BAYOU BEND PETROLEUM LTD.
(formerly Kit Resources Ltd.)

CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2007 AND 2006

Bayou Bend Petroleum Ltd.
Annual Report
For the Year Ended December 31, 2007

To our shareholders:

The year 2007 saw the emergence of Bayou Bend as the newest oil and gas company in the Lundin Group. The Lundin Group of Companies, with a combined market capitalization approaching $18 billion, has enjoyed enormous success in the oil and gas and mining industries over the past three decades and plans to continue that successful track record with Bayou Bend. Bayou Bend was launched through the acquisition of a 35.6% interest in the highly prospective Marsh Island project in the State waters offshore Louisiana and was mandated with a strategic focus in the Gulf of Mexico region.

Much was achieved and accomplished in its very first year including the formation of a quality portfolio of large, high impact prospects, the raising of $200 million in financing, and the assembly of a top-class management and technical team.

To date the Company has acquired 107,075 total gross acres in the Gulf of Mexico and Louisiana state waters and has embarked on an aggressive multi-year exploration program. The Company has had one discovery to date on the Marsh Island project and returned two idle wells back into production, tying all three wells into the Company's Eugene Island Block 7 production facility.

In 2008, the Company will drill up to twelve exploration wells. Nine are planned for Marsh Island and three on OCS Federal Waters prospects. The first well was spud on April 8, 2008 on the Eagle's Nest prospect on Marsh Island. Eagle's Nest is part of a joint exploration agreement with Contango Operators, Incorporated and other partners who will jointly drill and develop this prospect. Bayou Bend holds a 12.5% interest working interest. This prospect is a possible northern extension to Contango's Mary Rose discovery.

Marsh Island Area

At the Marsh Island Area located in State waters offshore Louisiana, the Company holds a large, highly prospective land package. The Marsh Island project is newly opened up acreage in a highly prolific area which has seen limited exploration to date. During March 2007, the Company drilled its first exploration well and established first production from the Marsh Island project with the discovery of the Greylock field, in which the Company holds a 54.5509% interest. In addition the Company reactivated two existing wells on the Company's Eugene Island Block 7 platform, in which the Company holds a 35.5809% interest.

In the second quarter, the Company drilled its second well, testing the Bootspur prospect, a large structural trap approximately 1.5 miles southeast from the Company's producing Greylock field. The well was drilled to a total depth of 15,788 feet. Log analysis indicated that the primary Cib Op section contained a sub-commercial gas accumulation. However, the shallower Cris I sand appeared to be gas saturated and the well will undergo further evaluation to determine the economic viability as a potential completion. In August 2007 the well bore was plugged and temporarily abandoned pending this further analysis.

During the third quarter the Company commenced drilling on the LaPosada prospect located in the Bayou Hebert Field to a planned depth of 19,368 feet TVD/MD. The prospect is a Lower Miocene deeper pool test on a high relief fault closure that has produced over 100 BCF from shallower Middle and Lower Miocene sands. The well encountered drilling problems due to the depleted overlying gas field and a sidetrack well was required. In January 2008, the sidetrack well reached a depth of 15,253 feet and encountered subsurface conditions that have resulted in the suspension of drilling operations. The geological assessment is that the prospect remains highly prospective as the target objectives came in higher than prognosis. The Company is currently reviewing the drilling issues and is hoping to redrill the prospect later in 2008 once a revised plan is in place.

Bayou Bend initiated an important "super merge" seismic reprocessing project over the entire Marsh Island area. There are currently 4 independent 3D surveys over the area (2 proprietary, 2 multi-client) and as a result, processing has been inconsistent causing data differences along the survey edges in all of the overlap zones. In addition, the deep imaging quality was compromised due to lack of merging the original seismic grids prior to 3D migration. Nearing completion, the reprocessing project will result in:

- Elimination of grid to grid differences in phase/datum shifts
- Relative amplitudes preserved for 3D-AVO analysis
- Significant improvements in deep imaging
- Customized interpretation and attribute volumes
- Detailed velocity field for depth conversion and pore pressure prediction
- Facilitate seismic calibration of prospects with analog fields and well control
- More confident high-grading and ranking of exploration portfolio

The Company and its partners are planning nine wells in 2008 on Marsh Island and look forward to further success on this very prospective and exciting acreage.

The first well will test the Eagle's Nest prospect as part of a joint exploration agreement with Contango Operators, Incorporated and other partners. Bayou Bend holds a 12.5% working interest. This prospect is a possible northern extension to Contango's Mary Rose discovery.

OCS Federal Waters

In Federal Gulf of Mexico waters, the Company was the successful bidder in several lease sales during the year and now holds 16 blocks under lease.

The first prospect tested was on West Cameron Block 332 where the Company drilled the West Cameron Block 332 #1 well to a total depth of 14,250' MD. Wire-line log evaluation indicated non-reservoir quality silts and tight sands in the objective section and, as a result, the well was plugged and abandoned.

During the third quarter, the Company drilled its second well, MU 736#1, in Federal Waters on Mustang Island Block 736. The well encountered mechanical difficulties which resulted in a side-track well being drilled to a total depth of 11,190 feet MD. The well was evaluated with open hole logs and production casing was run on an apparent petrophysical gas pay. The two formation tests completed in the well bore flowed fresh formation water and therefore the well was assessed as non-commercial. The well was plugged and abandoned in November, 2007.

The Company is planning to test three OCS prospects during the 2008 exploration drilling program.

Corporate

During the year, the Company continued to strengthen its management team.

Mr. William Hoffman was appointed Chief Financial Officer. Mr. Hoffman has worked in the accounting profession since 1975 and holds extensive experience in the oil and gas industry. Based in New Orleans, he developed an impressive career with KPMG, including 10 years as a Partner working with a number of publicly held oil and gas companies as well as numerous private enterprises. During the past 14 years, Mr. Hoffman served as Vice President and Chief Financial Officer of C.F. Bean LLC, a dredging company which he led through significant growth including the formation of a joint venture partnership with Royal Boskalis Westminster nv, the world's largest dredging company. In addition, Mr. Hoffman served for several years on the Oil and Gas Accounting Conference Board which addressed current issues impacting the industry from an accounting and financial disclosure viewpoint.

In addition, Mr. William Sack was appointed Senior Vice President of Exploration. Mr. Sack brings over 20 years of experience in the oil and gas industry with particular expertise in Gulf of Mexico exploration. Mr. Sack has enjoyed a consistent track record of success and held senior exploration management positions in large companies operating in the Gulf including Shell Offshore Inc. and Petsec Energy, Inc.

Mrs. Mindy Stuart has was appointed Vice President of Asset Development for the Company. Mindy Stuart has held various petroleum engineering positions in the Gulf Coast for 23 years. From 1998 through 2005, she was employed by Stone Energy Corporation, most recently as the Gulf Coast Exploitation Manager where she was responsible for the coordination of subsurface asset teams with a primary focus of prospect generation and implementing field development plans. Other positions included Reservoir Engineering Manager and Field Reservoir Engineer. Prior to Stone, she was employed by Chevron for 11 years and held positions in reservoir and production engineering. Mrs. Stuart holds a Bachelor of Science degree (B.S. 1984) in petroleum engineering from Louisiana State University.

Effective April 1, 2008, Mr. Rodney Dykes was appointed Senior Vice President of Operations. Mr. Dykes brings 30 years of oil and gas management experience to the Company and will be responsible for drilling, production and facility management. Prior to Bayou Bend, Mr. Dykes was most recently Senior Vice President of Production for Energy Partners, Ltd.

Bayou Bend is off and running. A new oil and gas company targeting high impact gas plays in the Gulf of Mexico offshore Louisiana. The Company looks forward to a successful 2008 drilling program.

On Behalf of the Board

Clinton W. Coldren
President and CEO

April 10, 2008

BAYOU BEND PETROLEUM LTD.
(Formerly Kit Resources Ltd.)

MANAGEMENT DISCUSSION AND ANALYSIS
(Amounts in United States Dollars unless otherwise indicated)
Years ended December 31, 2007 and 2006

Management's discussion and analysis ("MD&A") of Bayou Bend Petroleum Ltd.'s (the "Company" or "Bayou Bend") financial condition and results of operations should be read in conjunction with the audited consolidated financial statements for the years ended December 31, 2007 and 2006 and related notes therein, prepared in accordance with Canadian generally accepted accounting principles. The effective date of the MD&A is April 10, 2008. Additional information related to the Company is available on SEDAR at www.sedar.com and on the Company's web-site at www.bayoubendpetroleum.com.

Overview

Bayou Bend is a Canadian-based oil and gas company that currently holds various interests in oil and gas exploration and development properties in the USA. Prior to February 9, 2007, the Company operated under the name Kit Resources Ltd. and traded on the TSX Venture Exchange under the symbol "KIT". On February 9, 2007, the Company changed its name to Bayou Bend Petroleum Ltd. and started trading under the symbol "BBP".

Prior to December 31, 2006, the Company was a resource based company engaged in the continued search for new and viable opportunities in the mineral sector. During the three months ended March 31, 2007, the Company began its transition into an oil and gas exploration and development company and completed several significant acquisitions.

Effective April 1, 2007, the Company's reporting currency was changed from Canadian dollars to U.S. dollars. The Company anticipates that its future sales will be earned in U.S. dollars and significant expenditures of the Company costs will be incurred in U.S. dollars. The comparative financial statements from prior periods have been restated to reflect this change.

During the year ended December 31, 2007, the Company's major accomplishments and other significant events were as follows:

- February 2007 - Successfully completed a private placement of common stock raising Cdn$190,796,000 (net of fees) to be used for the acquisition of Summit Energy Company, L.L.C. ("Summit"), other properties and planned drilling programs, as well as general working capital purposes.
- February 2007 – Completed the acquisition of Summit, an oil and gas company with a quality portfolio of assets onshore and offshore Marsh Island in the Gulf of Mexico off the Louisiana Coast.

- February, 2007 - Acquired an additional 17.4175% interest in the Marsh Island project from other participants to bring the Company's total interest to 35.5809%.
- March 2007 - Drilled first well and established its first production from the Marsh Island project with the discovery of the Greylock field, in which the Company holds a 54.5509% interest, and reactivation of two existing wells on the Company's Eugene Island Block 7 platform, in which the Company holds a 35.5809% interest.
- May 2007 – Completed the acquisition of five Gulf of Mexico offshore exploration leases (the "GOM Assets") from Pearl Exploration and Production Ltd.
- June 2007 – Commenced drilling its first well in the West Cameron Block 332, in which the Company holds a 25% interest. In September, at a total depth of 14,250 feet MD, the well was logged and evaluated. The wire line log evaluation indicated non-reservoir quality silts and tight sands in the objective section. The well was subsequently plugged and abandoned.
- June 2007 – Commenced drilling its second well in the Marsh Island project. The well tested the Bootspur prospect, a large structural trap approximately 1.5 miles southeast from the Company's producing Greylock field. The well was drilled to a total depth of 15,788 feet. Log analysis indicated that the primary Cib Op section contained a sub-commercial gas accumulation. However, the shallower Cris I sand appeared to be gas saturate and the well will undergo further evaluation to determine the economic viability as a potential completion. In August 2007 the well bore was plugged and temporarily abandoned pending this further analysis.
- August 2007 – Commenced drilling its second well in Federal Waters of the Gulf of Mexico testing a prospect in Mustang Island Block 736. The well encountered mechanical difficulties which resulted in a side-track well being drilled to a total depth of 11,190 feet MD. The well was evaluated with open hole logs and production casing was run on an apparent petrophysical gas pay. The two formation tests completed in the well bore flowed fresh formation water and therefore the well was assessed as non-commercial. The well was plugged and abandoned in November 2007.
- August 2007 – Commenced drilling on the LaPosada prospect located in the Bayou Hebert Field to a planned depth of 19,368 feet TVD/MD. The prospect is a Lower Miocene deeper pool test on a high relief fault closure that has produced over 100 BCF from shallower Middle and Lower Miocene sands. The well encountered drilling problems due to the depleted overlying gas field and a sidetrack well was required. In January 2008, the sidetrack well reached a depth of 15,253 feet and encountered subsurface conditions that have resulted in the suspension of drilling operations. The geological assessment is that the prospect remains highly prospective as the target objectives came in higher than prognosis. The Company is currently reviewing the drilling issues and is hoping to redrill the prospect later this year once a revised plan is in place.
- October 2007 - The Company was the high bidder on seven blocks in West Cameron (#244, #250 and #251), East Cameron (#116 and #143), Vermillion

(#208) and Eugene Island (#59). With these seven blocks, the total gross acreage held by the Company is 107,075 acres.

- Subsequent to the year end, the Company announced that it had entered into a Joint Exploration Agreement with Contango Operators, Incorporated (Contango) and their partners to contribute acreage and jointly drill and develop the Company's Marsh Island Phase I area Eagle's Nest prospect located in Eugene Island Block 6 of the state waters of Louisiana. This prospect is a possible northern extension to the Mary Rose discovery previously announced by Contango. On April 8, 2008, the Company's first well on the prospect was spud. The well will be drilled to a depth of 15,900 feet and, if successful, production will flow through Contango's "H" Platform Facilities in Eugene Island Block 11.

- In March 2008, the Company was the apparent high bidder on the Vermillion #108 block in the OCS. Once this block is awarded by the Mineral Management Service, the total gross acreage held by the Company will be 112,075 acres.

Oil and Gas Acquisitions

On February 20, 2007, the Company acquired 100% of the membership interests in Summit (the "Summit Acquisition") and Summit became a wholly-owned subsidiary of the Company. The assets acquired included an 18.1634% interest in a portfolio of assets onshore and offshore Marsh Island in the Gulf of Mexico, together with an 18.1634% interest in a 40 MMcfgpd production facility tied into the existing regional pipeline infrastructure. The acquisition costs for this operating company totaled $45,847,000.

On March 8, 2007, the Company exercised its option under the Summit purchase agreement to acquire two additional properties for the issuance of 1,222,604 shares of stock with a value of $1,712,000.

Also in February 2007, the Company closed on an additional 17.4175% participating interest in the Phase I Area of the Marsh Island project for a total participating interest of 35.5809%. The acquisition costs totaled $28,601,000.

On May 8, 2007, the Company closed on the acquisition of the Gulf of Mexico Assets ("GOM Assets") from Pearl Exploration and Production Ltd (the "Pearl Acquisition"). The GOM Assets are comprised of a 100% working interest in five Gulf of Mexico offshore exploration blocks and farm-in rights to acquire a 25% working interest in a sixth offshore block. The GOM Assets were acquired in exchange for 10 million common shares with a value of $27.4 million.

In June 2007, the Company was the successful bidder on 10 tracts of land in the State of Louisiana oil and gas lease auction. The bids covered 2,170.47 acres of shallow water leases in the Marsh Island Project Area, in which the Company has a 35.5809% interest, bringing the total gross number of acres held by the Marsh Island Project Group to 27,060 total acres.

In August 2007, the Company successfully bid on two blocks (#542 and #547) in the West Cameron offshore area and in October the Company successfully bid on seven blocks in West Cameron (#244, #250 and #251), East Cameron (#116 and #143), Vermillion (#208) and Eugene Island (#59). Total gross acreage held by the Company currently is 107,075 acres which includes of 27,060 gross acres in Louisiana state waters associated with the Marsh Island Project and 75,760 gross acres in OCS blocks in Federal waters offshore Louisiana and Texas.

Selected Quarterly Information

The following is a summary of selected financial information for the Company for the periods indicated:

($000s, except per share data)	Dec 31 2007	Sep 30 2007	Jun 30 2007	Mar 31 2007	Dec 31 2006	Sep 30 2006	Jun 30 2006	Mar 31 2006
Revenue - oil & gas sales, net	$1,181	$1,077	$299	$172	$0	$0	$0	$0
Net income (loss)	($46,870)	($13,292)	$6,025	($4,335)	($352)	($167)	($346)	($51)
Net (loss) per share - basic	($0.15)	($0.04)	$0.02	($0.02)	($0.00)	($0.00)	($0.00)	($0.00)
Net (loss) per share - diluted	($0.15)	($0.04)	$0.02	($0.02)	($0.00)	($0.00)	($0.00)	($0.00)
Exploration & development expenditures	$28,127	$8,631	$4,189	$57,248	$0	$0	$1	$0
Total assets	$166,841	$221,632	$228,730	$186,398	$2,559	$2,972	$3,004	$2,532
Working capital surplus	$80,120	$99,432	$117,577	$114,796	$2,488	$2,681	$2,717	$2,258
Shareholders' equity	$151,665	$198,344	$211,542	$180,698	$2,559	$2,941	$2,977	$2,505
Common shares outstanding	308,256	308,256	308,256	298,056	83,239	83,034	39,874	79,874

Prior to December 31, 2006, the Company was a mineral company and had limited operational activities. Subsequent to December 31, 2006, the Company changed its strategic direction to become an oil and gas exploration and development company by acquiring a variety of oil and gas interests in the USA. Beginning in the current year, revenue includes oil and gas sales.

The Company follows the successful efforts method of accounting for its oil and gas properties. The above quarterly information for 2007 is based on the successful efforts method.

Production

	For the Year 2007	For the Quarter Ended Dec. 31 2007	Sep. 30 2007	Jun 30 2007	Mar 31 2007
Oil & gas sales, net ($000's)	$ 2,729	$ 1,181	$ 1,077	$ 299	$ 172
Oil (net bopd)	23	32	24	16	16
Natural gas (net mcf/d)	1,056	1,572	1,457	499	211
Total (net mcfe/d)*	1,194	1,766	1,601	593	306
Oil - average selling price per bbl	$ 79.63	$ 91.52	$ 77.37	$ 66.79	$ 60.73
Gas - average selling price per mcf	$ 6.20	$ 6.16	$ 5.85	$ 7.05	$ 7.66

* Production information is commonly reported in units of barrel of oil equivalent ("boe"), or if primarily a producer of natural gas in units of thousand cubic feet equivalent ("mcfe"), which may be misleading, particularly if used in isolation. For purposes of computing such units, thousand cubic feet of natural gas equivalent units have been calculated using an energy equivalence conversion rate of six thousand cubic feet of natural gas to one barrel of oil (6:1). The conversion ratio of 6:1 is based on an energy equivalency conversion method, which is primarily applicable at the burner tip and does not represent value equivalence at the wellhead.

Comparable production information for 2006 was nil since the Company transitioned to an oil and gas exploration and development company during the first quarter of 2007.

On June 8, 2007, the Company commenced its first production on its Greylock well, located within the Marsh Island Project Area. The well is producing at 614 mcf/d on a net revenue interest basis. The well, in which the Company holds a 54.5509% working interest and a 38.8703% net revenue interest, is tied into the Company's Eugene Island Block 7 production facility. The two wells adjacent to the Company's production facility, in which the Company holds a 35.5809% working interest and a 25.2124% net revenue interest, are producing at a combined rate of 79 mcf/d for a total field production of 693 mcf/d on a net revenue interest basis.

In addition to the production associated with the Eugene Island Block 7 facility, the Company's interest in its Jefferson Island wells produced 280 mcfe/d on a net revenue basis.

Results of Operations

	For the	For the Quarter Ended			
	Year 2007 ($000's)	Dec 31 2007 ($000's)	Sep 30 2007 ($000's)	Jun 30 2007 ($000's)	Mar 31 2007 ($000's)
Oil and gas sales	3,661	1,614	1,414	432	201
Royalties	(932)	(433)	(337)	(133)	(29)
Oil and gas sales, net	2,729	1,181	1,077	299	172
Operating	(945)	(397)	(351)	(152)	(45)
Exploration	(4,816)	(1,916)	(525)	(1,530)	(845)
Dry hole	(45,150)	(35,753)	(9,397)	-	-
Impairment of properties	(23,934)	(11,333)	(10,998)	-	(1,603)
Accretion	(37)	(11)	(13)	(13)	-
Depletion, depreciation and amortization	(3,259)	(2,248)	(759)	(174)	(78)
General and administrative	(3,035)	(3)	(888)	(1,687)	(457)
Stock-based compensation	(2,223)	(191)	(91)	(37)	(1,904)
Foreign exchange gain	18,016	2,627	7,264	8,125	-
Interest income	4,182	1,174	1,389	1,194	425
Net income (loss)	(58,472)	(46,870)	(13,292)	6,025	(4,335)

The Company had a consolidated net loss of $58,472,000 for the year ended December 31, 2007 compared to a net loss of $917,000 for the prior year. The above quarterly information is based on the successful efforts method of accounting used by the Company for its oil and gas operations.

The production volume and proven reserve base at this early stage of exploration result in higher costs per mcfe than would be the case for a later stage exploration company, particularly operating and general and administrative costs.

In 2006, the Company had limited activities associated with its mining activities.

The various income and expenses categories are explained below in more detail.

Oil and Gas Sales
The Company had oil and gas sales, net of royalties, of $2,729,000 for the year ended December 31, 2007, compared to $nil for the prior year. The increase in oil and gas sales during in 2007 compared to the prior year is primarily due to the gas production as a result of the Greylock well commencing production on June 8, 2007.

Operating Costs
The Company had operating costs of $945,000 for the year ended December 31, 2007, compared to $nil for the prior year. The Company had no oil and gas operations in the prior year. Operating costs during the year are primarily related to the Company's Greylock and Jefferson Island properties.

Dry Hole Costs
Dry hole costs were $45,150,000 for the year ended December 31, 2007, compared to $nil for the prior year. The costs are associated with four dry holes drilled during the year, the most significant of which was on the Mustang Island Block 736 (MU 736). The MU 736 well costs were $29,900,000. Of the other three dry holes, only the Boot Spur well was in the Marsh Island Project area.

Impairment of Properties
Impairment costs were $23,934,000 for the year ended December 31, 2007, compared to $nil for the prior year. Based on drilling results and new seismic information, four OCS leases in Federal waters acquired in the Pearl Acquisition for $15,697,000 and two prospects acquired in the Summit Acquisition for $7,049,000 were impaired. In addition, based on year end proved developed reserves, the Company impaired its Greylock property by $912,000.

Depletion, Depreciation and Amortization
Depletion, depreciation and amortization ("DD&A") was $3,259,000 for the year ended December 31, 2007 compared to $nil for the prior year. DD&A primarily results from production in Greylock and Jefferson Island properties.

Stock-Based Compensation
Stock-based compensation was $2,223,000 for the year ended December 31, 2007. Stock-based compensation was $432,000 for the year ended December 31, 2006. The

Company uses the fair value method of accounting for stock options granted to directors, officers, employees and consultants whereby the fair value of all stock options granted is recorded as a charge to operations. The fair value of common share options granted is estimated on the date of grant using the Black-Scholes option pricing model.

General and Administrative Expenses

General and administrative expenses for the year ended December 31, 2007 were $3,035,000, compared to $293,000 for 2006.

The current year general and administrative expenses include $1,370,000 for legal, accounting and audit costs, $863,000 for salaries and benefits, $470,000 for management and consulting fees, and $332,000 for travel and entertainment expenses. General and administrative expenses are expected to continue to increase over the prior periods as the Company continues to increase its exploration and production activities.

Foreign Exchange Gain

Foreign exchange gain was $18,016,000 for the year ended December 31, 2007, compared to $nil in 2006. The gain results from the strengthening of the Canadian dollar against the United States dollar during 2007.

Interest Income

For the year ended December 31, 2007, interest income was $4,182,000, compared to $63,000 for 2006. Interest income represents bank interest earned on excess cash and investments in government securities. The Company had excess cash balances as a result of its equity issues through the private placement.

Other Comprehensive Income

Other comprehensive income represents changes in shareholders' equity during a period arising from transactions and other events and circumstances from non-owner sources and includes unrealized foreign currency translation gains and losses.

The Company's operations in the United States are denominated in U.S. dollars and are considered self-sustaining. Effective April 1, 2007, the Company changed its reporting currency from the Canadian dollar to the United States dollar.

As of March 31, 2008, the Company had approximately $30,000,000 Canadian dollars in its cash and investments accounts.

Financial Condition

At December 31, 2007, the Company had total assets of $166,841,000 compared to $2,559,000 at December 31, 2006. The increase in assets is primarily the result of the private placement of common stock, the acquisition of the Summit assets in February 2007 and the acquisition of the GOM assets in May 2007.

Liquidity and Capital Resources

Working capital at December 31, 2007, totaled $80,120,000, compared to $2,488,000 at December 31, 2006.

Funds provided by operations were $16,240,000 for the year ended December 31, 2007 compared to funds used in operations of $467,000 in 2006. Funds provided by operations in 2007 were primarily from foreign exchanges gains of $18,016,000.

Net cash provided from financing activities for the year ended December 31, 2007 was $166,767,000, compared to $403,000 in 2006. During the three months ended March 31, 2007 the Company issued 214,817,538 common shares at an average price of Cdn $0.97 per share.

Net cash used in investing activities was $130,251,000 for the year ended December 31, 2007, compared to $1,000 in 2006. During 2007, the Company used cash of $98,195,000 in its oil and gas operations through the acquisition of leases and exploration and development activities.

Contributed surplus increased $671,000 for the year ended December 31, 2007 over the balance at December 31, 2006. The increase is due to stock-based compensation for the year offset by the exercise of options and warrants. When options are granted, the Black-Scholes option value method is used to calculate a value for the stock options. The offset to the amount that is recorded as stock compensation expense is a credit to contributed surplus. When the options are exercised, the applicable amounts of contributed surplus are transferred to share capital. During the three month period ended March 31, 2007, 750,000 stock options were exercised. No other stock options were exercised during 2007.

The Company does not currently generate sufficient cash flow from its oil and gas operations to fund the entire oil and gas exploration, development and acquisition activities. The Company has relied upon the issuance of common shares to assist with financing its ongoing oil and gas exploration, development and acquisition activities to the extent that sufficient cash flow from oil and gas assets or farming out interests in oil and gas properties is not sufficient to finance its operations.

Financial Instruments

The carrying amounts of financial instruments comprising cash, accounts receivable and accounts payable approximate their fair value due to the immediate or short-term nature of these financial instruments.

Off-Balance Sheet Arrangements

The Company has no off-balance sheet arrangements.

Outstanding Share Data

As of April 10, 2008, the Company had 308,756,088 shares outstanding, 3,215,000 stock options outstanding under its stock-based compensation plan and zero warrants outstanding.

Related Party Transactions

Namdo Management Services Ltd. (Namdo) provides administrative support to the Company under an agreement which commenced April 1, 2007. The amount paid to Namdo during 2007 was $187,000. Namdo is a private corporation owned by a shareholder of the Company.

During the year ended December 31, 2007, the Company incurred legal fees of $251,000 with a law firm in which an officer of the Company is a partner.

During the year ended December 31, 2007, the Company incurred geological and geophysical (G&G) costs of $134,000 with a G&G firm in which an officer of the Company is a managing partner.

Changes to Management

On February 19, 2007, the Company accepted the resignations of Matthew J. Mason as President and Chief Executive Officer, Peter D. Leitch as Director, Stephen G. Stanley as Director and Judee Fayle as Chief Financial Officer and Corporate Secretary.

Also on February 19th and on March 27th, 2007, the following individuals were appointed to the Company's Board of Directors:

Clinton W. Coldren
Brian D. Edgar*
Gary S. Guidry*
Keith C. Hill*
John Zaozirny.
* Member of Audit Committee

On February 19, 2007, Clinton W. Coldren was appointed President and Chief Executive Officer of the Company and Kevin E. Hisko was appointed Corporate Secretary. On April 1, 2007, William D. Hoffman was appointed Chief Financial Officer. On August 23, 2007, William Sack was appointed Senior Vice President of Exploration. On November 16, 2007, Melinda L. Stuart was appointed Vice President of Asset Development. On April 1, 2008, T. Rodney Dykes was appointed Senior Vice President of Operations.

Accounting Policies and Critical Accounting Estimates

Use of Estimates

The consolidated financial statements of the Company have been prepared by management in accordance with accounting principles generally accepted in Canada. In preparing financial statements, management makes informed judgments and estimates that affect the reported amounts of assets and liabilities as of the date of the financial statements and affect the reported amounts of revenues and expenses during the the reported period. Specifically, estimates were utilized in calculating depletion, asset retirement obligations, stock-based compensation, amortization and impairment write-downs. Actual results could differ from these estimates and the differences could be material.

Accounting for Oil and Gas Operations

Due to the Company's transition into the oil and gas exploration and development industry, effective in 2007, the Company has followed the successful efforts method of accounting for its oil and gas operations. Under this method acquisition costs of oil and gas properties, costs to drill and equip exploratory wells that find proved reserves and costs of drilling and equipping development wells are capitalized and subject to annual impairment testing.

Exploration well costs are initially capitalized and, if subsequently determined to have not found sufficient reserves to justify commercial production, are charged to exploration expense. Exploration well costs that have found sufficient reserves to justify commercial production, but whose reserves cannot be classified as proved, continue to be capitalized as long as sufficient progress is being made to assess the reserves and economic viability of the well and or related project. All other exploration costs, including geological and geophysical costs, are charged to exploration expense when incurred.

Capitalized costs of proved oil and gas properties are depleted using the unit of production method based on estimated gross proved reserves of petroleum and natural gas as determined by independent engineers. Successful exploratory wells and development costs and acquired resource properties are depleted over proved developed reserves. Acquisition costs of unproved reserves are not depleted or amortized while under active evaluation for commercial reserves.

Costs associated with significant development projects are depleted once commercial production commences.

A revision to the estimate of proved reserves can have a significant impact on earnings as they are a key component in the calculation of depreciation, depletion and accretion.

Producing properties and significant unproved properties are assessed annually, or more frequently as economic events dictate, for potential impairment. The impairment test is initially based on undiscounted future cash flows from proved and risk adjusted probable reserves. If an impairment is identified, fair value is calculated as the present value of estimated expected discounted cash flows from proved and risk-adjusted probable reserves. Any impairment loss is the difference between the carrying value of the oil and gas property and its fair value. If it is determined that the estimated fair value is less than the net carrying amount, a write-down to the oil and gas property's fair value is recognized during the period, with a charge to earnings.

Estimates of future cash flows used in the evaluation of impairment of assets are performed based on risk assessments on field and reservoir performance and include judgment assumptions regarding commodity prices, discount rates and future costs.

A substantial portion of the Company's exploration and development activities are conducted jointly with others. The financial statements reflect only the Company's proportionate interests in such activities.

The Company engaged Netherland, Sewell and Associates, Inc., an independent geoscience consultancy firm, to evaluate 100% of the Company's proved and probable oil and gas reserves. The estimation of reserves is subjective. Forecasts are based on engineering data, future prices, expected future rates of production and the timing of capital expenditures, all of which are subject to uncertainties and interpretations. Reserves will be revised upward or downward based on the results of future drilling, testing and production levels.

Risks and Uncertainties

The Company is exposed to a number of risks and uncertainties inherent in exploring for, developing and producing crude oil and natural gas. These risks and uncertainties include, but are not limited to, the following: economic risk of finding and producing reserves at a reasonable cost; cost of capital risk associated with securing the needed capital to carry out the Company's operations; risk of fluctuating currency exchange rates; risk of carrying out operations with minimal environmental impact; risk of weather, including hurricanes and other storms; risk of governmental policies, social instability or other political, economic or diplomatic developments in the US operations; market risk associated with investing the Company's cash reserves in interest bearing depository instruments; and environmental risks related to its oil and gas and mineral properties. Many of the previously mentioned risks are beyond the Company's control, and it is impossible to ensure that any exploration drilling program will result in commercial operations. The Company does not currently utilize derivative instruments to hedge its foreign currency exchange or interest rate risks.

Internal Controls over Financial Reporting

Management has designed, established and is maintaining a system of internal controls over financial reporting to provide reasonable assurance that the financial information prepared by the Company for external purposes is reliable and has been recorded, processed and reported in an accurate and timely manner in accordance with Canadian generally accepted accounting principles.

Outlook

The Company plans to continue pursuing Gulf of Mexico oil and gas opportunities to add to its portfolio of exploration and development properties, and to focus on the development of its existing interests in the USA.

The Company plans on drilling up to twelve wells during the remainder of 2008.

Forward-Looking Statements

Certain information regarding the Company contained herein may constitute forward-looking statements. Forward-looking statements may include estimates, plans, expectations, opinions, forecasts, projections, guidance or other statements that are not statements in facts. By their nature, forward-looking statements and information involve assumptions, inherent risks and uncertainties, many of which are difficult to predict, and are usually beyond the control of management, that could cause actual results to be materially different from those expressed by these forward-looking statements and information. The Company does not undertake to update or re-issue the forward-looking statements and information that may be contained herein, whether as a result of new information, future events or otherwise. The Company's forward-looking statements are expressly qualified in their entirety by this cautionary statement.

MANAGEMENT'S REPORT

The accompanying Consolidated Financial Statements of Bayou Bend Petroleum Ltd and related financial information presented in this annual report are the responsibility of Management and have been approved by the Board of Directors. The Consolidated Financial Statements have been prepared in accordance with Canadian generally accepted accounting principles. The Consolidated Financial Statements and related financial information reflect amounts which must, of necessity, be based upon informed estimates and judgments of Management with appropriate consideration to materiality. All financial information contained in the annual report is consistent, where appropriate, with that contained in the Consolidated Financial Statements.

The Company has developed and maintains systems of internal controls, policies and procedures in order to provide reasonable assurance as to the reliability of the financial records and the safeguard of assets.

KPMG LLP, independent external auditors, has audited the Consolidated Financial Statements in accordance with the auditing standards generally accepted in Canada on behalf of the shareholders. KPMG LLP has full and free access to the Audit Committee. Their report is included with the Consolidated Financial Statements.

The Board of Directors has established an Audit Committee. The Audit Committee reviews with Management and the external auditors any significant financial reporting issues, the financial statements, and any other matters of relevance to the parties. The Audit Committee meets quarterly to review and approve the interim consolidated financial statements prior to their release, as well as annually to review the Company's annual consolidated financial statements and Management's discussion and analysis, and to recommend their approval to the Board of Directors. The external auditors have unrestricted access to the Company, the Audit Committee and the Board of Directors.

Clinton W. Coldren
President and Chief Executive Officer

William D. Hoffman
Chief Financial Officer

April 10, 2008

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AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the consolidated balance sheet of Bayou Bend Petroleum Ltd. as at December 31, 2007 and the consolidated statements of operations and deficit, comprehensive loss and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

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

The financial statements as at December 31, 2006 and for the year ended December 31, 2006 were audited by other auditors who expressed an opinion without reservation on those statements in their report dated February 13, 2007.

KPMG LLP

Chartered Accountants

Vancouver, Canada

March 14, 2008

BAYOU BEND PETROLEUM LTD.
(formerly Kit Resources Ltd.)
Consolidated Balance Sheets
Expressed in United States Dollars

	December 31, 2007	December 31, 2006
ASSETS		
Current assets		
Cash and cash equivalents	$ 58,575,000	$ 2,535,000
Investments	32,056,000	-
Accounts receivable	3,109,000	11,000
Prepaid expenses	629,000	13,000
	94,369,000	2,559,000
Petroleum and natural gas properties	75,731,000	-
Accumulated depletion, depreciation & amortization	(3,259,000)	-
Net properties	72,472,000	-
	$ 166,841,000	$ 2,559,000
LIABILITIES		
Current liabilities		
Accounts payable and accrued expenses	$ 12,868,000	$ 53,000
Advances from joint interest holders	394,000	-
Asset retirement obligation	987,000	-
Due to related parties	-	18,000
	14,249,000	71,000
Asset retirement obligation	927,000	-
	15,176,000	71,000
SHAREHOLDERS' EQUITY		
Share capital	250,835,000	47,141,000
Contributed surplus	2,237,000	1,566,000
Accumulated other comprehensive income (loss)	3,282,000	(2,000)
Deficit	(104,689,000)	(46,217,000)
	151,665,000	2,488,000
Commitments		
	$ 166,841,000	$ 2,559,000

See accompanying notes to consolidated financial statements.

BAYOU BEND PETROLEUM LTD.
(formerly Kit Resources Ltd.)
Consolidated Statements of Operations and Deficit
Expressed in United States Dollars

	For the Year Ended December 31	
	2007	**2006**
Revenues		
Oil and gas sales	$ 3,661,000	$ -
Royalties	(932,000)	-
	2,729,000	-
Expenses		
Operating	945,000	-
Exploration	4,816,000	-
Dry hole costs	45,150,000	-
Impairment of properties	23,934,000	-
Accretion	37,000	-
Depletion, depreciation and amortization	3,259,000	-
Write-down of mineral property costs	-	255,000
General and administrative	3,035,000	293,000
Stock-based compensation	2,223,000	432,000
Foreign exchange (gain) loss	(18,016,000)	-
	65,383,000	980,000
Other income (expense)		
Interest income	4,182,000	63,000
	4,182,000	63,000
Net loss	(58,472,000)	(917,000)
Deficit, beginning of year	(46,217,000)	(45,300,000)
Deficit, end of year	$ (104,689,000)	$ (46,217,000)
Basic loss per share	$ (0.21)	$ (0.01)
Diluted loss per share	$ (0.21)	$ (0.01)
Weighted average number of common shares used in computing earnings per share:		
Basic	278,016,998	79,880,143
Diluted	278,016,998	79,880,143

See accompanying notes to consolidated financial statements.

BAYOU BEND PETROLEUM LTD.
(formerly Kit Resources Ltd.)
Consolidated Statements of Other Comprehensive Income
Expressed in United States Dollars

	For the Year Ended December 31			
		2007		2006
Net loss for the year	$	(58,472,000)	$	(917,000)
Other comprehensive income:				
Unrealized gains (losses) on adoption of U.S.functional currency		3,284,000		(2,000)
Comprehensive loss for the year	$	(55,188,000)	$	(919,000)

See accompanying notes to consolidated financial statements.

BAYOU BEND PETROLEUM LTD.
(formerly Kit Resources Ltd.)
Consolidated Statements of Cash Flows
Expressed in United States Dollars

	For the Year Ended December 31	
	2007	**2006**
Operating activities		
Net loss	$ (58,472,000)	$ (917,000)
Adjustments for non-cash and non-operating transactions:		
Depletion, depreciation and amortization	3,259,000	-
Impairment of properties	23,934,000	-
Dry hole costs	45,150,000	-
Accretion	37,000	-
Stock-based compensation	2,223,000	432,000
Changes in non-cash operating working capital:		
Accounts receivable	(3,098,000)	(9,000)
Prepaid expenses	(616,000)	(13,000)
Accounts payable and accrued expenses	2,715,000	40,000
Advances from joint interest holders	394,000	-
Asset retirement obligation	714,000	-
	16,240,000	(467,000)
Financing activities		
Issuance of share capital	166,785,000	466,000
Repayment of related party loans	(18,000)	(63,000)
	166,767,000	403,000
Investing activities		
Exploration and development expenditures	(98,195,000)	(1,000)
Investments	(32,056,000)	-
	(130,251,000)	(1,000)
Effect of exchange rate changes in cash	3,284,000	219,000
Net increase in cash and cash equivalents	56,040,000	154,000
Cash and cash equivalents - beginning of year	2,535,000	2,381,000
Cash and cash equivalents - end of year	$ 58,575,000	$ 2,535,000
Supplemental disclosures of non-cash financing and investing activities:		
Acquisition of Summit Energy Company, L.L.C. and related property interests through the issuance of common stock	$ 10,593,000	$ -
Acquisition of GOM assets through the issuance of common stock	24,764,000	-
	$ 35,357,000	$ -

See accompanying notes to consolidated financial statements.

1. NATURE OF OPERATIONS

Bayou Bend Petroleum Ltd. (formerly Kit Resources Ltd.) (the "Company") is incorporated under the British Columbia Business Corporations Act. The Company is engaged in the business of oil and gas exploration and development in the United States in the Gulf of Mexico.

On February 7, 2007, the Company received regulatory approval to change its name to Bayou Bend Petroleum Ltd. from Kit Resources Ltd. with an effective date of February 9, 2007. The Company's shares trade on the TSX Venture Exchange under the symbol of "BBP".

On February 20, 2007, the Company purchased 100% of the outstanding membership interests in Summit Energy Company, L.L.C. ("Summit").

Prior to the current year, the Company was considered to be a development stage enterprise for reporting purposes. Starting in 2007, the Company is no longer considered to be in the development stage. Notwithstanding that the Company has sufficient financial resources to fund operations through the 2008 fiscal year, continuing operations are dependent on discovery of economic oil and gas reserves and ultimately on the attainment of profitable operations.

2. SIGNIFICANT ACCOUNTING POLICIES

a) Basis of Presentation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries Bayou Bend Petroleum U.S.A., Ltd., Summit Energy Company, L.L.C. and Bayou Bend Offshore, Ltd.

These consolidated financial statements are prepared in accordance with generally accepted accounting principles in Canada. The significant accounting policies followed by the Company have been applied consistently in the preparation of these consolidated financial statements. These accounting policies are summarized below.

b) Cash and Cash Equivalents

For purposes of reporting cash flows, the Company considers cash and cash equivalents to include amounts held in banks and highly liquid investments with remaining maturities at point of purchase of 90 days or less. The Company places its cash and cash equivalents with institutions of high-credit worthiness.

c) Investments

Investments are accounted for at fair market value and consist of securities backed by the full credit of the United States Government with maturities of less than one year.

d) Petroleum and Natural Gas Properties

The Company uses the successful efforts method to account for its oil and gas exploration and development costs. Exploration well costs are initially capitalized and, if subsequently determined to have not found sufficient reserves to justify commercial production, are charged to dry hole expense. Exploration well costs that have found sufficient reserves to justify commercial production, but those reserves cannot be classified as proved, continue to be capitalized as long as sufficient progress is being made to assess the reserves and economic viability of the well or related project. All other exploration costs, including geological and geophysical costs and annual lease rentals, are charged to exploration expense when incurred.

Producing properties and significant unproved properties are assessed annually, or more frequently as economic events dictate, for potential impairment. Any impairment loss is the difference between the carrying value of the asset and its fair value. Fair value is calculated as the present value of estimated expected future cash flows from proved, probable and, as appropriate, possible reserves.

The Company engages independent engineers in order to determine its share of reserves.

e) Depreciation, Depletion and Amortization (DD&A)

Capitalized costs of proved oil and gas properties are depleted using the unit of production method. For purposes of these calculations, productions and reserves of oil are converted to cubic feet of natural gas on an energy equivalent basis at a ratio of one barrel (bbl) of oil to six thousand cubic feet (mcf) of natural gas.

Successful exploratory wells and development costs are depleted over proved developed reserves. However, to the extent significant development costs are incurred in connection with proved undeveloped reserves, such costs are excluded from depletion until the reserves are developed. Acquired resource properties with proved reserves, including offshore platform costs, are depleted over proved reserves. Acquisition costs of probable reserves are not depleted or amortized while under active evaluation for commercial reserves. Costs are transferred to depletable costs as proved reserves are recognized. Costs associated with significant development projects are not depleted until commercial production commences.

Corporate assets are depreciated using the straight-line method at annual rates of 20% to 25%.

f) Asset Retirement Obligations

The fair value of the statutory, contractual or legal liability associated with the retirement and reclamation of oil and gas properties is recorded when incurred, with a corresponding increase to the carrying amount of the related oil and gas properties. The increase to capitalized costs is depleted to earnings on a unit of production basis over the life of the proved reserves for each property. Subsequent changes in the estimated fair value of the asset retirement obligation (ARO) are capitalized and depleted over the remaining useful life of the underlying oil and gas properties.

The ARO liabilities are carried at their discounted present value and are accreted over time for the change in their present value. Actual expenditures incurred are charged against the accumulated obligation.

g) Revenue Recognition

Revenues from the sale of petroleum and natural gas are recorded when title passes to an external party.

h) Income Taxes

The Company follows the asset and liability method of accounting for income taxes. Under this method current income taxes are recognized for the estimated income taxes payable for the current year. Future income taxes are recognized for temporary differences between the tax and accounting basis of assets and liabilities and for the benefit of losses available to be carried forward for tax purposes that are likely to be realized.

Future tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect of future tax assets and liabilities of a change in tax rates is recognized in income in the period that included the date of enactment or substantive enactment.

i) Stock-Based Compensation

All stock-based awards made to employees and non-employees are measured and recognized using a fair value based method. Accordingly, the fair value of the options at the date of the grant is determined and charged to operations, with the offsetting credit to contributed surplus, on a straight-line basis over the vesting period. If and when the stock options are ultimately exercised, the applicable amounts of contributed surplus are transferred to share capital.

j) Loss per Share

Basic earnings per share is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding during the year. The computation of diluted earnings per share assumes the conversion, exercise or contingent issuance of securities only when such conversion, exercise or issuance would have a dilutive effect on earnings per share. The dilutive effect of outstanding options and warrants and their equivalents is reflected in diluted earnings per share by application of the treasury stock method. The treasury stock method assumes that the proceeds received from the exercise of in-the-money stock options are used to repurchase common shares at the average market price for the reporting period.

k) Joint Interests

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

l) New Accounting Standards

On January 1, 2007, the Company adopted a new accounting standard issued by the Canadian Institute of Chartered Accountants (CICA), Handbook Section 1530, Comprehensive Income.

Section 1530 introduces comprehensive income, which consists of net income and other comprehensive income. Other comprehensive income represents changes in shareholders’ equity during a period arising from transactions and other events and circumstances from non-owner sources and includes unrealized foreign currency translation gains and losses arising from self-sustaining foreign operations.

On January 1, 2007, the Company also adopted the following new CICA accounting standards: “Financial Instruments – Recognition and Measurement” (section 3855); "Financial Instruments – Disclosure and Presentation" (section 3861), and "Hedges" (section 3865). The adoption of these standards had no financial statement impact to the Company.

m) Use of Estimates

The preparation of consolidated financial statements in accordance with Canadian GAAP requires that management make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. These estimates are subject to measurement uncertainty. Actual results could differ from and affect the results reported in these consolidated financial statements.

In the accounting for oil and gas interests, amounts recorded for depletion and amounts used for impairment test calculations are based on estimates of oil and gas reserves and future cash flows, including development costs. By their nature, the estimates of reserves and the related future cash flows are subject to measurement uncertainty and the impact on the consolidated financial statements of future periods could be material.

n) Foreign Currency Translation

Effective April 1, 2007, the Company's reporting currency was changed from Canadian dollars to U.S. dollars. The Company anticipates that its future sales will be earned in U.S. dollars and significant expenditures of the Company costs will be incurred in U.S. dollars. The comparative financial statements from prior periods have been restated to reflect this change.

For the restatement, the Company followed the method prescribed by the CICA Emerging Issues Committee ("EIC") in release number EIC-130. All prior year financial statements were translated using the current rate method. This method of translation resulted in the financial statements of prior years being translated as if the U.S. dollar reporting currency had been used in those years. The resulting exchange gains and losses were recorded as a cumulative translation adjustment in shareholders' equity.

Prospectively, activities denominated in currencies other than the U.S. dollar are translated using the temporal method. Under this method, monetary assets and liabilities denominated in other currencies are translated into U.S. dollars at the exchange rate in effect at the balance sheet date. Non-monetary assets and liabilities denominated in other currencies are translated at rates in effect on the dates the assets were acquired or liabilities were assumed. Revenues and expenses are translated at rates approximating exchange rates in effect at the time of the transactions. Gains and losses on translation are reflected in the Statement of Operations and Deficit.

Expressed in United States Dollars Unless Otherwise Noted

3. FAIR VALUE OF FINANCIAL INSTRUMENTS

The Company's financial instruments consist of cash and cash equivalents, accounts and interest receivable, amounts due to related parties and accounts payable and accrued liabilities. Unless otherwise noted, it is management's opinion that the Company is not exposed to significant interest, currency or credit risks arising from the financial instruments. The fair values of these financial instruments approximate their carrying values due to their short-term maturity or capability of prompt liquidation.

4. COMPREHENSIVE INCOME (LOSS)

The following table reconciles the changes in accumulated other comprehensive income (loss) for the years ended December 31, 2007 and 2006.

	For the Year Ended December 31	
	2007	2006
Accumulated other comprehensive loss, beginning of year	$ (2,000)	$ -
Other comprehensive income:		
Unrealized gains (losses) on adoption of U.S. functional currency	$ 3,284,000	$ (2,000)
Accumulated other comprehensive income (loss), end of year	$ 3,282,000	$ (2,000)

5. ACQUISITIONS

On February 20, 2007, the Company acquired all of the issued and outstanding membership interests of Summit for cash consideration of $34,043,000. The assets acquired included an 18.1634% interest in a portfolio of assets onshore and offshore Marsh Island in the Gulf of Mexico, together with an 18.1634% interest in a 40 million cubic feet of gas per day (MMcfgpd) production facility tied into the existing regional pipeline infrastructure.

On March 8, 2007, the Company exercised its option under the Summit Purchase Agreement to acquire two additional properties for the issuance of 1,222,604 shares of stock with a value of $1,458,000.

The Company also acquired from certain other participants an additional 17.4175% interest in the Marsh Island project for consideration of $21,263,000. The consideration paid included the issuance of 393,267 shares of stock with a value of $474,000.

Expressed in United States Dollars Unless Otherwise Noted

In connection with the above transactions and the private placement described in Note 8(a), the Company issued 2.2 million shares of stock as a finders' fee to third parties. An additional 5 million shares of stock were issued under the terms of certain assignment agreements pursuant to which the Company was granted the opportunity to acquire Summit. The value of the 7.2 million shares issued was $8,661,000.

The total consideration, including other related properties and transaction costs, for the above acquisitions was $65,425,000. The allocation of the purchase price is as follows:

Petroleum and natural gas properties	$ 63,881,000
Working capital	2,707,000
Asset retirement obligation	(1,163,000)
	$ 65,425,000

On May 8, 2007, the Company closed on the acquisition of the Gulf of Mexico Assets from Pearl Exploration and Production Ltd., an affiliated company. The Gulf of Mexico Assets were acquired in exchange for 10 million common shares with a value of $24,764,000.

6. INVESTMENTS

Investments at December 31, 2007 consist of the following.

		Par Value	Market Value
Federal Home Loan Bank Notes	$	23,235,000	23,223,000
Federal National Mortgage Association Notes		8,025,000	8,014,000
Federal Home Loan Mortgage Corporation Notes		750,000	744,000
Bank Certificate of Deposit		75,000	75,000
	$	32,085,000	32,056,000

Expressed in United States Dollars Unless Otherwise Noted

7. PETROLEUM AND NATURAL GAS PROPERTIES

	December 31, 2007		
	Cost	Accumulated Depletion	Net
Petroleum and natural gas	$ 75,627,000	$ (3,239,000)	$ 72,388,000
Office equipment	104,000	(20,000)	$ 84,000
	$ 75,731,000	$ (3,259,000)	$ 72,472,000

At December 31, 2006, the net book value of petroleum and natural gas properties was nil.

Producing properties include the Greylock, Eugene Island Block 7 and Jefferson Island properties.

As of December 31, 2007, the Company reviewed its portfolio of unproved properties. Based on this review, the Company recorded an impairment expense of $23,934,000, primarily related to four leases on the Outer Continental Shelve (OCS) and two prospects in the Marsh Island Project area. These impairments resulted from the evaluation of drilling activities in 2007 and new seismic data.

Expressed in United States Dollars Unless Otherwise Noted

8. SHARE CAPITAL

a) Details are as follows:

	Number of Shares		Share Capital		Contributed Surplus
Authorized:					
Unlimited common shares without par value					
Issued and fully paid:					
Balance - December 31, 2005	39,873,550	$	45,470,000	$	-
Issued for cash:					
- private placement	40,000,000		1,228,000		1,155,000
- warrants exercised	715,000		63,000		
- fair value portion of warrants exercised	-		21,000		(21,000)
- stock options exercised	2,650,000		359,000		-
Issued during the year:					
- stock options granted	-		-		432,000
Balance - December 31, 2006	83,238,550	$	47,141,000	$	1,566,000
Issued for cash:					
- private placement	166,666,667		163,114,000		
- property acquisition	10,000,000		24,764,000		
- warrants exercised	38,785,000		4,433,000		(1,120,000)
- stock options exercised	750,000		790,000		(432,000)
Issued during the year:					
- Summit acquisitions	8,815,871		10,593,000		
- stock options granted					2,223,000
Balance - December 31, 2007	308,256,088	$	250,835,000	$	2,237,000

During the first quarter of 2007, the Company closed a private placement of 166,666,667 shares at a price of Cdn$1.20 per share. Gross proceeds of the offering were Cdn$200,000,000 (Cdn$190,796,000 net of filing fees). During the second quarter the Company finalized the acquisition of the Gulf of Mexico Assets in exchange for 10 million common shares of the Company.

During 2006, the Company closed a non-brokered private placement of 40,000,000 units at Cdn$0.07 per unit. Gross proceeds of the offering were Cdn$2,800,000 (Cdn$2,786,000 net of filing fees). Each unit consisted of one common share and one warrant, with each warrant giving the holder the right to purchase one common share at Cdn$0.10, exercisable by January 9, 2008. As the units consisted of shares and warrants, the net proceeds of the units were divided between the two instruments. The value assigned to share capital was Cdn$1,471,000 and to contributed surplus was Cdn$1,315,000.

Expressed in United States Dollars Unless Otherwise Noted

b) Share Options

The Company has an established share purchase option plan whereby a committee of the Company's board of directors may, from time to time, grant up to a total of 10% of the issued share capital to directors, officers, employees or consultants. The number of shares under option at any specific time to any one optionee shall not exceed 5% of the issued and outstanding common shares of the Company. The term of any options granted under the plan will be fixed by the Board of Directors and may not exceed five years from the date of grant. All options granted are subject to a four month hold period from the date of granting. Vesting terms are at the discretion of the Board of Directors. The exercise price of an option is not less than the closing price on the TSX Venture Exchange ("the Exchange") on the last trading day preceding the grant date, less the applicable discount, provided that the exercise price will not be less than Cdn $0.10 per share.

The continuity of incentive stock options issued and outstanding is as follows:

Stock Option Continuity

	Number of Options	**Weighted Average Exercise Price**
Outstanding at December 31, 2005	2,900,000	Cdn $0.15
Granted	750,000	Cdn $0.76
Exercised	(2,650,000)	Cdn $0.15
Outstanding at December 31, 2006	1,000,000	Cdn $0.61
Granted	3,165,000	Cdn $1.47
Exercised	(750,000)	Cdn $0.56
Cancelled/Forfeited	(200,000)	Cdn $2.20
Outstanding at December 31, 2007	3,215,000	Cdn $1.37

At December 31, 2007, 2,765,000 options are exercisable at an average exercise price of Cdn $1.37 per share with a weighted average remaining life of 3.4 years.

Stock Based Compensation

The Company recognizes compensation expense on stock options granted to both employees and non-employees using the fair value method at the date of grant, which the Company records as an expense. The stock option compensation expense is calculated using the Black-Scholes Option Pricing

Expressed in United States Dollars Unless Otherwise Noted

Model. The weighted average fair value of options granted during 2007 and the assumptions used in their determination are as follows.

	December 31, 2007
Expected dividend yield	0%
Risk-free interest rate (weighted average)	4.07%
Expected stock price volatility (weighted average)	68.94%
Expected option life in years (weighted average)	4.36

Stock option compensation expense for the year ended December 31, 2007 and 2006 were $2,223,000 and $432,000, respectively.

Option pricing models require the input of highly subjective assumptions including the expected price volatility. Changes in the subjective input assumptions can materially affect the fair value estimate, and therefore the existing models do not necessarily provide a reliable single measure of the fair value of the Company's stock options.

c) Warrants

As of December 31, 2006, the Company had share purchase warrants outstanding to purchase 39,285,000 shares at Cdn $0.10 per share, exercisable by January 9, 2008. These warrants are outstanding pursuant to the private placement of 40,000,000 units that closed during 2006. During the first three months ended March 31, 2007, 38,585,000 shares were issued at Cdn $0.10 per share, pursuant to these warrants. During the second three months ended June 30, 2007, 200,000 shares were issued at Cdn $0.10 per share. As of September 30, 2007, the Company had share purchase warrants outstanding to purchase 500,000 shares at Cdn $0.10 per share, exercisable by January 9, 2008. These warrants were subsequently exercised on January 8, 2008.

9. ASSET RETIREMENT OBLIGATION

The total future asset retirement obligation was estimated based on the Company's net ownership interest in all wells and facilities, the estimated costs to abandon and reclaim the wells and facilities and the estimated timing of the costs to be incurred in future periods. The total undiscounted amount of the estimated cash flows required to settle the asset retirement obligations is approximately $2,300,000, which will be incurred over the next 20 years with 60% of the costs incurred between 2008 and 2012.

Expressed in United States Dollars Unless Otherwise Noted

Changes to the asset retirement obligation were as follows:

	December 31, 2007	December 31, 2006
Beginning balance	$ -	$ -
Liabilities acquired through acquisitions	1,163,000	-
Liabilities incurred during the year	825,000	-
Liabilities settled during the year	(111,000)	-
Accretion	37,000	-
Ending balance	$ 1,914,000	$ -

10. INCOME TAXES

a. Future income tax expense:

The provision for income taxes reflects an effective tax rate which differs from Federal and Provincial statutory tax rates. The main differences are as follows:

		Years Ended December 31, 2007	Years Ended December 31, 2006
Loss before income taxes	$	(58,472,000)	(917,000)
Corporate income tax rate		34.1%	34.1%
Computed income tax recovery		(19,939,000)	(313,000)
Increase (decrease) resulting from:			
Non-taxable foreign exchange gain		(6,143,000)	-
Share issuance costs charged to share capital		(2,819,000)	-
Non-deductible compensation expense		758,000	147,000
Foreign tax rate difference		(524,000)	-
Effect of change in tax rates		216,000	124,000
Change in valuation allowance		28,813,000	64,000
Other		(362,000)	(22,000)
Income tax expense	$	-	-

Expressed in United States Dollars Unless Otherwise Noted

b. The components of the future income tax assets are as follows:

		December 31, 2007	December 31, 2006
Future income tax assets:	$		
Non-capital losses		18,887,000	332,000
Share issue costs carried forward		2,257,000	18,000
Properties - tax basis over carrying value		7,996,000	-
Exploration expenses		875,000	852,000
Future income tax assets		30,015,000	1,202,000
Valuation allowance		(30,015,000)	(1,202,000)
Future income tax asset	$	-	-

c. The Company has available to carryforward the following:

		December 31, 2007	December 31, 2006
Canadian losses from operations	$	796,000	1,071,000
Canadian exploration expenses		3,240,000	2,747,000
Canadian unamortized share issue costs		7,460,000	57,000
U.S. Federal losses from operations		53,349,000	-
U.S. Federal - tax basis over carrying values of properties		22,846,000	-

The Canadian losses from operations may be used to offset future Canadian taxable income and will expire over the period from 2010 to 2026. The Canadian exploration expenses may be carried forward indefinitely to offset future taxable Canadian income. Canadian unamortized share issue costs may offset future taxable Canadian income of years 2008 to 2011. The U.S. Federal losses are available to offset future taxable income in the United States through 2027.

11. SIGNIFICANT CUSTOMERS

The Company has oil and natural gas sales to customers accounting for 69% and 27%, respectively, of total oil and natural gas revenues for the year ended December 31, 2007.

12. RELATED PARTY TRANSACTIONS

Namdo Management Services Ltd. (Namdo) provides administrative support to the Company under an agreement which commenced April 1, 2007. The amount paid to Namdo during the year ended December 31, 2007 was $187,000. Namdo is a private corporation owned by a shareholder of the Company.

Expressed in United States Dollars Unless Otherwise Noted

During the year ended December 31, 2007, the Company incurred legal fees of $251,000 with a law firm in which an officer of the Company is a partner.

During the year ended December 31, 2007, the Company incurred geological and geophysical (G&G) costs of $134,000 with a G&G firm in which an officer of the Company is a managing partner.

13. COMMITMENTS

The Company enters into commitments and contractual obligations in the normal course of business, including the purchase of services, farm-in agreements, seismic data acquisition agreements and lease agreements.

a) The Company has agreed to purchase seismic data totaling $4,082,000 in 2008.

b) The Company has operating leases for office space which expire on various dates through 2011. Future minimum commitments as of December 31, 2007 under these operating leases are as follows:

2008	$	122,000
2009		117,000
2010		92,000
2011		8,000
	$	339,000

Expenses related to operating leases were $7,000 and $Nil in 2007 and 2006, respectively.

14. SUBSEQUENT EVENT

On January 18, 2008, the Company and its partners suspended drilling operations on the LaPosada well (Broussard Estates #1) due to encountering subsurface conditions that prevented the completion of the well to its targeted depth. The Company and its partners are evaluating whether to re-commence drilling operations from a new location. The costs of the suspended drilling operations have been included in dry hole expense by the Company at December 31, 2007.

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