



**Q2 2009 CONSOLIDATED FINANCIAL STATEMENTS**

# Consolidated Balance Sheets

(000's) (unaudited)

	June 30, 2009	December 31, 2008
<b>Assets</b>		
Current assets:		
Accounts receivable	\$ 14,343	\$ 18,527
Investments (note 3)	-	21,010
Deposits and prepaid expenses	879	709
	<b>15,222</b>	40,246
Petroleum and natural gas assets (note 2)	154,249	136,810
	<b>\$ 169,471</b>	\$ 177,056
<b>Liabilities and Shareholders' Equity</b>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 12,563	\$ 30,132
Long-term debt (note 4)	26,603	18,844
Future taxes	3,902	5,831
Asset retirement obligations (note 5)	1,970	1,883
Shareholders' equity:		
Share capital (note 6)	118,817	109,660
Contributed surplus (note 6)	6,092	5,607
Retained earnings (deficit)	(476)	5,099
	<b>124,433</b>	120,366
Commitments (notes 6 and 8)		
	<b>\$ 169,471</b>	\$ 177,056

See accompanying notes to consolidated financial statements.

## Consolidated Statements of Income (Loss), Comprehensive Income (Loss) and Retained Earnings (Deficit)

(000's, except per share amounts) (unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2009	2008	2009	2008
<b>Revenues:</b>				
Petroleum and natural gas sales	\$ 6,371	\$ 15,576	\$ 11,519	\$ 26,819
Royalties	(1,293)	(3,567)	(2,613)	(6,108)
Gain on investments (note 3)	-	-	479	-
Other income	16	39	39	142
	<b>5,094</b>	12,048	<b>9,424</b>	20,853
<b>Expenses:</b>				
Operating and transportation	1,824	1,997	3,288	4,358
Interest	150	350	204	746
General and administration	1,203	1,151	1,916	2,092
Depletion, depreciation and accretion	6,735	5,567	11,393	10,618
	<b>9,912</b>	9,065	<b>16,801</b>	17,814
Income (loss) before taxes	<b>(4,818)</b>	2,983	<b>(7,377)</b>	3,039
Future taxes (reduction)	<b>(1,150)</b>	809	<b>(1,802)</b>	857
Net income (loss) and comprehensive income (loss)	<b>(3,668)</b>	2,174	<b>(5,575)</b>	2,182
Retained earnings, beginning of period	<b>3,192</b>	518	<b>5,099</b>	510
<b>Retained earnings (deficit), end of period</b>	<b>\$ (476)</b>	\$ 2,692	<b>\$ (476)</b>	\$ 2,692
Income (loss) per share: (note 6)				
Basic	\$ (0.06)	\$ 0.05	\$ (0.11)	\$ 0.05
Diluted	\$ (0.06)	\$ 0.05	\$ (0.11)	\$ 0.05

See accompanying notes to consolidated financial statements.

## Consolidated Statements of Cash Flows

(000's) (unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2009	2008	2009	2008
<b>Cash provided by (used in):</b>				
<b>Operations:</b>				
Net income (loss)	\$ (3,668)	\$ 2,174	\$ (5,575)	\$ 2,182
Items not involving cash:				
Depletion, depreciation and accretion	6,735	5,567	11,393	10,618
Stock-based compensation	137	134	279	264
Gain on investments (note 3)	-	-	(479)	-
Future taxes (reduction)	(1,150)	809	(1,802)	857
Abandonment expenditures	(73)	(35)	(103)	(70)
Changes in non-cash working capital	(1,884)	(4,847)	(245)	(1,592)
Cash flow from operations	97	3,802	3,468	12,259
<b>Financing:</b>				
Increase in long-term debt	11,941	2,653	7,759	3,590
Issue of common shares	9,647	-	9,647	(192)
Share issue costs	(687)	-	(687)	-
Changes in non-cash working capital	90	-	90	-
Cash flow from financing	20,991	2,653	16,809	3,398
<b>Investing:</b>				
Petroleum and natural gas additions	(4,081)	(4,695)	(28,366)	(16,327)
Proceeds from disposition of investments (note 3)	-	-	21,489	-
Changes in non-cash working capital	(17,007)	(1,760)	(13,400)	670
Cash flow (used in) investing	(21,088)	(6,455)	(20,277)	(15,657)
Changes in cash	-	-	-	-
Cash, beginning of period	-	-	-	-
<b>Cash, end of period</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>
Interest paid	\$ 116	\$ 303	\$ 187	\$ 673

Cash is defined as cash and cash equivalents.

See accompanying notes to consolidated financial statements.

## Notes to Consolidated Financial Statements

For the three and six months ended June 30, 2009 and 2008  
(Tabular amounts are stated in thousands of dollars except share and per share amounts)  
(unaudited)

The interim consolidated financial statements for Midnight Oil Exploration Ltd. ("Midnight" or the "Company") have been prepared in accordance with accounting principles generally accepted in Canada, using the same accounting policies and methods of computation as set out in note 1 to the consolidated financial statements for the year ended December 31, 2008. The disclosures provided below are incremental to those included with the audited consolidated financial statements for the year ended December 31, 2008. The interim financial statements should be read in conjunction with the audited financial statements for the year ended December 31, 2008.

### Nature of operations

The principal business of the Company is the exploration, exploitation, development and production of oil and natural gas reserves. All activity is conducted in Western Canada and comprises a single business segment.

#### 1. Future accounting changes

In May 2009, the CICA amended Section 3862, "Financial Instruments – Disclosures," to include additional disclosure requirements about fair value measurement for financial instruments and liquidity risk disclosures. These amendments require a three level hierarchy that reflects the significance of the inputs used in making the fair value measurements. Fair values of assets and liabilities included in Level 1 are determined by reference to quoted prices in active markets for identical assets and liabilities. Assets and liabilities in Level 2 include valuations using inputs other than quoted prices for which all significant outputs are observable, either directly or indirectly. Level 3 valuations are based on inputs that are unobservable and significant to the overall fair value measurement. These amendments are effective on December 31, 2009.

#### 2. Petroleum and natural gas assets

	June 30, 2009	December 31, 2008
Cost	\$ 240,599	\$ 211,857
Accumulated depletion and depreciation	(86,350)	(75,047)
	\$ 154,249	\$ 136,810

During the six months ended June 30, 2009, the Company capitalized \$1,420,000 (2008 – \$1,441,000) of general and administration expenses related to exploration and development activities. Included in this amount is the non-cash related stock-based compensation of \$206,000 (2008 - \$196,000). In addition, the future tax liability of \$70,000 (2008 - \$66,000) associated with the capitalized stock-based compensation has been capitalized.

The cost of unproven properties at June 30, 2009 of \$23,983,000 (2008 - \$26,081,000) has been excluded from the depletion and depreciation calculation. Future development costs of proven reserves of \$25,225,000 (2008 - \$10,549,000) have been included in the depletion and depreciation calculation.

#### 3. Investments

Investments formerly held by the Company were comprised of the Trust Units received from the disposition of interests in certain petroleum and natural gas assets to Daylight Resources Trust, a publicly traded oil and gas royalty trust and a related party. Midnight considered the units to be financial assets and accounted for them as held for trading determining fair values based on quoted market prices. At December 31, 2008 the Company held 2,690,200 Trust Units

with a fair value of \$21,010,000. In January of 2009, Midnight disposed of its remaining Trust Units for \$21,489,000. A gain of \$479,000 was realized on the disposition.

#### 4. Long-term debt

Midnight has a revolving term credit facility available up to \$35.0 million with a Canadian chartered bank. The facility is available on a revolving basis until May 29, 2010. On May 29, 2010, at the Company's discretion, the facility is available on a non-revolving basis for a period of 366 days, at which time the facility would be due and payable. Alternatively, the facility may be extended for a further 364-day period at the request of the Company and subject to approval by the bank. The credit facility bears interest at the bank's prime rate or Bankers' Acceptance rates plus stamping fees based on the Company's debt to cash flow ratio, calculated using the two most recent fiscal quarters. The facility is secured by a \$50 million first floating charge debenture and a general securities agreement. At June 30, 2009, \$26,603,000 (2008 – \$18,844,000) was drawn on this facility. The \$35.0 million borrowing base is subject to a semi-annual and annual review by the bank. These reviews are based primarily on the reserves and using commodity prices estimated by the bank, as well as other factors and therefore there can be no assurance that the credit facility available upon the next scheduled review will not be reduced. The last review was performed on May 29, 2009 with the next review scheduled for on or prior to November 29, 2009.

#### 5. Asset retirement obligations

The Company's asset retirement obligations result from net ownership interests in petroleum and natural gas assets including well sites, gathering systems and processing facilities. The Company estimates the total undiscounted amount of cash flow required to settle its asset retirement obligations is approximately \$4,823,000 (2008 - \$4,658,000) which will be incurred from 2009 to 2054. The majority of the costs will be incurred between 2015 and 2030. An inflation factor of 2% has been applied to the estimated asset retirement cost at June 30, 2009 and December 31, 2008. A credit-adjusted risk-free rate of between 8% and 10% was used to calculate the fair value of the asset retirement obligations at June 30, 2009 and December 31, 2008.

A reconciliation of the asset retirement obligations is provided below:

	June 30, 2009	December 31, 2008
Balance, beginning of period	\$ 1,883	\$ 2,102
Liabilities incurred	100	119
Change in estimates	-	837
Liabilities settled	(103)	(554)
Liabilities transferred on disposal	-	(824)
Accretion expense	90	203
Balance, end of period	\$ 1,970	\$ 1,883

#### 6. Share capital

(a) Authorized:

The authorized share capital consists of an unlimited number of common shares without par value.

(b) Issued and outstanding:

	Number of Shares	Amount
Common shares:		
Balance, December 31, 2007	47,595,129	\$ 113,032
Shares repurchased	(1,420,000)	(3,372)
Balance, December 31, 2008	46,175,129	\$ 109,660
Issued pursuant to short form prospectus	11,710,000	9,647
Share issue costs (net of tax of \$197,000)		(490)
Balance, June 30, 2009	57,885,129	\$ 118,817

On April 9, 2009 the Company issued 8,000,000 common shares at a price of \$0.77 per common share and 3,710,000 flow-through common shares at a price of \$0.94 per flow-through common share. The proceeds, net of share issue costs of \$687,000 (\$490,000 net of tax), were \$8,960,000. Management participated in this issue, acquiring 210,000 flow-through common shares at \$0.94 per flow-through common share. Under the terms of the flow-through share agreements, the Company is required to renounce \$3,487,000 of qualifying oil and natural gas expenditures effective December 31, 2009 and has until December 31, 2010 to incur the expenditures. No qualifying expenditures have been incurred as at June 30, 2009.

On November 7, 2008, Midnight filed notice with the Toronto Stock Exchange (the "TSX") to make a normal course issuer bid to purchase its outstanding common shares on the open market. The TSX has authorized Midnight to purchase up to 4,081,619 common shares during the period from November 12, 2008 to November 11, 2009. There were no shares repurchased during the six months ended June 30, 2009.

(c) Per share amounts:

The following summarizes the common shares used in calculating per share amounts:

	Three months ended June 30,		Six months ended June 30,	
	2009	2008	2009	2008
Weighted average shares outstanding:				
Basic	56,726,997	47,422,629	51,480,212	47,438,589
Diluted	56,726,997	47,542,005	51,480,212	47,467,404

The reconciling items between basic and diluted average common shares outstanding are stock options and warrants. At June 30, 2009 there were 4,167,500 (2008 – 2,967,000) options that were anti-dilutive and at June 30, 2008 there were also 2,013,333 warrants that were anti-dilutive. There were no warrants outstanding at June 30, 2009.

(d) Stock options:

The Company has a stock option plan whereby up to 10% of the issued and outstanding common shares may be granted under option to employees, directors and other persons who provide ongoing management or consulting services to the Company. Stock options are normally granted for a term up to five years and vest over three years from the date granted. The exercise price of each option equals the market price of the Company's common shares on the date of the grant.

The summary of stock option activity is presented below:

	Number of options	Weighted average exercise price
Balance, December 31, 2007	2,992,000	\$ 2.56
Granted	1,218,000	1.28
Forfeited	(67,500)	1.01
Balance, December 31, 2008	4,142,500	\$ 2.21
Granted	97,500	0.82
Forfeited	(72,500)	2.13
Balance, June 30, 2009	4,167,500	\$ 2.18
Exercisable at June 30, 2009	2,518,166	\$ 2.45

(e) Stock-based compensation:

Midnight accounts for its stock-based compensation plan using the fair value method. Under this method, a compensation cost is charged over the vesting period for warrants and options granted to employees, officers, and directors.

Midnight has not incorporated an estimated forfeiture rate for stock options that will not vest, rather the Company accounts for actual forfeitures as they occur.

The fair value of options granted were estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions and resulting values for the six months ended June 30, 2009 and for the year ended December 31, 2008:

	2009	2008
Fair value of options granted	\$ 0.36	\$ 0.46
Risk free interest	1.9%	3.1%
Estimated hold period prior to exercise	4 years	4 years
Expected volatility	60%	40%
Dividend per share	\$ 0.00	\$ 0.00

(f) Contributed surplus:

The following table reconciles Midnight's contributed surplus:

	June 30, 2009	December 31, 2008
Balance, beginning of period	\$ 5,607	\$ 2,442
Stock-based compensation	485	962
Forfeiture and expiration of warrants	-	40
Repurchase of common shares	-	2,163
Balance, end of period	\$ 6,092	\$ 5,607

## 7. Financial risk management

(a) Fair value of financial instruments:

Financial instruments comprise cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities and long-term debt. The fair values of cash and cash equivalents, accounts receivable and accounts payable and accrued liabilities approximate their carrying amounts due to their short-term maturities. The Company's long-term debt bears interest at a floating market rate and accordingly the fair market value approximates the carrying value.

(b) Credit risk:

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Company's receivables from joint venture partners and petroleum and natural gas marketers. As at June 30, 2009 Midnight's receivables consisted of \$10,067,000 (2008 - \$10,432,000) from joint venture partners, \$3,789,000 (2008 - \$5,345,000) from petroleum and natural gas marketers and \$487,000 (2008 - \$245,000) of other trade receivables. At December 31, 2008 the Company had accounts receivable of \$2,505,000 from a brokerage house for the disposition of Trust Units that was collected during the first quarter of 2009.

At June 30, 2009, the Company had \$427,000 (2008 - \$1,000,000) of receivables that were considered past due. The majority of these amounts are due from large well established joint venture partners.

Midnight establishes an allowance for doubtful accounts as determined by management based on their assessment of collection, therefore the carrying amount of accounts receivable and cash and cash equivalents represents the maximum credit exposure. Midnight has an allowance for doubtful accounts of \$83,000 that was provided for in 2008. No additional provisions have been made in 2009. Although an allowance has been provided Midnight will continue to pursue collection of this balance. The allowance may be adjusted if circumstances or events change.

(c) Liquidity risk:

Midnight's financial liabilities consist of its long-term debt, as outlined in note 4, and its accounts payable and accrued liabilities.

The following are the contractual maturities of financial liabilities at June 30, 2009.

Financial Liability	Total	Less than 1 Year	1-2 Years	2-5 Years
Account payable and accrued liabilities	\$ 12,563	\$ 12,563	\$ -	\$ -
Long-term debt	26,603	-	26,603	-
Total	\$ 39,166	\$ 12,563	\$ 26,603	\$ -

(d) Market risk:

Market risk comprises three types of risk: currency risk, interest rate risk and other price risk.

Foreign currency exchange rate risk is the risk that the fair value or future cash flows will fluctuate as a result of changes in foreign exchange rates. The Company had no forward exchange rate contracts in place as at June 30, 2009 and December 31, 2008.

Commodity price risk is the risk that the fair value or future cash flows will fluctuate as a result of changes in commodity prices. There were no financial instruments in place to manage commodity prices during the six months ended June 30, 2009 or the year ended December 31, 2008.

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. The Company is exposed to interest rate risk on its cash and cash equivalents, when held, and long-term debt that have a floating interest rates. If interest rates had been 100 basis points lower for the six months ended June 30, 2009, net income would have increased \$26,000 and cash flow from operations would have been \$34,000 higher. An equal and opposite impact would have occurred to net income and cash flow from operations had interest rates been 100 basis points higher for the period. The Company had no interest rate swaps or hedges at June 30, 2009 or December 31, 2008.

(e) Capital management:

The management of capital includes share capital of \$118,817,000 and net debt of \$23,944,000 which includes working capital (the sum of current assets and current liabilities) and long-term debt. The Company manages its capital structure and makes adjustments by continually monitoring its business conditions, including: changes in economic conditions, the risk profile of its drilling inventory, the efficiencies of past investments, the efficiencies of forecasted investments and the timing of such investments, the current and forecasted net debt levels, the forecasted commodity prices and resulting cash flow. The Company strives to balance the proportion of debt and equity in its capital structure and monitors net debt to funds from operations. The calculation of this ratio is based on current net debt divided by funds from operations from the previous 2 quarters which is annualized. Funds from operations is defined as cash flow from operations before abandonment expenditures and changes in non-cash working capital from operating activities. At June 30, 2009 this ratio increased to 3.1 as a result of reduced cash flows from lower commodity prices.

The calculation is detailed as follows:

	June 30, 2009	December 31, 2008
Long-term debt	\$ 26,603	\$ 18,844
Current assets	(15,222)	(40,246)
Current liabilities	12,563	30,132
Net debt	\$ 23,944	\$ 8,730
Cash flow from operations for quarter	\$ 97	\$ 7,563
Changes in non-cash working capital from operations	1,884	(3,365)
Abandonment expenditures	73	484
Funds from operations for quarter	\$ 2,054	\$ 4,682
Prior quarter funds from operations	1,762	7,923
	\$ 3,816	\$ 12,605
	x 2	x 2
Annualized funds from operations	\$ 7,632	\$ 25,210
Ratio of net debt to annualized funds from operations	3.1	0.3

In order to maintain or adjust the capital structure, the Company may from time to time issue shares, if available on reasonable terms, sell assets, farm out properties and adjust its capital spending to manage current and projected debt levels. The Company may also review its level of bank credit obtainable based on the growth of its oil and natural gas reserves.

The Company's capital management objectives, evaluation measures and targets have remained unchanged over the periods presented.

## 8. Commitments

Midnight's normal day to day activities includes farm-ins and farm-outs of joint venture properties. Midnight had entered into a farm-in commitment at Bilbo to drill and complete six wells. At June 30, 2009 the Company has completed its drilling obligation respecting the six wells of which three have been completed. Midnight has elected to drill and complete another commitment well under this farm-in which will also earn all option lands under this agreement. Midnight expects to incur an additional \$4,000,000 to \$6,000,000 in the balance of 2009 to fulfill this commitment.

## 9. Related Party

Midnight is considered related to Daylight Energy Ltd. ("Daylight"), the administrator of Daylight Resources Trust, as a director and officer of Midnight is Daylight's Chairman and, a director and officer of Daylight is also a director of Midnight. Midnight and Daylight are joint venture partners in certain properties, and as a result, revenues and costs related to these properties are allocated to each partner under standard joint venture billing arrangements. Each partner's costs and revenues are based on the exchange amounts which reflect actual third party costs incurred and revenue received. All transactions are conducted under standard business terms and are considered within the normal course of the Company's business activities and operations.

For the six months ended June 30, 2009, Daylight charged Midnight \$300,000 (2008 - \$749,000) for administrative services and premise costs. At June 30, 2009 Midnight had a receivable balance of approximately \$8,300,000 due from Daylight (2008 - \$2,800,000) which includes amounts for joint venture and commodity marketing. At June 30, 2009 Midnight also had \$1,800,000 (2008 - \$3,900,000) due to Daylight for unexpended cash calls.

## Selected Information

	2008					2009		
	Q1	Q2	Q3	Q4	Year	Q1	Q2	YTD
<b>Financial</b> (000's, except for per share amounts)								
Petroleum and natural gas sales	\$ 11,243	\$ 15,576	\$ 14,930	\$ 7,828	\$ 49,577	\$ 5,148	\$ 6,371	\$ 11,519
Royalties	2,541	3,567	3,171	1,515	10,794	1,320	1,293	2,613
Operating expenses	2,154	1,883	1,934	1,683	7,654	1,413	1,770	3,183
Transportation expenses	207	114	80	64	465	51	54	105
Netback	\$ 6,341	\$ 10,012	\$ 9,745	\$ 4,566	\$ 30,664	\$ 2,364	\$ 3,254	\$ 5,618
G&A – cash charge	811	1,017	1,453	1,012	4,293	571	1,066	1,637
Interest	396	350	369	257	1,372	54	150	204
Other income	(103)	(39)	-	(1,385)	(1,527)	(23)	(16)	(39)
Funds from operations	\$ 5,237	\$ 8,684	\$ 7,923	\$ 4,682	\$ 26,526	\$ 1,762	\$ 2,054	\$ 3,816
Per share – Basic	0.11	0.18	0.17	0.10	0.56	0.04	0.04	0.07
– Diluted	0.11	0.18	0.17	0.10	0.56	0.04	0.04	0.07
Net income (loss)	\$ 8	\$ 2,174	\$ 1,647	\$ 760	\$ 4,589	\$ (1,907)	\$ (3,668)	\$ (5,575)
Per share – Basic	0.00	0.05	0.03	0.02	0.10	(0.04)	(0.06)	(0.11)
– Diluted	0.00	0.05	0.03	0.02	0.10	(0.04)	(0.06)	(0.11)
Petroleum and natural gas additions	\$ 11,632	\$ 4,695	\$ 6,417	\$ 13,423	\$ 36,167	\$ 24,285	\$ 4,081	\$ 28,366
Property dispositions	-	-	-	(30,371)	(30,371)	-	-	-
Net debt	34,996	31,042	29,536	8,730	8,730	30,804	23,944	23,944
Total assets	169,706	172,905	172,180	177,056	177,056	183,219	169,471	169,471
Shares outstanding								
Basic	47,423	47,423	47,423	46,175	46,175	46,175	57,885	57,885
Diluted	52,430	53,543	53,591	50,318	50,318	50,353	62,053	62,053
<b>Operations</b>								
Average daily production								
Natural gas (mcf/d)	5,239	5,799	6,097	5,465	5,651	4,867	9,004	6,947
Oil & NGLs (bbls/d)	883	942	941	803	892	708	688	698
Combined (boe/d)	1,756	1,908	1,957	1,714	1,834	1,519	2,189	1,856
Average prices received								
Natural gas (\$/mcf)	\$ 7.95	\$ 10.44	\$ 8.64	\$ 6.96	\$ 8.53	\$ 5.26	\$ 3.45	\$ 4.08
Oil & NGLs (\$/bbl)	91.88	116.87	114.18	58.54	96.81	44.08	56.56	50.26
Combined (\$/boe)	\$ 70.35	\$ 89.71	\$ 82.91	\$ 49.65	\$ 73.87	\$ 37.64	\$ 31.99	\$ 34.29
Royalties	15.90	20.54	17.61	9.61	16.08	9.65	6.49	7.78
Operating expenses	13.48	10.85	10.74	10.67	11.41	10.33	8.89	9.48
Transportation expenses	1.30	0.66	0.44	0.41	0.69	0.37	0.27	0.31
Operating netback (\$/boe)	\$ 39.67	\$ 57.66	\$ 54.12	\$ 28.96	\$ 45.69	\$ 17.29	\$ 16.34	\$ 16.72