Sections 3862 and 3863 replace section 3861 "Financial Instruments – Disclosure and Presentation" which revises and enhances financial instrument disclosure requirements and leaves unchanged its presentation requirements. The objective of section 3862 is to provide financial statement disclosure to enable users to evaluate the significance of financial instruments on the Corporation's financial position and performance. The section also requires increased disclosure on the nature and extent of risks arising from financial instruments that the Corporation is exposed to during the reporting period and the balance sheet date and how the Corporation is managing those risks. The purpose of section 3863 is to enhance the financial statement users' understanding of the significance of financial instruments on the Corporation's financial position, performance and cash flows.

### Future Accounting Policies

The Canadian Accounting Standards Board (AcSB) has confirmed that the use of the International Financial Reporting Standards ("IFRS") will be required in 2011 for publicly accountable profit-oriented enterprises. IFRS will replace Canada's current GAAP for those enterprises that are responsible to large or diverse groups of stakeholders. The official changeover date is for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. Companies will be required to provide comparative IFRS information for the fiscal year of 2010. Galleon is in the initial stages of evaluating the impact of adopting IFRS and is in the process of developing a changeover plan which includes determining appropriate changes to accounting policies and required amendments to financial disclosures; identifying changes required in associated processes and information systems; compliance with internal control requirements; and education and training of internal stakeholders.

CICA 3064, Goodwill and Intangible Assets, will replace CICA 3062, Goodwill and Other Intangible Assets, and results in withdrawal of CICA 3450, Research and Development Costs, and amendments to Accounting Guideline (AcG) 11, Enterprises in the Development Stage and CICA 1000, Financial Statement Concepts. The standard intends to reduce the differences with IFRS in the accounting for intangible assets as under current Canadian standards, more items are recognized as assets. The objectives of CICA 3064 are to reinforce the principle-based approach to the recognition of assets only in accordance with the definition of an asset and the criteria for asset recognition.

The application of the concept of matching revenues and expenses is that the current practice of recognizing as assets items that do not meet the definition and recognition criteria is eliminated. The standard will also provide guidance for the recognition of internally developed intangible assets (including research and development activities), ensuring consistent treatment of all intangible assets, whether separately acquired or internally developed. These changes are effective for fiscal years beginning on or after October 1, 2008. Galleon Energy Inc. is evaluating the effects of adopting this standard.

On January 20, 2009 the CICA Emerging Issues Committee ("EIC") issued EIC-173 Credit risk and the fair value of financial assets and financial liabilities. Under EIC-173, an entity's own credit risk and the credit risk of the counterparty should be taken into account in determining the fair value of financial assets and liabilities, including derivative instruments. Galleon will adopt the requirements of EIC-173 effective January 1, 2009. The impact of this EIC upon the Corporation's financial statements is currently being assessed.

## CONTROLS AND PROCEDURES

### Disclosure Controls and Procedures

The Corporation's Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") have designed, or caused to be designed under their supervision, disclosure controls and procedures to provide reasonable assurance that: (i) material information relating to the Corporation is made known to the Corporation's Chief Executive Officer and Chief Financial Officer by others, particularly during the period in which the annual filings are being prepared; and (ii) information required to be disclosed by the Corporation in its annual filings, interim filings or other reports filed or submitted by it under securities legislation is recorded, processed, summarized and reported within the time period specified in securities legislation. Such officers have evaluated, or caused to be evaluated under their supervision, the effectiveness of the Corporation's disclosure controls and procedures at the financial year end of the Corporation and have concluded that the Corporation's disclosure controls and procedures are effective at the financial year end of the Corporation for the foregoing purposes.

### Internal Controls over Financial Reporting

The CEO and CFO have designed, or caused to be designed under their supervision, internal controls over financial reporting to provide reasonable assurance regarding the reliability of the Corporation's financial reporting and the preparation of financial statements for external purposes in accordance with the Canadian GAAP. Such officers have evaluated, or caused to be evaluated under their supervision, the effectiveness of the Corporation's internal controls over financial reporting at the financial year end of the Corporation and concluded that the Corporation's internal controls over financial reporting is effective, at the financial year end of the Corporation, for the foregoing purpose.

The Corporation's CEO and CFO are required to cause the Corporation to disclose any change in the Corporation's internal controls over financial reporting that occurred during the Corporation's most recent interim period that has materially affected, or is reasonably likely to materially affect, the Corporation's internal controls over financial reporting. No material changes in the Corporation's internal controls over financial reporting were identified during such period that has materially affected, or are reasonably likely to materially affect, the Corporation's internal controls over financial reporting.

It should be noted that a control system, including the Corporation's disclosure and internal controls and procedures, no matter how well conceived, can provide only reasonable, but not absolute, assurance that the objectives of the control system will be met and it should not be expected that the disclosure and internal controls and procedures will prevent all errors or fraud.

## SHARE INFORMATION

The following table summarizes the outstanding shares of Galleon as of December 31:

	2008	2007
Class A shares outstanding		
Basic	75,170,733	63,215,552
Diluted <sup>1</sup>	76,747,483	67,294,002
Class B shares outstanding	–	922,500
Class A shares issuable on conversion of Class B shares <sup>2</sup>	–	595,161

<sup>1</sup> Includes options of 1,576,750 (December 31, 2007 – 4,078,450).

<sup>2</sup> All Class B shares were converted into an aggregate of 1,720,232 Class A shares on December 15, 2008. The value at December 31, 2007 assumes the closing price at that date of \$15.50 per Class A share.

At December 31, 2008, the market value of Galleon's Class A shares was \$383.4 million based on the December 31, 2008 closing price of 5.10 per Class A share. As of March 11, 2009, the number of Class A shares and options outstanding are 75,233,283 and 6,964,901 respectively.

## ADDITIONAL INFORMATION

Additional information relating to Galleon, including Galleon's Annual Information Form, can be accessed on-line on SEDAR at [www.sedar.com](http://www.sedar.com), or from the Corporation's website at [www.galleonenergy.com](http://www.galleonenergy.com).

## OUTLOOK

The year 2008 saw technical and economic success of Galleon's natural gas Montney resource projects. Large resource bases were captured and the development of these projects was advanced through horizontal drilling technology and multi-stage fracture techniques. These resource projects are characterized by long reserve life and stable production. In addition, Galleon's oil projects were successful in contributing significant cash flow with crude oil prices at record levels in the first part of 2008. The exploration and development capital program was funded primarily by cash flow (80%) with an additional portion (15%) funded by an increase in bank debt and working capital.

Galleon plans to maintain or modestly increase production levels in 2009. A disciplined allocation of capital towards lower risk, development projects is planned. The level of the capital program will vary throughout 2009 but it is expected to closely match cash flow levels with no incremental bank debt planned.

Other than an expansion of an owned natural gas plant in the Central Montney project, there are no major facility projects planned in 2009. Commitments are limited to one drilling rig contract, office rental costs and operating leases (see note 12 – Commitments).

Galleon expects to generate significant positive cash flow in 2009. Capital will be expended in moving probable reserves to proven and moving proved reserves to proven producing. The Corporation has entered into commodity price contracts on approximately 30% of its estimated 2009 production volumes in order to realize certain sales prices. Royalty rates are expected to increase in 2009 due to the new royalty framework effective January 1, 2009. The Corporation expects to partially offset these increases by electing, where appropriate, under the transitional royalty program. In addition, on March 3, 2009, the Alberta Government announced an energy incentive program. This program is expected to have a positive impact. Transportation, operating and G&A costs are expected to decrease slightly in 2009 based on industry activity levels. At current commodity prices levels, earnings may be negative.

In summary, Galleon is strongly positioned to continue to execute its business plan in 2009 and beyond. The Corporation has access to a large land base in its core area of the Peace River Arch. The resource projects offer multi-year drilling and growth in production and reserves. Revenue from the existing production base is expected to provide sufficient financial resources to fund the planned capital program. Our Galleon staff has the experience and ability to identify and create opportunities in these challenging times.

# Quarterly Highlights

	2008				2007			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
<b>PRODUCTION</b>								
Light oil (Bbl/d)	5,491	5,222	4,629	4,871	4,419	3,375	3,317	3,127
Heavy oil (Bbl/d)	1,046	1,257	2,066	2,919	1,746	1,949	2,247	2,081
Natural Gas (Mcf/d)	67,875	61,329	53,971	52,644	49,486	48,989	45,314	38,845
Liquids (Bbl/d)	604	499	501	441	283	237	256	206
<b>BOE/d</b>	<b>18,453</b>	<b>17,200</b>	<b>16,191</b>	<b>17,005</b>	14,695	13,726	13,372	11,888
Total BOE produced	1,697,711	1,582,369	1,473,414	1,547,476	1,351,986	1,262,762	1,216,855	1,069,915
<b>Daily BOE of production per million Class A shares – basic</b>								
	<b>250</b>	<b>236</b>	<b>229</b>	<b>254</b>	232	229	226	206
<b>PRICES (net of transportation)</b>								
Light oil (\$/Bbl)	61.80	115.20	120.68	94.79	83.38	78.43	70.12	63.24
Heavy oil (\$/Bbl)	24.75	98.51	88.93	63.52	37.32	40.04	35.89	36.55
Crude oil (\$/Bbl)	55.88	111.96	110.88	85.20	70.34	63.25	56.30	52.57
Natural Gas (\$/Mcf)	6.72	7.73	9.65	7.73	6.16	5.73	7.14	7.36
NGLs (\$/Bbl)	42.76	73.16	71.19	59.59	72.90	64.05	59.67	56.64
<b>PER BOE (\$)</b>								
Revenues	47.29	73.20	81.85	65.60	52.77	47.64	49.91	49.51
Royalties, net of ARTC and GCA	(6.51)	(13.13)	(14.29)	(11.79)	(8.55)	(8.41)	(9.04)	(7.84)
Transportation costs	(1.39)	(1.35)	(1.64)	(1.04)	(1.18)	(1.13)	(1.16)	(1.47)
Operating costs	(12.20)	(11.95)	(12.71)	(11.28)	(10.52)	(8.35)	(8.63)	(8.86)
<b>NET</b>	<b>27.19</b>	<b>46.77</b>	<b>53.21</b>	<b>41.49</b>	32.52	29.75	31.08	31.34
Other revenue	0.06	0.07	0.07	0.08	–	–	–	–
G&A	(2.37)	(2.05)	(2.51)	(1.53)	(2.00)	(1.19)	(1.48)	(1.18)
Interest	(1.53)	(1.74)	(2.02)	(1.81)	(1.83)	(2.14)	(2.20)	(2.10)
Capital and other taxes	(0.05)	(0.18)	(0.24)	(0.22)	0.05	(0.18)	(0.41)	(0.21)
Realized gain (loss) on financial derivative	15.78	(6.00)	(7.00)	(2.18)	(2.49)	(0.44)	–	0.35
<b>Funds from operations<sup>1</sup></b>	<b>39.08</b>	<b>36.87</b>	<b>41.51</b>	<b>35.83</b>	26.25	25.80	26.99	28.20

<sup>1</sup>See "Non-GAAP Measurements"

# Quarterly Highlights

(unaudited)

2008

	Q4	Q3	Q2	Q1
<b>FINANCIAL (\$000s)</b>				
Revenues	80,280	115,835	120,602	101,516
Operating costs	(20,704)	(18,917)	(18,726)	(17,460)
General & Administrative expenses	(4,019)	(3,238)	(3,698)	(2,371)
Interest expense	(2,599)	(2,759)	(2,977)	(2,803)
<b>FUNDS FROM OPERATIONS<sup>1</sup></b>	<b>66,365</b>	<b>58,331</b>	<b>61,157</b>	<b>55,445</b>
Per share, basic <sup>1</sup>	0.90	0.80	0.86	0.83
Per share, diluted <sup>1</sup>	0.90	0.79	0.84	0.81
<b>EARNINGS</b>	<b>25,113</b>	<b>38,061</b>	<b>5,673</b>	<b>10,417</b>
Per share, basic	0.34	0.52	0.08	0.16
Per share, diluted	0.34	0.51	0.08	0.15
<b>Total assets</b>	<b>1,181,003</b>	<b>1,121,339</b>	<b>1,070,765</b>	<b>975,911</b>
Weighted average outstanding Class A shares-basic	73,710,516	72,938,357	70,741,901	67,034,895
Weighted average outstanding Class A shares-diluted	74,032,935	73,955,365	72,575,607	68,630,474

(unaudited)

2007

	Q4	Q3	Q2	Q1
<b>FINANCIAL (\$000s)</b>				
Revenues	71,339	60,156	60,734	52,974
Operating costs	(14,227)	(10,547)	(10,507)	(9,478)
General & Administrative expenses	(2,712)	(1,507)	(1,797)	(1,264)
Interest expense	(2,476)	(2,707)	(2,681)	(2,246)
<b>FUNDS FROM OPERATIONS<sup>1</sup></b>	<b>35,483</b>	<b>32,566</b>	<b>32,834</b>	<b>30,170</b>
Per share, basic <sup>1</sup>	0.56	0.54	0.55	0.52
Per share, diluted <sup>1</sup>	0.55	0.53	0.54	0.50
<b>EARNINGS</b>	<b>(495)</b>	<b>1,590</b>	<b>3,270</b>	<b>3,921</b>
Per share, basic	(0.01)	0.03	0.06	0.07
Per share, diluted	(0.01)	0.03	0.05	0.07
<b>Total assets</b>	<b>799,359</b>	<b>743,932</b>	<b>699,112</b>	<b>692,749</b>
Weighted average outstanding Class A shares-basic	63,206,585	59,880,135	59,204,393	57,800,899
Weighted average outstanding Class A shares-diluted	64,716,872	61,724,550	61,175,217	59,947,494

<sup>1</sup> See "Non-GAAP Measurements"

# *Management's Responsibility for Financial Reporting*

The accompanying financial statements and all information in the annual report are the responsibility of management. Management has prepared the financial statements in accordance with Canadian generally accepted accounting principles. In the opinion of management, the financial statements have been prepared within acceptable limits of materiality and, when necessary, management has made informed judgments and estimates in accounting for transactions that were not complete at the balance sheet date. When alternative accounting methods exist, management has chosen those it deems most appropriate in the circumstances as indicated in the notes to the financial statements. Financial information contained elsewhere in the annual report has been prepared and reviewed by management to ensure it is consistent with the financial statements.

Management has established systems of internal controls over financial reporting to provide reasonable assurance regarding the reliability of the Corporation's financial reporting and the preparation of financial statements for external purposes in accordance with Canadian generally accepted accounting principles.

The Audit and Reserves Committee is appointed by the Board of Directors, and comprises directors that are not employees of the Corporation. The Committee meets regularly with management, as well as the external auditors, to discuss internal controls over the financial reporting process, auditing matters and financial reporting issues, to satisfy itself that each party is discharging its responsibilities, and to review the financial statements and the external auditors' report. The Board of Directors has approved the financial statements.



Steve Sugianto  
*President & Chief Executive Officer*



Shivon M. Crabtree  
*Vice President, Finance & Chief Financial Officer*

*March 11, 2009*

# Auditors' Report

To the Shareholders of Galleon Energy Inc.

We have audited the consolidated balance sheets of Galleon Energy Inc. as at December 31, 2008 and 2007 and the consolidated statements of earnings, comprehensive income and retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Corporation as at December 31, 2008 and 2007 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

*Ernst + Young LLP*

Chartered Accountants  
Calgary, Canada

March 11, 2009

# Consolidated Balance Sheets

<i>As at December 31</i>	<b>2008</b>	<b>2007</b>
<i>(\$000s)</i>		
<b>ASSETS</b>		
Current		
Accounts receivable	54,864	35,406
Deposits and prepaid expenses	6,661	5,459
Fair value of financial derivatives (note 13)	1,237	–
	<b>62,762</b>	<b>40,865</b>
Goodwill (notes 3 and 4)	34,891	16,022
Equipment inventory	12,200	2,829
Property and equipment (notes 3, 4, 5, 6, 7 and 8)	1,071,150	739,643
	<b>1,181,003</b>	<b>799,359</b>
<b>LIABILITIES</b>		
Current		
Accounts payable and accrued liabilities	91,305	71,044
Capital leases (notes 4 and 9)	2,110	–
Bank loan (note 8)	249,015	163,378
Fair value of financial derivatives (note 13)	–	9,075
	<b>342,430</b>	<b>243,497</b>
Asset retirement obligation (note 7)	39,905	25,535
Capital leases (notes 4 and 9)	1,541	–
Future income taxes (note 11)	107,603	52,299
	<b>491,479</b>	<b>321,331</b>
<b>SHAREHOLDERS' EQUITY</b>		
Share capital (note 10)	547,298	419,011
Contributed surplus (note 10)	23,009	19,064
Retained earnings	119,217	39,953
	<b>689,524</b>	<b>478,028</b>
	<b>1,181,003</b>	<b>799,359</b>

See accompanying notes

Approved on behalf of the Board of Directors:



William L. Cooke  
Director



Daryl H. Gilbert  
Director

# Consolidated Statements of Earnings

<i>Year ended December 31</i>	<b>2008</b>	<b>2007</b>
<i>(\$000s, except per share amounts)</i>		
<b>REVENUE</b>		
Petroleum and natural gas revenue	418,233	245,203
Royalties, net of GCA	(71,122)	(41,553)
Realized gain (loss) on financial derivative <i>(note 13)</i>	3,621	(3,545)
Unrealized gain (loss) on financial derivative <i>(note 13)</i>	10,311	(9,264)
Gain on gas contract <i>(note 5)</i>	5,340	–
Other income	438	–
	<b>366,821</b>	<b>190,841</b>
<b>EXPENSES</b>		
Operating	75,807	44,759
Transportation	8,537	6,024
General and administration	13,326	7,281
Interest	11,138	10,110
Stock-based compensation <i>(note 10)</i>	7,670	8,516
Accretion	2,253	1,949
Depletion and depreciation	137,157	100,331
	<b>255,888</b>	<b>178,970</b>
<b>EARNINGS BEFORE TAXES</b>	<b>110,933</b>	<b>11,871</b>
Income taxes <i>(note 11)</i>		
Capital and other taxes	1,064	879
Future income taxes	30,605	2,706
	<b>31,669</b>	<b>3,585</b>
<b>NET EARNINGS AND COMPREHENSIVE INCOME</b>	<b>79,264</b>	<b>8,286</b>
<b>RETAINED EARNINGS, BEGINNING OF PERIOD</b>	<b>39,953</b>	<b>31,667</b>
<b>RETAINED EARNINGS, END OF PERIOD</b>	<b>119,217</b>	<b>39,953</b>
Basic	1.11	0.14
Diluted	1.10	0.13
Weighted average Class A shares – basic	71,105,806	60,037,422
– diluted	72,128,065	61,827,278

See accompanying notes

# Consolidated Statements of Cash Flows

<i>Year ended December 31</i>	<b>2008</b>	<b>2007</b>
<i>(\$000s)</i>		
Cash provided by (used in):		
<b>OPERATING ACTIVITIES</b>		
Net earnings	79,264	8,286
Items not requiring cash:		
Future income taxes	30,605	2,706
Depletion and depreciation	137,157	100,331
Accretion	2,253	1,949
Stock-based compensation	7,670	8,516
Unrealized loss (gain) on financial derivative	(10,311)	9,264
Gain on gas contract (note 5)	(5,340)	–
Abandonment costs	(2,385)	(2,172)
Change in non-cash working capital	(10,837)	(5,812)
	<b>228,076</b>	<b>123,068</b>
<b>FINANCING ACTIVITIES</b>		
Issue of common shares	11,825	93,257
Share issue costs	(181)	(4,925)
Capital lease payment	(2,034)	–
Working capital assumed on acquisition of ExAlta (note 4)	(44,966)	–
Working capital assumed on acquisition of Adamant (note 5)	8,308	–
Bank loan	85,637	40,382
	<b>58,589</b>	<b>128,714</b>
<b>INVESTING ACTIVITIES</b>		
Additions to equipment inventory	(8,073)	(293)
Additions to oil and gas properties	(273,598)	(208,344)
Acquisition of oil and gas properties (note 6)	(17,541)	(50,919)
Change in non-cash working capital	12,547	7,774
	<b>(286,665)</b>	<b>(251,782)</b>
<b>CHANGE IN CASH</b>	<b>–</b>	<b>–</b>
<b>CASH, BEGINNING AND END OF PERIOD</b>	<b>–</b>	<b>–</b>
<b>SUPPLEMENTARY INFORMATION</b>		
Cash interest paid	10,890	10,084
Cash taxes paid	811	542

See accompanying notes

# Notes to the Consolidated Financial Statements

For the years ended December 31, 2008 and 2007

Unless otherwise stated, amounts presented in these notes are in Canadian dollars and tabular amounts are in thousands of Canadian dollars, except number of shares and per share amounts.

## 1. ACCOUNTING POLICIES

### Nature of Business and Basis of Presentation

Galleon Energy Inc. ("Galleon" or the "Corporation") was incorporated under the Business Corporations Act of Alberta on March 27, 2003. The business of the Corporation is the acquisition of, exploration for and development of petroleum and natural gas properties in western Canada. Galleon is listed on the TSX under the symbol "GO".

The financial statements include the accounts of the Corporation, its wholly owned subsidiaries and its partnerships on a consolidated basis.

The financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"), and have, in management's opinion, been properly prepared within reasonable limits of materiality and within the framework of the accounting policies summarized below.

### Measurement uncertainty

The amounts recorded for depletion and depreciation of property and equipment, the provision for asset retirement obligations, the provision for income taxes, the ceiling test calculation and the goodwill impairment test are based on estimates of proven reserves, production rates, oil and natural gas prices, future costs, future prices, and other relevant assumptions. Accruals for royalties and costs are prepared based on estimates when actual amounts are not yet known. Stock based compensation amounts are determined using certain assumptions (see note 10). The fair value of financial derivatives are based on quoted market prices (see note 13). By their nature, these estimates and assumptions are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future years could be significant.

### Cash and cash equivalents

Cash and cash equivalents may include highly liquid short-term investments with initial maturities of three months or less. They are recorded at cost which approximates fair market value.

### Property and equipment

#### *Petroleum and natural gas properties and equipment*

The Corporation follows the full cost method of accounting whereby all costs related to the exploration for and development of petroleum and natural gas reserves, whether productive or unproductive, are capitalized in one Canadian cost centre. Such costs include land acquisition, drilling, equipping, geological and geophysical and overhead expenses related to exploration and development activities.

These costs are depleted on the unit-of-production method using estimated gross proven petroleum and natural gas reserves as determined by independent professional engineers. Petroleum and natural gas reserves are converted to a common unit of measure on an energy equivalent basis of six mcf of gas to one barrel of oil. Costs of acquiring and evaluating unproven properties are excluded from the depletion calculation until it is determined whether or not proven reserves are attributable to the properties or impairment occurs. Proceeds from the sale of petroleum and natural gas properties and related equipment are applied against capitalized costs, with no gain or loss recognized, unless such a sale would result in a change in the rate of depletion of 20% or more.

### *Ceiling test*

The Corporation evaluates its petroleum and natural gas assets in each reporting period to determine that the costs are recoverable. If the sum of the anticipated undiscounted cash flows from proved reserves, based on expected future escalating product prices and costs, exceed the carrying value of the assets, the costs are considered recoverable. If the carrying value is not considered recoverable, an impairment loss is recognized to the extent that the carrying value exceeds the sum of the discounted cash flows expected from production of the proved and probable reserves.

### *Office furniture and equipment*

Office furniture, equipment and other assets are recorded at cost and depreciated on a straight-line basis over their estimated useful lives of three to five years.

### *Equipment inventory*

The Corporation records equipment inventory as a long-term asset on the balance sheet.

### *Leases*

The Corporation's leases are classified as either capital or operating. Capital leases are those which transfer substantially all the benefits and risks of ownership to the lessee. Assets acquired under capital leases are depleted along with the petroleum and natural gas properties. Obligations recorded under capital leases are reduced by the principal portion of lease payments as incurred and the imputed interest portion of capital lease payments is charged to interest expense. Payments under operating leases are expensed as incurred.

### *Goodwill*

Goodwill, at the time of acquisition, represents the excess of the purchase price of a business over the fair value of net assets acquired; thereafter, goodwill is assessed for impairment at least annually. If the fair value of the business is less than the book value, a second test is performed to determine the amount of the impairment. The amount of the impairment is determined by deducting the fair value of the business' other assets and liabilities from the fair value of the business to determine the implied fair value of goodwill and comparing that amount to the book value of goodwill. Any excess of the book value of goodwill over the implied fair value is the impairment amount and will be charged to income in the period of the impairment. For the years ended December 31, 2008 and 2007, no goodwill impairment was required.

### *Asset retirement obligation*

The Corporation follows the recommendations for asset retirement obligations as set out in the CICA Handbook section 3110. This standard requires the recognition and measurement of liabilities related to the legal obligation to abandon and reclaim property, plant and equipment incurred upon acquisition, construction, development and/or normal use of the asset. The initial liability must be measured at fair value and subsequently adjusted for the accretion of discount and changes in the fair value. The asset retirement cost is capitalized as part of property and equipment and depleted into earnings based on units of production. Actual costs incurred upon settlement of the obligations are charged against the liability.

### *Revenue recognition*

Petroleum and natural gas sales are recognized when delivery of the product has been completed and title passes to an external party.

### *Financial instruments*

The financial instruments recognized on the Corporation's balance sheet are deemed to approximate their estimated fair values. All financial assets except derivatives were classified as loans or receivables and are accounted for on an amortized cost basis. All financial liabilities are classified as other liabilities. Derivative instruments are classified as held-for-trading and are recorded on the balance sheet at fair value (see Note 13) with actual amounts received, or paid, on the settlement of the derivative financial instrument recorded in revenue. There were no financial assets on the balance sheet which were designated as available-for-sale.

### *Joint interests*

The Corporation's petroleum and natural gas activities may be conducted jointly with others. These financial statements reflect only the Corporation's proportionate interest in such activities.

### *Future income taxes*

The liability method is used in accounting for income taxes. Under this method, future income tax assets and liabilities are recognized based on differences between the financial reporting and tax bases of assets and liabilities, and measured using the substantively enacted tax rates and laws that will be in effect when the differences are expected to reverse. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the period in which the change is substantively enacted.

### *Flow-through shares*

The Corporation has financed a portion of its exploration and development activities through the issuance of flow-through shares. Under the terms of the flow-through share agreements, the tax attributes of the related expenditures are renounced to subscribers. To recognize the foregone tax benefits to the Corporation, the carrying value of the shares issued is reduced by the tax effect of the tax benefits renounced to subscribers when the renouncements are filed.

### *Fair values*

The carrying values of accounts receivable and accounts payable approximated their fair values at December 31, 2008 due to their short-term nature. The carrying value of the bank loan approximates its fair value due to the floating interest rate on the facility. The carrying value of the financial derivatives approximates current market prices for comparable contracts at December 31, 2008.

### *Stock-based compensation*

The Corporation follows the accounting standard on stock based compensation as presented in the CICA Handbook section 3870. This standard requires the recognition of stock-based compensation expense for "awards to" or "grants to" employees and non-employees using the fair value method.

The standard requires the fair value of all stock based compensation awards to be expensed over the vesting period of the award with an offsetting credit to contributed surplus. The Black-Scholes option pricing model has been used to calculate the fair value of the stock options granted. Consideration paid by optionees on the exercise of stock options is credited to share capital together with any amount previously included in contributed surplus.

## 2. CHANGES IN SIGNIFICANT ACCOUNTING POLICIES

As of January 1, 2008, Galleon adopted several new CICA standards, section 1400 "General Standards of Financial Statement Presentation", section 1535 "Capital Disclosures", section 3031 "Inventories", section 3862 "Financial Instruments – Disclosures" and Section 3863 "Financial Instruments – Presentation".

CICA 1400, was amended to include requirements to assess and disclose an entity's ability to continue as a going concern. The new requirements are effective for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2008. The adoption of this standard did not have an impact on the Corporation's financial statements.

Section 1535 establishes standards for disclosing information regarding the capital of the entity and how it is managed. The section specifies the disclosure of i) objectives, policies, and processes for managing capital by the entity; ii) quantitative data about what the entity regards as capital; iii) whether the entity has complied with any capital requirements; and iv) if it has not complied, the consequences of such non-compliance.

CICA 3031 replaces CICA 3030 and establishes standards for measurement and disclosure of inventories. This standard provides guidance on the determination of cost and subsequent recognition as an expense, including any write-down to net realizable value and the reversal of previous write-downs when there is a subsequent increase in the value of inventories. It also provides guidance on the cost formulas that are used to assign costs. The adoption of this standard did not have an impact on the Corporation's financial statements.

Sections 3862 and 3863 replace section 3861 "Financial Instruments – Disclosure and Presentation" which revises and enhances financial instrument disclosure requirements and leaves unchanged its presentation requirements. The objective of section 3862 is to provide financial statement disclosure to enable users to evaluate the significance of financial instruments on the Corporation's financial position and performance. The section also requires increased disclosure on the nature and extent of risks arising from financial instruments that the Corporation is exposed to during the reporting period and the balance sheet date and how the Corporation is managing those risks. The purpose of section 3863 is to enhance the financial statement users' understanding of the significance of financial instruments on the Corporation's financial position, performance and cash flows.

### Future accounting policies

The Canadian Accounting Standards Board (AcSB) has confirmed that the use of the International Financial Reporting Standards ("IFRS") will be required in 2011 for publicly accountable profit-oriented enterprises. IFRS will replace Canada's current GAAP for those enterprises that are responsible to large or diverse groups of stakeholders. The official changeover date is for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. Companies will be required to provide comparative IFRS information for the fiscal year of 2010. Galleon is in the initial stages of evaluating the impact of adopting IFRS and is in the process of developing a changeover plan which includes determining appropriate changes to accounting policies and required amendments to financial disclosures; identifying changes required in associated processes and information systems; compliance with internal control requirements; and education and training of internal stakeholders.

CICA 3064, Goodwill and Intangible Assets, will replace CICA 3062, Goodwill and Other Intangible Assets, and results in withdrawal of CICA 3450, Research and Development Costs, and amendments to Accounting Guideline (AcG) 11, Enterprises in the Development Stage and CICA 1000, Financial Statement Concepts. The standard intends to reduce the differences with IFRS in the accounting for intangible assets as under current Canadian standards, more items are recognized as assets. The objectives of CICA 3064 are to reinforce the principle-based approach to the recognition of assets only in accordance with the definition of an asset and the criteria for asset recognition. The application of the concept of matching revenues and expenses is that the current practice of recognizing as assets items that do not meet the definition and recognition criteria is eliminated.

The standard will also provide guidance for the recognition of internally developed intangible assets (including research and development activities), ensuring consistent treatment of all intangible assets, whether separately acquired or internally developed. These changes are effective for fiscal years beginning on or after October 1, 2008. Galleon Energy Inc. is evaluating the effects of adopting this standard.

On January 20, 2009 the CICA EIC issued EIC-173 Credit risk and the fair value of financial assets and financial liabilities. Under EIC-173, an entity's own credit risk and the credit risk of the counterparty should be taken into account in determining the fair value of financial assets and liabilities, including derivative instruments. Galleon will adopt the requirements of EIC-173 effective January 1, 2009. The impact of this EIC upon the Corporation's financial statements is currently being assessed.

### 3. ACQUISITION OF PARTNERSHIP

On February 1, 2007, the Corporation closed a transaction resulting in an acquisition of an interest in a partnership and the minority partnership's holdings resulting in a 100% consolidated interest. The partnership held oil and gas assets within Galleon's core area of Dawson, Alberta. The total consideration of \$28.7 million was paid in cash. The business combination has been accounted for as a purchase as at the closing date of the transaction, with the purchase price allocated to assets and liabilities as follows:

<i>Allocation of Purchase Price</i>	<i>\$</i>
Property and equipment	30,874
Goodwill	5,883
Asset retirement obligation	(980)
Future income taxes	(7,045)
	<u>28,732</u>
<i>Calculation of Purchase Price</i>	
Cash for purchase of interest	28,664
Transaction costs	68
	<u>28,732</u>

### 4. ACQUISITION OF EXALTA ENERGY INC.

On January 16, 2008, the Corporation acquired all of the outstanding common shares of ExAlta Energy Inc. ("ExAlta"). The ExAlta acquisition was accounted for by the purchase method and shares were acquired for an aggregate of \$62.5 million by the issuance of 4,334,856 Class A shares of Galleon at a value of \$14.42 per share plus the assumption of \$48.5 million of net debt including capital leases. The acquisition has been accounted for as a purchase as at the closing date of the transaction, with the purchase price allocated to assets and liabilities as follows:

<i>Allocation of Purchase Price</i>	<i>\$</i>
Property and equipment	95,748
Equipment inventory	1,027
Goodwill	18,869
Future income taxes	582
Bank debt and working capital assumed (including bank debt of \$43.1)	(44,966)
Asset retirement obligation	(3,403)
Capital lease	(3,575)
	<u>64,282</u>
<i>Calculation of Purchase Price</i>	
Fair value of shares issued	62,509
Transaction costs	1,773
	<u>64,282</u>

## 5. ACQUISITION OF ADAMANT ENERGY INC

On May 9, 2008, the Corporation acquired all of the outstanding common shares of Adamant Energy Inc. ("Adamant"). The Adamant acquisition was accounted for by the purchase method and shares were acquired for an aggregate of \$65.2 million by the issuance of 4,193,288 Class A shares of Galleon at a value of \$15.55 per share. The acquisition has been accounted for as a purchase as at the closing date of the transaction, with the purchase price allocated to assets and liabilities as follows:

<i>Allocation of Purchase Price</i>		<i>\$</i>
Property and equipment		76,099
Equipment inventory		271
Working capital assumed (including cash of \$2.4 million)		8,308
Future income taxes		(9,130)
Asset retirement obligation		(4,431)
Gas contract		(5,340)
		<u>65,777</u>
<i>Calculation of Purchase Price</i>		
Fair value of shares issued		65,206
Transaction costs		571
		<u>65,777</u>

The gas contract was amortized over the term of the contract which expired on December 31, 2008.

## 6. PROPERTY AND EQUIPMENT

On July 3, 2007 the Corporation purchased oil and gas properties in the Eaglesham/Kakut area of Alberta for cash of \$15.7 million. An asset retirement obligation of \$436,367 was recorded.

On June 29, 2007 the Corporation purchased oil and gas properties in the Shadow area of Alberta for cash of \$5.1 million. An asset retirement obligation of \$65,750 was recorded.

On October 22, 2008 the Corporation purchased oil and gas properties in the Senex area of Alberta for cash, net of adjustments, of \$5.8 million and issuance of 215,000 Class A shares for a total purchase price of \$7.1 million.

<i>Allocation of Purchase Price</i>		<i>\$</i>
Property and equipment		5,836
Undeveloped land		1,858
Asset retirement obligations		(551)
		<u>7,143</u>

As at December 31, 2008, \$108.4 million (December 31, 2007 – \$105.8 million) of undeveloped land, seismic and equipment under construction have been excluded from and \$173.1 million (December 31, 2007 – \$110.8 million) in future development costs have been added into the full cost pool for depletion purposes. For the year ended December 31, 2008, \$1.2 million (December 31, 2007 – \$1.0 million) of exploration salaries have been capitalized.

<i>As at December 31, 2008</i>	<i>Cost</i> \$	<i>Accumulated depletion</i> \$	<i>Net book value</i> \$
Petroleum and natural gas properties & equipment	1,413,071	(348,822)	1,064,249
Equipment under capital lease	6,878	(1,278)	5,600
Office furniture and equipment	2,492	(1,191)	1,301
	<b>1,422,441</b>	<b>(351,291)</b>	<b>1,071,150</b>

<i>As at December 31, 2007</i>	<i>Cost</i> \$	<i>Accumulated depletion</i> \$	<i>Net book value</i> \$
Petroleum and natural gas properties & equipment	952,752	(213,401)	739,351
Equipment under capital lease	–	–	–
Office furniture and equipment	1,025	(733)	292
	<b>953,777</b>	<b>(214,134)</b>	<b>739,643</b>

The Corporation has performed the ceiling test using the following benchmark reference prices at December 31, 2008 for the years 2009 to 2014 and adjusted for commodity differentials specific to the Corporation. Beyond year 2014, the price forecast escalates on average 2.5% per year. A foreign exchange rate of \$0.90 US to \$1.00 CDN was used. No impairment was required.

#### Benchmark Reference Price Forecasts:

	<i>2009</i>	<i>2010</i>	<i>2011</i>	<i>2012</i>	<i>2013</i>	<i>2014</i>
WTI oil USD/Bbl	57.00	69.53	76.38	86.99	94.74	97.11
Alberta spot gas \$Cdn/Mcf	7.31	7.99	8.09	8.47	8.67	8.77

## 7. ASSET RETIREMENT OBLIGATION

The Corporation's asset retirement obligations result from net ownership interests in petroleum and natural gas assets including well sites, gathering systems and processing facilities. The Corporation estimates the total undiscounted amount of cash flows required to settle its asset retirement obligation is approximately \$92.0 million, which will be incurred over the next 18 years. Credit adjusted risk free rates of 5% and 8% and an inflation rate of 2% were used to calculate the fair value of the asset retirement obligation.

	<i>Year ended December 31, 2008</i> \$	<i>Year ended December 31, 2007</i> \$
Balance, beginning of year	25,535	21,432
Accretion expense	2,253	1,949
Liabilities incurred	6,668	3,346
Liabilities acquired ( <i>notes 4 and 5</i> )	7,834	980
Settlement of liabilities	(2,385)	(2,172)
<b>Balance, end of year</b>	<b>39,905</b>	<b>25,535</b>

## 8. CREDIT FACILITY

The Corporation has extendible revolving term credit facilities of \$310 million in place with a bank syndicate. The facilities bear interest at rates ranging from the bank's prime rate to prime plus 0.75% per annum on \$290 million and at rates ranging from the bank's prime rate plus 0.95% to prime plus 1.75% on \$20 million based on the Corporation's debt to cash flow ratio. The Corporation may also borrow at the prevailing Banker's Acceptance rate. Collateral for the facilities consists of a demand debenture for \$500 million collateralized by a first floating charge over all of the property and equipment of the Corporation. An annual review is scheduled to occur on or before May 31, 2009. At December 31, 2008, an amount of \$249 million was drawn against the credit facilities (December 31, 2007 – \$163.4 million). As at December 31, 2008, the Corporation is in compliance with all covenants, obligations and conditions of its Credit Agreement.

## 9. CAPITAL LEASE OBLIGATIONS

The Corporation has entered into a series of equipment lease financing arrangements. Under these arrangements, the Corporation is committed to annual minimum lease payments as follows:

	\$
2009	2,274
2010	1,605
Total minimum lease payments	3,879
Less interest included in payments	(228)
Principal portion of minimum lease payments	3,651
Less current portion	(2,110)
<b>Capital lease obligation at December 31, 2008</b>	<b>1,541</b>

Interest expense of \$0.3 million was incurred on the capital leases during the year ended December 31, 2008 (December 31, 2007 – \$nil million).

The applicable terms and commitments are summarized in the following table:

<i>End of lease term</i>	<i>Outstanding principal</i>	<i>Purchase price at end of lease</i>	<i>Interest rate</i>
June 2009	\$126	\$142	2.2 percent above the 30-day bankers' acceptance rate
October 2009	\$198	\$nominal	2.1 percent above the 30-day banker's acceptance rate
December 2009	\$1,002	\$nominal	6.0 percent
September 2010	\$2,325	\$1,000	6.3 percent

A general security agreement and a first charge against the equipment have been provided as collateral.

## 10. SHARE CAPITAL

### *Authorized*

Unlimited number of preferred shares with no par value

Unlimited number of voting Class A shares with no par value

Unlimited number of voting Class B shares with no par value, convertible (at the option of the Corporation) at any time after December 31, 2007 and before December 31, 2008, into Class A shares. The conversion factor is calculated by dividing \$10 by the greater of \$1 and the then current market price of Class A shares.

On December 15, 2008 the Class B shares were converted into Class A shares. The conversion factor was calculated by dividing \$10 by \$5.36264, being the weighted average trading price for the Class A shares for the 30 consecutive trading days commencing October 15, 2008.

<b>CLASS A SHARES</b>	<i>Number of Shares</i>	<i>Amount \$</i>
<b>Balance at December 31, 2006 (a)</b>	57,712,077	334,662
Issued for cash (b)	1,869,200	30,001
Issue of flow-through shares for cash (b)	2,944,900	60,000
Issued for cash on exercise of stock options	689,375	3,256
Tax effect of flow through shares (b)	–	(11,692)
Share issue costs, net of tax of \$1,431	–	(3,494)
Transfer from contributed surplus	–	1,071
<b>Balance at December 31, 2007</b>	63,215,552	413,804
Issued as consideration for shares in ExAlta Energy Inc. (b)	4,334,856	62,509
Issued for cash on exercise of stock options	1,491,797	11,825
Tax effect of flow through shares	–	(16,200)
Share issue costs, net of tax of \$49	–	(132)
Issued as consideration for shares in Adamant Energy Inc. (b)	4,193,288	65,206
Issued on acquisition of petroleum and natural gas properties (b)	215,000	1,354
Issued on conversion of Class B shares	1,720,240	5,207
Transfer from contributed surplus	–	3,725
<b>Balance at December 31, 2008</b>	<b>75,170,733</b>	<b>547,298</b>
<b>CLASS B SHARES</b>		
Balance at December 31, 2007 and December 31, 2006	922,500	5,207
Conversion of Class B shares to Class A shares	(922,500)	(5,207)
<b>Total share capital at December 31, 2008</b>	<b>75,170,733</b>	<b>547,298</b>

- a) On June 7, 2006, the shareholders of the Corporation approved a three-for-two Class A share split. The number of Class A shares above has been restated to reflect the share split.
- b) On October 22, 2008, the Company issued 215,000 Class A shares at a price of \$6.30 per share to a third party as part of the consideration for the acquisition of certain petroleum and natural gas properties.
- c) On May 9, 2008, the Corporation issued 4,193,288 Class A shares at \$15.55 per share as consideration for shares in Adamant Energy Inc. as described in Note 5.
- d) On January 16, 2008, the Corporation issued 4,334,856 Class A shares at \$14.42 per share as consideration for shares in ExAlta Energy Inc. as described in Note 4.

The tax effect of \$16.2 million related to the renouncement in January 2008 of the flow-through shares was recorded in 2008.

On September 28, 2007, the Corporation issued 1,869,200 Class A shares at \$16.05 per share and 1,463,400 flow-through Class A shares at \$20.50 per share pursuant to a public offering for aggregate gross proceeds of \$60.0 million. All of the required qualifying expenditures have been incurred with respect to this issuance.

On April 19, 2007, the Corporation issued 1,481,500 flow-through Class A shares at \$20.25 per share by way of private placement for gross proceeds of \$30.0 million. All of the required qualifying expenditures have been incurred with respect to this issuance.

The Corporation has a share option plan which was approved on May 19, 2005 and amended on August 25, 2005, June 19, 2007 and May 13, 2008. The exercise price of each option equals the closing price of the Corporation's Class A shares on the day immediately prior to the date of the grant. Compensation expense is recognized as the options vest. Prior to November 2008, one third of the options vest immediately, and one third vest on each of the first and second anniversaries of the date of the grant. With options granted commencing November, 2008, the vesting period is one third on each of the next three anniversaries of the date of the grant. The options expire five years from the date of grant. The Corporation may grant up to 10% of the aggregate number of Class A shares outstanding and no one optionee is permitted to hold options entitling such optionee to purchase more than 5% of the aggregate number of issued and outstanding Class A shares. Class A shares have been reserved for all options granted.

	<i>Year ended</i> <i>December 31, 2008</i>	<i>Year ended</i> <i>December 31, 2007</i>
	\$	\$
Contributed surplus, beginning of year	19,064	11,619
Stock based compensation expense	7,670	8,516
Transfer to share capital	(3,725)	(1,071)
<b>Contributed surplus, end of year</b>	<b>23,009</b>	<b>19,064</b>

The fair value of options granted was estimated at the date of grant using a Black-Scholes Option Pricing Model with the following assumptions: risk-free interest rates of 2.00-4.51%; dividend yield of 0%; volatility factors of the market price of the Corporation's common shares of 34-51%; and, an average expected life of the options of three years. Options granted in 2008 had fair values of between \$1.52 and \$5.12 per option.

	<i>Number of</i> <i>Options</i>	<i>Weighted Average</i> <i>Exercise Price</i>
		\$
Outstanding, December 31, 2006	5,310,325	10.28
Granted	1,720,000	15.51
Forfeited	(130,000)	(9.60)
Exercised	(689,375)	(4.72)
Outstanding, December 31, 2007	6,210,950	12.36
Granted	3,306,000	10.87
Forfeited	(987,502)	(10.40)
Exercised	(1,491,797)	(7.93)
<b>Outstanding, December 31, 2008</b>	<b>7,037,651</b>	<b>11.87</b>

The following table summarizes information regarding stock options at December 31, 2008:

<i>Exercise</i> <i>Price \$</i>	<i>Options Outstanding</i>			<i>Options Exercisable</i>	
	<i>Number</i> <i>Outstanding</i>	<i>Weighted</i> <i>Average</i> <i>Life (Years)</i>	<i>Weighted</i> <i>Average</i> <i>Exercise</i> <i>Price \$</i>	<i>Number</i> <i>Exercisable</i>	<i>Weighted</i> <i>Average</i> <i>Exercise</i> <i>Price \$</i>
2.84 – 4.20	265,750	0.68	3.15	245,750	3.07
4.70 – 6.99	2,095,000	3.52	5.39	1,221,000	5.89
7.73 – 10.80	503,999	1.92	8.56	453,999	8.31
12.00 – 14.02	1,052,501	3.52	13.61	414,168	13.46
14.27 – 15.04	805,401	3.47	14.46	465,401	14.41
15.78 – 17.00	1,262,500	3.65	16.41	705,833	16.58
17.20 – 22.83	1,052,500	3.27	19.41	754,167	19.92
	<b>7,037,651</b>	<b>3.28</b>	<b>11.87</b>	<b>4,260,318</b>	<b>11.90</b>

### *Earnings per share*

The Corporation utilizes the treasury stock method in the determination of diluted per share amounts. Under this method, the diluted weighted average number of shares is calculated assuming the proceeds that arise from the exercise of outstanding and in the money options are used to purchase common shares of the Corporation at their average market price for the period. For the year ended December 31, 2008, 5,460,901 options have been excluded from the diluted earnings per share calculation as they are anti-dilutive (December 31, 2007 – 2,132,500).

## 11. INCOME TAXES

The future income tax liability is comprised of the following temporary differences as at:

	<i>December 31, 2008</i>	<i>December 31, 2007</i>
	\$	\$
Property and equipment	101,197	47,108
ACRI benefit	(870)	(870)
Share issue costs	(2,712)	(3,716)
Asset retirement obligation	(869)	(209)
Non-capital losses	(54,628)	(27,020)
Partnership income tax deferral	66,137	39,517
Capital leases	(986)	–
Financial derivative	334	(2,511)
<b>Future income tax liability</b>	<b>107,603</b>	<b>52,299</b>

The provision for income tax differs from the amount that would have been expected if the reported earnings had been subject only to the statutory Canadian income tax rate of 29.73% (December 31, 2007 – 32.45%).

<i>Years ended December 31</i>	<i>2008</i>	<i>2007</i>
	\$	\$
Earnings before income tax	110,934	11,871
Corporate tax rate	29.73%	32.45%
Expected tax	32,981	3,852
Increase (decrease) in taxes resulting from:		
Non-deductible items	47	25
Stock-based compensation	2,280	2,763
Statutory tax rate changes	(4,494)	(3,652)
Deductible capital taxes	(317)	(285)
Other	108	3
	<b>30,605</b>	<b>2,706</b>

As at December 31, 2008 Galleon has approximately \$659.6 million (December 31, 2007 – \$544.6 million) of tax deductions for Canadian income tax purposes.

## 12. COMMITMENTS

### Drilling Rig

The Corporation has entered into a Master Daywork Contract whereby it is entitled to the use of a drilling rig for a two year period which commenced in November, 2007. Future minimum payments under this contract are as follows:

<i>Year</i>	<i>Amount \$</i>
2009	1,791

### Office Lease Payments

At December 31, 2008 the Corporation has committed to future minimum payments under operating leases that cover office space as follows:

<i>Year</i>	<i>Amount \$</i>
2009	2,518
2010	1,801

The above commitment includes an estimate of the Corporation's share of operating expenses, utilities and taxes for the duration of the office lease.

### Equipment

At December 31, 2008 the Corporation committed to future minimum payments for leased equipment under operating leases, as follows:

<i>Year</i>	<i>Amount \$</i>
2009	678

### Litigation

The Corporation is involved in various other claims and legal actions arising from the normal course of business. The Corporation does not expect that the outcome of these proceedings will have a material adverse effect on the Corporation as a whole.

## 13. FINANCIAL INSTRUMENTS AND FINANCIAL RISK FACTORS

### *Fair value of financial assets*

The Corporation's financial instruments recognized in the balance sheet consist of accounts receivable, accounts payable, bank loan and financial derivative ("financial instruments"). The carrying value of accounts receivable and accounts payable approximated their fair values at December 31, 2008 due to their short-term nature. The carrying value of the bank loan approximates fair value due to the floating interest rate on the facility. The fair value of the financial derivative is recognized on the balance sheet as described below.

### *Credit risk*

Credit risk is the risk that a customer or counterparty will fail to perform an obligation or fail to pay amounts due causing a financial loss. The Corporation's accounts receivable are with customers and joint venture partners in the oil and gas industry and are subject to normal credit risks. A portion of the Corporation's production is currently sold through joint venture partners under normal industry sale and payment terms. As at December 31, 2008, approximately 27% of the accounts receivable balance is due from two customers, compared to 56% at December 31, 2007.

These customers are considered to have high credit worthiness. The Corporation generally grants unsecured credit but routinely assesses the financial strength of its customers and joint venture partners. No provision has been made for past due receivables as of December 31, 2008 as the Corporation has assessed there are no impaired receivables.

	<i>2008</i>
	\$
Current	43,444
30 – 60 days	3,327
60 – 90 days	3,402
Greater than 90 days	4,691
<b>Total</b>	<b>54,864</b>

### *Liquidity risk*

Liquidity risk arises through excess financial obligations over available financial assets due at any point in time. The Corporation's objective in managing liquidity risk is to maintain sufficient available reserves in order to meet its liquidity requirements at any point in time. The Corporation believes that it has access to sufficient capital through internally generated cash flows and external equity sources, and to undrawn committed credit facilities to meet current spending forecasts. All of the Corporation's current liabilities mature within a one year period.

### *Interest rate risk*

The Corporation is exposed to interest rate risk as changes in interest rates may affect future cash flows and the fair value of its financial instruments. The Corporation's primary debt facility has a floating interest rate that will fluctuate based on prevailing market conditions. Cash flows are sensitive to changes in interest rates on this instrument. Given the amount of debt employed, the Corporation's strategy is to manage interest rate risk within the current framework. If interest rates on the floating instrument were to change by 1% it is estimated that annual cash flow would change by approximately \$2.5 million.

### *Market risk*

Market risk is the risk of uncertainty arising from possible market price movements and their impact on the future performance of the business. The market price movements that could adversely affect the value of the Corporation's financial assets, liabilities and expected future cash flows include commodity price risk and interest rate risk. It is estimated that annual cash flow would change approximately by \$2.0 million and by \$5.1 million, respectively, due to a \$1 USD WTI and a \$0.25/Mcf CDN change in oil and natural gas prices.

The Corporation has the following financial fixed price contracts in place for natural gas as at December 31, 2008:

### *Natural Gas*

January 1, 2009 – June 30, 2009	5,000 GJ/d	CDN \$6.00/GJ
January 1, 2009 – June 30, 2009	5,000 GJ/d	CDN \$6.00/GJ
April 1, 2009 – October 31, 2009	5,000 GJ/d	CDN \$7.40/GJ

Galleon has entered into the above contracts for the purpose of protecting funds generated from operations from the volatility of natural gas prices. The Corporation recognizes the fair value of its financial derivatives on the balance sheet each reporting period with the change in fair value recognized as an unrealized gain or loss on the statement of earnings. The fair value is based on quoted market prices. At December 31, 2008 the fair value was estimated to be an asset of \$1.2 million.

The fair value of a financial instrument is the amount of consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act. Fair values for commodity price derivatives are provided by the financial intermediary with whom the transactions were completed and tested by the Corporation for reasonableness based on comparative market prices and the fixed prices of the contracts. In determining fair values, the Corporation uses quoted prices for identically traded commodities obtained from active exchanges such as the New York Mercantile Exchange and the Natural Gas Exchange, or obtained directly from brokers, or other publicly available market data providers.

Subsequent to December 31, 2008 the Corporation has entered into the following financial contracts:

#### *Natural Gas*

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Fixed Price:

March 1, 2009 – March 31, 2010	5,000 GJ/d CDN \$5.96/GJ
March 1, 2009 – March 31, 2010	5,000 GJ/d CDN \$6.01/GJ

#### *Crude Oil*

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Fixed Price:

March 1, 2009 – December 31, 2009	1,000 Bbl/d WTI CDN \$68.25/Bbl
February 1, 2009 – December 31, 2009	500 Bbl/d WTI CDN \$63.30/Bbl
February 1, 2009 – December 31, 2009	500 Bbl/d WTI CDN \$63.85/Bbl

Costless Collar:

March 1, 2009 – December 31, 2009	500 Bbl/d WTI CDN \$60.00-\$70.00/Bbl
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#### *Interest Rate Swap*

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Notional Amount CAD \$100 million	Term: January 20, 2009 – January 20, 2011
Fixed rate 1.1% — Floating 1.08667% reset against CAD — CDOR on each 3 month anniversary	

## 14. CAPITAL STRUCTURE FINANCIAL POLICIES

The Corporation defines capital as total debt and shareholders' equity comprised of retained earnings and share capital. The Corporation's primary capital management objective is to maintain a strong balance sheet affording the Corporation financial flexibility to achieve goals of continued growth and access to capital. The basis for the Corporation's capital structure is dependent on the Corporation's expected business growth and changes in the business environment. The Corporation manages its capital structure and makes adjustments according to market conditions to maintain flexibility while achieving the objectives stated above. To manage the capital structure, the Corporation may adjust capital spending, issue new shares, issue new debt or repay existing debt.

The Corporation monitors its progress through the following two measures utilizing book values: net debt to funds from operations and total debt to total debt and shareholders' equity. Net debt to funds from operations is calculated as current liabilities and long term debt less current assets divided by the most recent four quarters funds from operations. Total debt to total debt plus shareholders' equity is calculated as short term debt plus long term debt divided by short term debt plus long term debt plus shareholders' equity.

The Corporation's strategy is to maintain net debt to funds from operations at or below a level of 1.5 to 1. While the Corporation may exceed this rate from time to time, variations are viewed as short term, and efforts are made after a period of variation to bring the measure back in line.

The Corporation's strategy concerning capitalization is to utilize more equity than debt. This is measured by targeting total debt to total debt plus shareholders' equity at a ratio of less than 0.4 to 1. The Corporation has no externally imposed capital requirements.

<i>At December 31 (\$000s)</i>	<i>Target Measure</i>	<i>2008</i> \$	<i>2007</i> \$
Components of ratios			
Current assets (excluding fair value of financial derivative)		61,525	40,865
Current liabilities (including short term debt and excluding fair value of financial derivative)		342,430	234,422
Short term debt (bank loan and current portion of capital lease)		251,125	163,378
Net debt (working capital and capital leases)		282,446	193,557
Total debt (bank loan and capital leases)		252,666	163,378
Shareholders' equity (share capital plus retained earnings)		666,515	458,964
Total capitalization (total debt plus shareholders' equity)		919,181	622,342
Funds from operations <sup>1</sup>		241,298	131,052
Net debt/funds from operations	< 1.5 times	1.2	1.5
Total debt/total debt plus shareholders' equity	< 0.4 times	0.3	0.3

<sup>1</sup> *Funds from operations is a non-GAAP measure and is based on cash flow from operating activities before changes in non-cash working capital and abandonment expenditures.*

## 15. COMPARATIVE FIGURES

Certain comparative figures have been reclassified to conform to the current period's consolidated financial statement presentation.

## 16. SUBSEQUENT EVENTS

On November 24, 2008, Galleon received regulatory approval for a Normal Course Issuer Bid ("Bid") to purchase, for cancellation, up to a maximum of 5,610,908 Class A shares of the Corporation. The Bid commenced on November 26, 2008 and will terminate on November 25, 2009. There were no shares purchased for cancellation as at December 31, 2008. As at March 11, 2009, Galleon has purchased 10,100 shares for total consideration of \$32,627.

# Corporate Information

## HEAD OFFICE

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[www.galleonenergy.com](http://www.galleonenergy.com)

## BOARD OF DIRECTORS

John A. Brussa  
Glenn R. Carley, *Executive Chairman*  
William L. Cooke <sup>1 3 4</sup>  
Lawrence Fenwick <sup>2 3</sup>  
Daryl H. Gilbert <sup>1 2</sup>  
Brad R. Munro <sup>1 2 4</sup>  
Steve Sugianto

<sup>1</sup> Member of the Audit Committee

<sup>2</sup> Member of the Reserves Committee

<sup>3</sup> Member of the Compensation Committee

<sup>4</sup> Member of the Corporate Governance Committee

## OFFICERS

Steve Sugianto, *President and Chief Executive Officer*  
Glenn R. Carley, *Executive Chairman*  
Shivon M. Crabtree, *Vice President, Finance & Chief Financial Officer*  
Jim Iverson, *Vice President, Exploration*  
Dale Orton, *Vice President, Engineering*  
Devin Sundstrom, *Vice President, Production*  
Chris Tibbles, *Vice President, Land*  
Bill Wee, *Vice President, Corporate Development*  
C. Steven Cohen, *Secretary*

## AUDITOR

Ernst & Young LLP  
Calgary, Alberta

## BANK

The Bank of Nova Scotia  
Calgary, Alberta  
ATB Financial  
Calgary, Alberta  
HSBC Bank Canada  
Calgary, Alberta  
The Toronto-Dominion Bank  
Calgary, Alberta  
Fortis Capital Canada Ltd.  
Calgary, Alberta  
Union Bank of California  
Canada Branch  
Calgary, Alberta

## LEGAL COUNSEL

Burnet, Duckworth & Palmer LLP  
Calgary, Alberta

## EVALUATION ENGINEERS

DeGolyer and MacNaughton  
Canada Limited  
Calgary, Alberta

## REGISTRAR AND TRANSFER AGENT

Valiant Trust Company  
Calgary, Alberta

## STOCK EXCHANGE LISTING

Toronto Stock Exchange  
Trading Symbol GO

